

DBULLETIN

Great Idea for Business? What Else is Needed

Establishing any new business is a daunting prospect. Start ups are notoriously difficult to make a success out of but good planning will often get you a long way. A number of different sectors, in particular, marketing communications, energy and climate change and technology sectors have seen more than their fair share of new ventures that have been born from a new idea, new technology or a new demand.

At Devonshires we have been involved in a number of these for clients including:

- Establishing a customer loyalty scheme by the Ice Organisation Limited aimed at mobilising consumer spending in favour of sustainable goods and services;
- Establishing a new healthcare communications agency as a joint venture between management and Chime Communications Plc;
- Establishing web based service modules to enable corporations to implement energy and climate change related legislation;
- Advising on the legal aspects of the design, construction, operation and maintenance of an energy centre (CHP) serving PFI and private developments.

An idea is one thing however making it work is entirely another. I have heard the phrase a number of times "it is not about the product" but it's about the way in which it is developed, enhanced, brought to market and the quality of the team that is involved in doing so. Set out below are some of the more important things you need to consider when starting a new business of whatever size or complexity:

The Team

The importance of having this in place is underestimated but it is central to the perceived and actual success of the venture. Funders will look closely at whether the right people are in the key roles such as CEO, finance director and sales/marketing director

albeit in some ventures it is the chief technology officer or some other role that is given prominence. Non executive directors also are important to provide independence and market expertise. Founders and how they are to be treated will need careful thought to enable flexibility to be built into the model.

Finance: Debt v Equity

The first decision to make is whether debt finance from primary lenders is an option but often with new ventures it will not be. Equity or quasi-equity will therefore need to be arranged from institutions, corporations or high net worth individuals. We have been involved in a number of structures that use convertible loan notes (secured or unsecured) which can be swapped into ordinary shares upon reaching certain milestones. This gives the investor some confidence and control if the plan didn't work out.

Tax planning is important when determining the route to funding. Investors will want to get as much money back on a tax neutral basis as possible and so the use of loan notes and redeemable preference shares are common. Private equity and venture capitalists will want to structure the deal in the most advantageous fashion for themselves and the owner or manager will need advice on the value of the new venture and the cost of their own strip of equity.

Intellectual Property

Do you fully understand which type of intellectual property that you have and use in your business? Copyright, trade marks, patents and design rights all come about and/or are used in different ways. You

Great Idea for Business? What Else is Needed

will need to make sure that you own or have the right to use the intellectual property that is important to your business. Investors will want to see intellectual property protected by registration if appropriate and other trade secrets also protected.

Infrastructure

What exactly is going to be needed to put the project on the map. Different stages and different skills will be needed to ensure development is carried out to plan. The correct number of contractors and employees should be used; the right level of computer and software support; the network of suppliers built etc. Putting in place the infrastructure once the funding has been obtained and the plan for doing so is key to the success of the project.

Share structure

Often this is left to the last minute since it requires input from all sides including initial valuation of the venture (which can be tricky since at that point there may be no profits or revenue) and the percentage of equity that will be provided to the investors. This can be an interesting conversation based on discounted cash flows and arbitrary discounts. Once determined, then comes the task of working out the share capitalisation to ensure the initial pricing, nominal value, share premium and number of shares in issue, all fit together with a view to producing an incrementally increasing share price if the growth happens that is anticipated. We would suggest some FD or accounting support at this stage to help out the lawyers.

Fundraising documents

The fundraising documents and contents will be prescribed for entities that are choosing to list on a recognised exchange. However companies not offering shares to the public have carte blanche to fill the contents of the fundraising documents as they see fit. However, whilst some companies seek to provide a small amount of information and ask investors to rely on their own due diligence,

others particularly when seeking equity from private clients will need to produce documents to a similar standard to those produced by public companies in order that investor confidence is met.

However, putting valuations and projected cash flows, profit and loss and balance sheets into fundraising documents is not a good idea. How then to best present this information, and determine the fundraising process (treading carefully through the regulatory minefields) needs to be thought through carefully based upon who is involved and how it is intended it will happen in practice.

Seed capital

Generally putting together the team, the initial infrastructure and the fundraising documents will require the engagement of a professional team even if the management have done this a number of times before. All of this costs money and unless you have a clear route to the target fundraising amount through placement letters or other commitments, it is unlikely that all this will get carried out without a certain level of initial costs or risk on the part of the promoters of the new business. Seed capital therefore is important to get into the Company either from the management team themselves, friends or family. A cornerstone investor is also important and may even be persuaded to put up some of the seed capital to get the venture going in the first instance.

Conclusion

All new ventures are different and whilst the issues may be similar, the outcomes after discussion will undoubtedly be bespoke and geared towards the business being developed. Working out strategy and implementation plans are paramount which brings us back full circle..... when establishing a new venture, planning (and the taking of relevant advice) is crucial to its success.

For further information please contact:

Jonathan Ebsworth on 020 7065 1867 or
jonathan.ebsworth@devonshires.co.uk