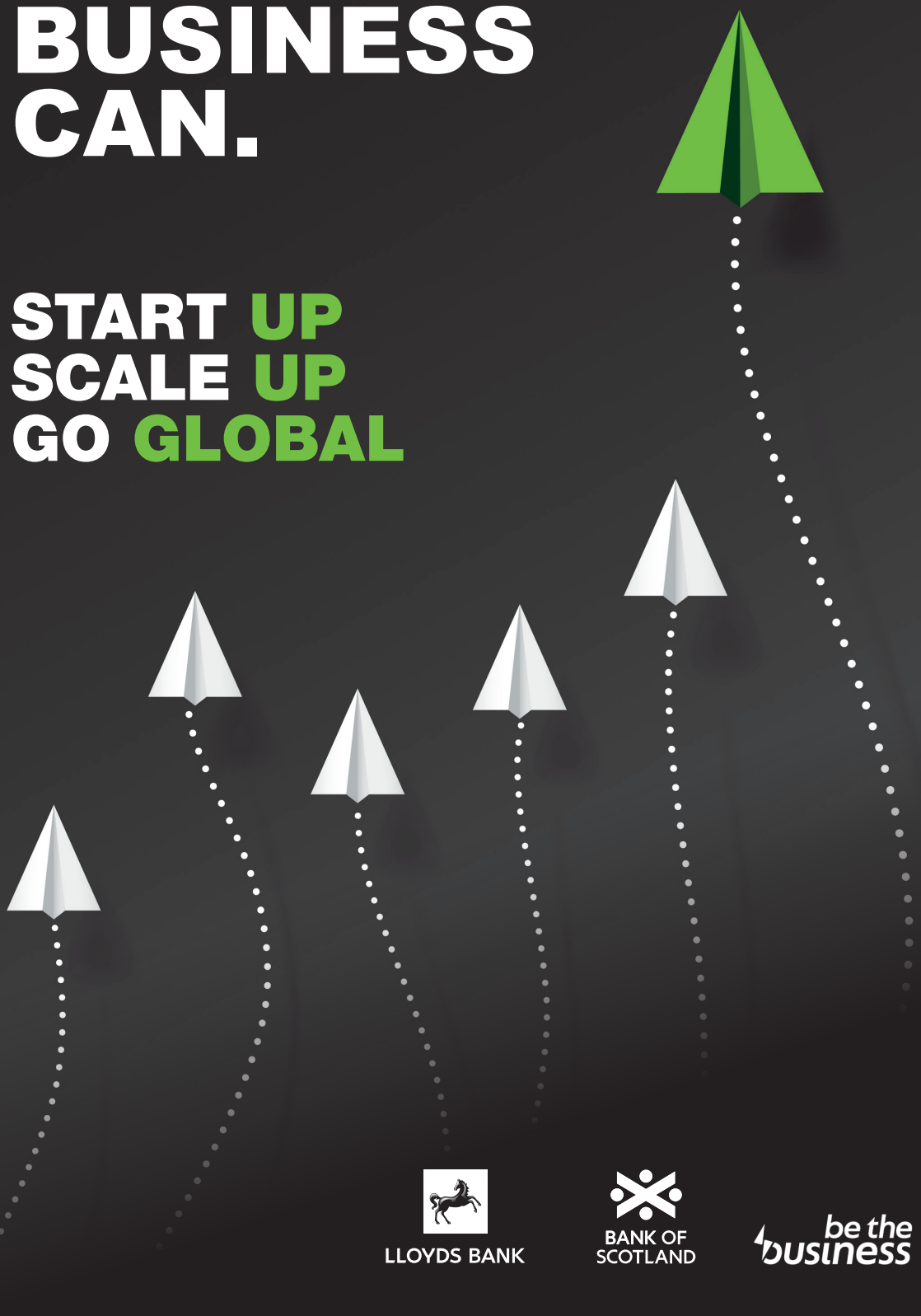
YES BUSINESS CAN.

START UP
SCALE UP
GO GLOBAL



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INTRODUCTION

LLOYDS BANK AND BANK OF SCOTLAND

António Horta-Osório, *Chief Executive of Lloyds Banking Group*

The UK stands on the brink of an era of unprecedented change. Changes in the geopolitical landscape, rapid technological acceleration, and climate and energy issues are all pressures that require businesses to adapt and evolve. But we believe that British business is a powerful, dynamic force that has the ability to turn challenge into opportunity and drive the country forward, bringing communities together and delivering positive social and economic change.

Statistics show businesses in the UK provide livelihoods for millions of people and contribute billions of pounds to the UK economy. In 2018, Britain's 5.7 million small and medium-sized enterprises – over 99 per cent of all businesses – delivered a combined annual turnover of £2.0 trillion.[1] British businesses help build the supply chains and infrastructure that keep the whole country moving, contributing significant amounts to good causes and growing our connections with the rest of the world.

This book aims to celebrate the vital contribution from UK businesses, demonstrating how to succeed from startup to realising value and beyond. It combines expertise from Lloyds Bank and Bank of Scotland, with key insight from supporting contributors and our co-sponsor Be the Business, a not-for-profit organisation established to drive up UK productivity and competitiveness.

As part of our commitment to Helping Britain Prosper, there is something in this book to help every British business. Wherever you are on your journey, you will find information and inspiration on everything from securing funding, improving productivity and investing in intellectual property, to financing growth and safeguarding mental health in the workplace.

We want to play our part in helping businesses take Britain forward, because we believe in business, and we believe in the UK.

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START UP

1

DOING BUSINESS IN THE UK: WHAT YOU NEED TO KNOW

DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY

The government is committed to making the UK the best place in the world to start and grow a business. Our aim is to create a business environment to meet the challenges and opportunities of new technologies and ways of doing business. Small businesses contribute enormously to our society and are essential for a thriving economy. At the start of 2018, 5.7 million UK businesses were small and medium-sized enterprises (SMEs). These SMEs accounted for 99.9 per cent of all businesses and employed 16.3 million people, which is 60 per cent of total UK private sector employment. SMEs also had a combined annual turnover of £2.0 trillion – 52 per cent of total turnover in the private sector.[1]

The UK is a great place to do business. Globally, the country ranks in the top 10 for ease of doing business and competitiveness by the World Bank and World Economic Forum, respectively, which is among the very best in Europe.[2] Furthermore, the Global Entrepreneurship and Development Institute ranks the UK as the second most entrepreneurial economy in Europe and the fourth most entrepreneurial in the world.[3]

The UK has a long history of entrepreneurship and is filled with ambitious entrepreneurs. In 2018, 8.2 per cent of working-age adults were involved in starting or running a new business.[4]

This chapter details some of the resources available to those wishing to start and grow their business. This list is not exhaustive, and we encourage anyone wishing for more information to head to *www.gov.uk* and carry out a search if the support you are looking for is not covered in this chapter.

SETTING UP A BUSINESS

The UK has one of the most straightforward and transparent regimes in the world for registering a new business, and our website has all the information you need. However, the setup instructions depend on your type of business, where you work and whether you have people helping you. Most businesses will register either as a sole trader, limited company or partnership.

SETTING UP A LIMITED COMPANY

A limited company is a company restricted by shares or by guarantee. Our website has a step-by-step guide on setting up a limited company, but you will first want to check if setting up a limited company is right for you. Alternatives include setting up as a sole trader, a business partnership, a social enterprise, an overseas company or an unincorporated association.

SUPPORT BEYOND SETUP

There are multiple avenues of support provided by different resources to help you to run and grow your business. *Gov.uk* is an excellent starting point where you can easily search for information on any topic including regulation, funding (grants), finance, inward investment, innovation and exports. All businesses can access core services and guidance on starting and running a business, as well as their statutory rights and obligations. Business support is largely a devolved matter and, where relevant, the website will link to the support provided by devolved administrations in Scotland, Wales and Northern Ireland.

In England, the Business Support Helpline provides trusted information, advice and signposting to relevant sources of business support. The helpline maintains regular business hours Monday through Friday and can be reached by telephone at +44 (0)30 0456 3565 or by email to *enquiries@businesssupporthelpline.org*.

The devolved administrations have their own arrangements. Details of Scotland's Business Gateway, Wales' Business Wales Helpline and the Invest Northern Ireland helpline can all be found at *https://www.gov.uk/business-support-helpline*.

> *Gov.uk* is an excellent starting point where you can easily search for information on any topic including regulation, funding (grants), finance, inward investment, innovation and exports.

There are 38 growth hubs around England, one in each local enterprise partnership (LEP) area. For a map detailing the LEP network, go to *www.lepnetwork.net/about-leps/location-map*. Growth hubs (led and governed by LEPs) simplify the local business support landscape, bringing together organisations that provide business support from across the public and private sectors. Growth hubs provide all businesses across England with advice via a free and impartial single point of contact. They offer a diagnostic and signposting service to make sure that all businesses, regardless of size or sector, know what is available and can access the right support at the right time.

Innovate UK provides funding to businesses with the ambition and potential to commercialise their game-changing or disruptive ideas and to grow through innovation, helping them develop capacity and maximise impact. Funding can be for a completely new product, service or process, or for an unprecedented use of an existing one. Innovate UK believes that good ideas can come from anyone.

You can also get free advice, services and support on doing business overseas by visiting *www.great.gov.uk*. You will be able to:

- read guidance on how to create an export plan;
- create a free business profile and promote your business overseas;
- search and apply for live global export opportunities and connect to buyers;
- identify global online marketplaces and ecommerce support;
- explore export finance and insurance;
- join events from major trade fairs, missions and exhibitions to webinars and local events; and
- find your regional trade office and contact a trade adviser in your area.

BUSINESS FINANCE

The UK's world-leading financial services sector has unrivalled breadth and liquidity. This means that each business can access the finance that is right for them, from conventional loans to asset finance to equity capital for fast-growing businesses.

The government-owned British Business Bank hosts an online advice platform, the Finance Hub, which is an interactive guide to finance options with case studies and short videos.[5] Also available for download is The Business Finance Guide, published with the Institute of Chartered Accountants of England and

Wales and 21 other industry bodies.[6] This is a comprehensive guide to the different types of finance available to smaller businesses.

There is one group of business owners that find it difficult to access finance – those who are just starting on their entrepreneurial journey. That doesn't mean startups are excluded from bank funding. Banks tend to base loan decisions around the individual's application. Your personal credit record and experience are likely to be factored in. Additionally, the bank may want reassurance that you have committed some of your own funds too – this demonstrates confidence in your venture. The British Business Bank's Start Up Loans programme also addresses this need, with reasonably priced loans available to anyone over the age of 18 who is starting a business but lacking access to the necessary finance or support to realise their ambitions.[7] The British Business Bank also provides equity and loan guarantees to enable established businesses to grow and stay ahead.

ENTREPRENEURS WELCOME

Britain is the entrepreneurial centre of Europe, the ideal place to start and grow a business. It has more new businesses and a higher level of equity investment than any other country. If you are from outside the European economic area, you can apply for a startup or innovator visa if you want to set up an innovative business in the UK. This offers an excellent opportunity for entrepreneurs to start their business career by pursuing an idea that will bring wider benefits to the UK economy. No matter the sector, the business idea or the business size, we are here to support our entrepreneurs.

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2

BUILDING A STARTUP ECOSYSTEM: THE LONDON STORY

BINDI VENTURES

Bindi Karia, *Innovation Expert and Adviser, Connector of People and Business*

As of 2019, the term *startup ecosystem* has become a globally well-known and understood concept. These types of communities are driving innovation and small business energy, allowing entrepreneurs to feed off each other's talent and support. This chapter defines how startup ecosystems create an environment in which entrepreneurs can thrive, collaborate and grow. Additionally, it details how these systems work and how they have evolved over the past several years. The London story is a great example of how factors external to your company can provide significant growth opportunities. By understanding the relationships within the ecosystem, you can improve the performance of both your company and your community.

The concept of startup ecosystems has been around for a long time and has generated a huge buzz across the UK and rest of Europe after firmly taking root in the US. Indeed, it has become part of the vernacular among entrepreneurs, and Colorado-based investor Brad Feld wrote a book exploring this topic. In his book *Startup Communities*, he discusses the Boulder Thesis, which was informed by his 20+ years of experience as an entrepreneur and venture capitalist. The Boulder Thesis includes the following core tenets:[1]

- Entrepreneurs must lead the startup community.
- The leaders must have a long-term commitment.
- The startup community must be inclusive of anyone who wants to participate in it.
- The startup community must engage the entire *entrepreneurial stack* (essentially anyone who wants to be involved in the community, such as governments, corporates, universities, mentors, service providers and other small, locally focused businesses).

Feld argues that entrepreneurs must lead the startup community. His definition of an entrepreneurial company is specific: to be considered entrepreneurial, the company must have the potential to be a high-growth business and be heavily involved in the local ecosystem as an employer and indirect contributor to the local economy. However, startup founders are rarely involved in the broader business community because they are exceptionally focused on their own companies. Not all entrepreneurs will be leaders, but all the community needs is a critical mass – fewer than a dozen people – to provide that leadership. Furthermore, these leaders need

to make a long-term commitment, especially during economic downturns, when other players will likely be focused on other things.

Feld's concept of inclusiveness applies to all levels of a startup community – not just business leaders. It is not a zero-sum game. Everyone can be a winner over the long term – the new entrepreneurs and players joining the ecosystem, as well as incoming supporters (i.e. government, corporates, advisers and students). The startup community is continually evolving, and this evolution cannot be controlled. It should be embraced and supportive of new people and ideas. It's a game of increasing returns, with greater things happening over time.

> The startup community is continually evolving, and this evolution cannot be controlled. It should be embraced and supportive of new people and ideas.

Finally, Feld believes that effective startup communities must engage the entire entrepreneurial stack in an inclusive manner without a 'leader of the leaders'. The best communities are loosely organised with evolving networks of people, which means new leaders emerge organically. The leaders of today may not necessarily be the leaders of tomorrow.

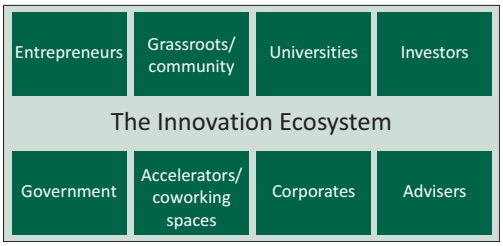
THE INNOVATION ECOSYSTEM

My perspective of an ecosystem is based on my work with many organisations where I had to build an ecosystem to deliver the business's needs (Trayport, Microsoft Emerging Business Team/Ventures, Silicon Valley Bank Entrepreneur Banking Division and now my own advisory business, Bindi Ventures).

I applied Feld's Boulder Thesis to what I've seen in London over the past 10 years and further segmented the innovation ecosystem into eight different components:

- entrepreneurs;
- grassroots/community;
- universities;
- investors;
- government;
- accelerators/coworking spaces;
- corporates; and
- advisers.

The ecosystem consists of all the components working in collaboration. The concept of a zero-sum game (or lack thereof) rings true: each of the individual components must work together to encourage long-term growth and create a self-sustaining ecosystem.



According to data compiled by Dealroom.co, since 2008, the UK has created 60 unicorns (tech companies valued at $1 billion or more), which is 35 per cent of the 169 created in Europe and Israel. Over the past three years, the UK has created more unicorns (25) than France, Germany, The Netherlands and Sweden combined (19). London alone has produced 23 unicorns with a combined value of $132 billion – compare that to Berlin's eight, which are worth $32 billion.[2] Clearly, the startup ecosystem in the UK is working.

So what is the story with the London ecosystem, and what lessons can be learned from the 10 years of rapid growth in the city's tech industry? Let's start by discussing how the ecosystem evolved.

LONDON ECOSYSTEM 2008–2010: THE SEEDS ARE SOWN

In 2007–2008, the global financial crisis was in full force. The banking industry was devastated across the globe, particularly in US and UK markets. The sub-prime mortgage crisis led to a breakdown of trust among banks, regulators and

their customers, leading to an international crisis signalled by the collapse of Lehman Brothers in September 2008. However, in London, a nascent ecosystem started to grow after 'flying under the radar' since the 2000 dot-com crash. At the time, entrepreneurs, grassroots/communities and universities were present but working very much independently and in silos. Investors and only a few corporates were launching programmes focused on the startup ecosystem.

ENTREPRENEURS

Well-known entrepreneurs were generating a London ecosystem buzz. Like the PayPal Mafia (a group of employees and founders who since founded other tech companies) in Silicon Valley, a Skype Mafia born from the London ecosystem was forming and beginning to launch funds, startups and seedfunds (Atomico, Seedcamp). Some of today's best-known UK unicorns, all founded during or just after the previous dot-com boom, were in execution mode, albeit not playing a very active part in the emerging ecosystem (e.g. MatchesFashion, BGL Group, Access Group).

GRASSROOTS/COMMUNITY

The startup community in London began establishing networks (e.g. Drinktank, launched by the founders of Huddle) and events (e.g. Founder's Forum launched by the one of the founders of Lastminute.com) to connect its participants. Around the same time, East London was becoming a tech cluster. MOO, an online print and design company, opened large offices near the Old Street Roundabout and offered space to fellow startups, who leapt at the cost-efficient solution. Startups were naturally migrating to each other to find affordable office space in London, which created a buzz that the rest of the ecosystem began to notice.

INVESTORS, CORPORATES AND GOVERNMENT

Core investors were already part of the ecosystem and had been deploying capital since the first dot-com boom, and new funds were also forming via the Skype Mafia and other large UK exits, such as MessageLabs. Meanwhile, investor and government involvement in the startup ecosystem was minimal but just starting to percolate. Besides the standard corporate venture capital firms (VCs), very few corporates were involved in the early stage of the market (Microsoft, Amazon). However, the UK government's Web Mission trip (in which it sent eight early stage tech founders to Silicon Valley) marked the beginning of long-term networks and a well-connected community that was about to explode

LONDON ECOSYSTEM 2010–2012: TAKING SHAPE

The seeds planted in 2008–2010 flourished in 2010–2012. The fledgling ecosystem was beginning to take shape. In this phase, the involvement of entrepreneurs, grassroots/community players, investors and corporates continued. In addition to their increased activity, London saw more involvement from governments and universities, as well as increased interest from the adviser community. The city also witnessed the launch of the first generation of coworking spaces and accelerators.

GOVERNMENT

From 2010–2012, two major government initiatives were implemented. In late 2010, Prime Minister David Cameron announced the launch of Tech City UK, an organisation striving to create a cluster comparable to Silicon Valley in East London. At the time, there were 85 startups in the area in 2010, and one year later the number had jumped to 200. In 2012, WIRED UK updated this figure to nearly 5,000 companies, illustrating the area's significant growth.[2] In addition, the government also launched an entrepreneur visa to allow non-British talent to live and work in the UK and grow their companies locally.

UNIVERSITIES

Although they had always been involved in intellectual property creation and spin-outs, universities were beginning to focus on funding incubating tech startups and implementing an entrepreneurial element into their curricula. The National Association of College and University Entrepreneurs was also launched during this period, sponsored by large corporates and other organisations. London alone was supported by 45 higher education institutions, including five world-renowned universities: King's College, Imperial College, University College London, London School of Economics and London Business School.

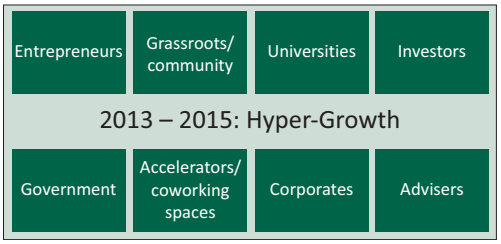
ENTREPRENEURS, GRASSROOTS, INVESTORS AND CORPORATES

During this two-year period, many of today's unicorns were born, while existing ones saw massive exits – for example, the sale of Skype to Microsoft for $8.5 billion in 2011 – thereby allowing a capital influx into the UK ecosystem. London also saw the rise of VCs, crowdfunding platforms and further accelerator programmes, and more corporates began to get involved, including Google, Silicon Valley Bank and Telefonica Wayra.

In summary, the period from 2010–2012 saw a blossoming of activity across London, which initiated a period of growth, scaleup and increased collaboration across the entire ecosystem.

LONDON ECOSYSTEM 2013–2015: HYPER-GROWTH

The period from 2013–2015 can be characterised as one of hyper-growth and scaleup. At this time, all the core elements of the ecosystem were represented and starting to collaborate with each other.



The 2014 UK Scaleup Report, driven by contributions from key players in the ecosystem, illustrated that a boost of just 1 per cent to the UK scaleup population would drive an additional 238,000 jobs and £38 billion gross value added to the UK economy.[3] The report delivered a set of 12 recommendations that resulted in the launch of the UK ScaleUp Institute.

COWORKING SPACES

Coworking spaces started to become more industry focused and property-company driven. For example, Canary Wharf Group launched Level39, and Delancey launched Here East (a 1.2 million sq ft tech super campus) in Stratford, the London 2012 Olympics location. According to a 2015 Tech Nation report, there were over 36 business accelerators (e.g. Seedcamp, Wayra, Techstars) and more than 70 coworking spaces in London alone.[4]

ADVISERS

Advisers started launching practices focused on the tech sector. The Big Four accounting firms had set up businesses and hired leaders specifically for the high-growth tech sector and entrepreneurs. Banks were beginning to focus on lending to tech startups, and banking specifically focused on this higher risk segment. Law firms established practices to serve tech founders and VCs, providing open-source legal documents and hosting tech events as a part of their contribution to the London tech community.

ENTREPRENEURS, GRASSROOTS, UNIVERSITIES, INVESTORS, GOVERNMENT AND CORPORATES

Companies started to reach unicorn status at a much faster rate during this time, demonstrating the increasing power of the ecosystem: BenevolentAI and Darktrace were both launched in 2013 and reached unicorn status within five years. Three Fintechs founded in 2015 – OakNorth, Revolut and Monzo – became unicorns in less than three years. And one of the best-known acquisitions occurred around this time: DeepMind, which was acquired by Google in 2014. London & Partners, the Mayor of London's business development organisation, increasingly became involved in the community by actively promoting London as a global tech centre; other notable launches in this period included Tech London Advocates in 2013 and London Tech Week in 2014. TechCrunch held its first Disrupt event in London in 2014. Even British royalty was starting to contribute via the 2014 launch of the Duke of York's Pitch@ Palace event. Additionally, the Seed Enterprise Investment Scheme, which became permanent legislation in 2013, opened the doors for tax-efficient angel investing in early stage startups.

Technology and telecom corporates were no longer the only ones launching accelerator and venture programmes. Traditional mainstream corporates were starting to enter the fray, including John Lewis, Unilever and Aviva.

Universities were increasingly providing talent pools and incubators. For the first time, tech and entrepreneurship were viable career opportunities, and the number of student interns joining, or even launching, tech startups started to grow.

LONDON ECOSYSTEM 2016–2018: THE UNICORN AND SCALEUP ERA

By the unicorn and scaleup era, all the elements of the ecosystem were working together and operating at full capacity. In 2017 and 2018, a succession of London-headquartered tech companies raised investment 'mega-rounds' in excess of $250 million each, including TransferWise ($280 million), FarFetch ($397 million) and Deliveroo ($480 million). In September 2018, FarFetch floated on the New York Stock Exchange, valuing the company at $5.8 billion (£4.45 billion). At last, London companies were achieving US-level valuations.

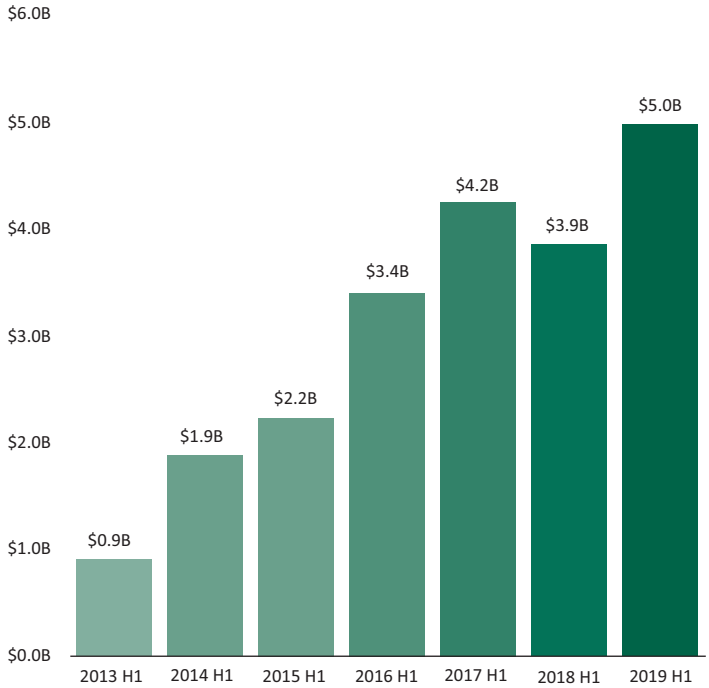
The grassroots and community were at a fever pitch, hosting multiple events every night. And the Silicon Roundabout was now just one of several tech hubs in London; locations like West London, Soho, Kings Cross, Croydon, London Bridge, The City, Canary Wharf and Stratford had become buzzing tech clusters in their own right.

From an investor perspective, more than 60 first-time funds were launched around the London area, mainly focused on early stage investing, and more capital from the US, China and Japan contributed to massive UK growth stage rounds. Government remained deeply involved with the ecosystem and now from a city and local borough perspective. Corporates were launching accelerators, VC funds, coworking spaces, ecosystem scouts and strategic partnerships throughout the country (e.g. Centrica, Ford, BMW, Aviva, Nationwide and Mishcon de Raya).

THE LONDON ECOSYSTEM: 2019

The 2019 numbers speak for themselves (see Figure 1). According to a Tech Nation report released for London Tech Week, UK investment nearly matched Germany, France and Sweden combined, and was more than double that of Israel. In fact, the UK has the third highest number of unicorns (behind only the US and China), and London comes in second for the number of Fintech unicorns (after the Bay Area). With a population of 8.2 million people, London has 45 unicorns, $570 investment per capita and

FIGURE 1. All-time record VC investment by H1 2019



TECH NATION dealroom.co

*Reproduced with permission from: Tech Nation and dealroom.co, 'London Tech Week: Update'. (June 2019). Available at: https://blog.dealroom.co/wp-content/uploads/2019/06/londontechweek2019.pdf.

146 accelerators. It listed 915,471 job openings in the digital economy and a median salary of £53,296. Undoubtedly, London has demonstrated global leadership in the Fintech, retail tech, health tech and deep tech/industrial sectors, as well as emerging tech sectors such as artificial intelligence, robotics and quantum computing.[5]

London has become a global technology hub, a true innovation ecosystem with all the core elements collaborating with each other. The city is a global leader and recognised internationally as a model for other cities looking to create their own ecosystems.

LESSONS LEARNED

There are many lessons to be learned from the London story. It illustrates how the 'pay it forward', collaborative approach outlined by Brad Feld pays off in spades. As he states, effective startup communities must engage the entire entrepreneurial stack in an inclusive manner without a 'leader of the leaders'. The most successful communities are loosely organised with evolving networks of people, so new leaders emerge organically. The various phases of the London ecosystem development illustrate this perfectly: in 2008, entrepreneurs, the community and investors were the primary active components of the ecosystem; only when the other elements became involved did London become one of the largest and best-known startup ecosystems.

London's ecosystem would not have been as successful without each element's contributions:

- the right ideas by entrepreneurs;
- investors making the right bets;

- advisers helping founders along their journeys;
- coworking spaces hosting new companies and other members of the ecosystem;
- community builders organising networking events;
- corporates serving as startup customers, connectors and investors;
- universities creating and pushing out talent; and
- government providing the right policies and incentives for the tech community.

All of the segments of the ecosystem must coexist and collaborate to move the ecosystem further ahead. Siloed thinking simply does not work.

This interconnected thinking and collaboration is relevant to every single player in the ecosystem. From my own experience, connecting and engaging with just four of the players in the ecosystem offers a much more holistic way for my clients to drive the value creation of their business. For example, if you're an entrepreneur – even if you are laser focused on building and growing your company – engaging with the various elements of the ecosystem will invariably lead to long-term success.

Your advisers (e.g. bankers, lawyers, accountants) should be able to connect and introduce you to the right investors, fellow advisers, coworking spaces, corporates for sales/investment leads and other entrepreneurs for strategic partnerships or networking. And why? Because they are engaged in the community.

When it comes to talent, sales, marketing or growth, your VC should be able to connect you to the right players in the ecosystem. And why? Because their reputation is built on the value-add they can provide to you on a global basis, not just in your local ecosystem.

The community and grassroots leaders can showcase your business in the various events and networks they have created, thereby giving you the wider exposure you need to grow. And why? Because they are only as good as the last valuable insights and events they are able to provide for their network.

Motivated by economic growth and job creation, the government can provide entrepreneur-friendly policies and incentives that lead to long-term benefit for its cities and country. Universities are driven by ensuring their students graduate with the skill sets required to meet the needs of the 'real world'.

As an entrepreneur, you should know that the same logic applies equally for each and every player in the ecosystem. For example, banks may work closely with fellow advisers, investors, coworking spaces and grassroots leaders to gain larger entrepreneur client base. And if the entrepreneur values those benefits (i.e. connecting them to your ecosystem of investors, spaces, corporates and advisers), they will no doubt reference their entrepreneur friends to work with that bank. Understanding the perspectives of other ecosystem participants can help you navigate relationships with those key players, which ultimately helps your business and the local startup community.

Ecosystem thinking is relevant throughout the entire entrepreneurial stack. If you want to build an ecosystem like London or Silicon Valley in your region, utilising all the pieces of the puzzle will certainly help lead to local success.

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3

BUILDING BRILLIANCE: HOW TO OVERCOME THE CHAOS OF THE EARLY STAGE STARTUP

TECHSTARS

Max Kelly, *Senior Vice President, Strategy*

At Techstars, we help entrepreneurs succeed through our worldwide network of mentors, investors, corporate partners, community leaders and city governments. Over 1,700 companies have been through our mentorship-driven accelerator programmes, so we know how entrepreneurship works. Several companies in our portfolio have become unicorns (companies valued at over $1 billion) with a further 50 worth $100 million or more.

We love startups because we believe that entrepreneurs will build a better future through their passion and drive to make an impact on the world.

STARTING A BUSINESS HAS NEVER BEEN EASIER

In the last decade, the business environment has changed significantly. The barrier to starting a business has been lowered, producing flourishing ecosystems for startups around the world.

Cloud computing combined with software delivered as a service has made setting up the infrastructure of a business very straightforward, and open-source software in technical libraries, such as GitHub, has made creating new technology much easier.

Tech startups can get going with just a handful of dedicated founders: the 'hacker' who writes code, the 'hipster' who designs the product and the 'hustler' who does the sales.

Little funding is needed for this small team, but this does not limit the startup's global ambitions – they will usually launch in their home market and then expand internationally.

Corporates are feeling the pressure. Over half the companies that were in the S&P 500 at the turn of the century are no longer there. They are struggling with innovation, which is second nature for startups.

This trend is reflective in the behaviour of recent business school graduates: no longer are MBAs from Harvard, INSEAD or the London Business School targeting investment banks or management consultancies. They want to be something more special – an entrepreneur.

RECOGNISING THE CHALLENGES OF STARTING A COMPANY

It has been a wonderful decade for entrepreneurship, but that does not mean that it is easy to succeed. The product may not be right for the intended customers, the company may run out of money or the founders may fall out. The stark reality is that building a company is hard: 7 out of 10 companies will fail.

At Techstars, we recognise the heroic efforts that founders put into their business, and we aim to help them succeed. Following research across our extensive portfolio, we have identified the 10 best ways to overcome the chaos of the early stage startup.

1. HAVE THE RIGHT MINDSET FROM THE START

The research firm Gallup conducted a survey of employees from around the world. Amazingly, it has found that 9 out of 10 people are not engaged with their jobs. This is a woeful waste of human productivity, and it is a strong indicator of why many people dream of starting their own business.

However, it is insufficient to *not* want something. We see that successful startups are led by founders who are obsessed with the idea of building a specific business – they can think of nothing else, and they will run through walls to make it happen.

The worst reason to start a company is to make money. First, the odds are against you, and if you consider the risks, you will likely make more money working in a 'normal' job. Second, when tough times come (and they will), you will not be able to push through unless the purpose of the business continues to thrill you.

Rule 1: create a business with a clear purpose that you are committed to.

2. UNDERSTAND THE TIME IT TAKES

There are generally two outcomes an entrepreneur is looking for when building a business: either to sell the business or to run it at scale.

The data firm CB Insights shows that the average amount of time between the first round of venture capital and the sale of the business for companies sold in 2018 was 8.6 years. Considering it usually takes two years from starting the company to raise the first venture capital, the total time to success is normally longer than 10 years (and this is especially the case for the companies that are an 'overnight success').

Rule 2: be prepared to commit at least a decade of your life to your startup.

3. CO-FOUND A COMPANY

Companies that are started by more than one founder are more likely to succeed. This does not mean that sole founders cannot build great businesses, it just means that the odds are better for those companies with co-founders.

The logic is easy to understand: a team of founders can support one another through long hours and difficult times. If one person is having a bad day, then it is likely that the others can pick up the slack.

Co-founding teams usually have two or three members. They share the ownership of the business and will often take low salaries. They are highly committed to the venture and will move heaven and earth to make progress.

Rule 3: build a strong founding team.

4. TWO DISTINCT PERIODS: PRE AND POST 'PRODUCT–MARKET FIT'

In the early stages of a startup, things are messy. It may not be clear who the target market is. Often, the problem that needs to be solved for the target customer is not well understood. Therefore, it is hard to determine the right solution for those customers, and multiple product iterations are needed.

This uncertainty can create stress within the founding team; however, it can also be exhilarating when breakthroughs are made. It is often worthwhile to use a tool like the Lean Canvas (a one-page business plan template) to ensure the team is aligned. Continued progress is critical because momentum is incredibly important at this early stage.

Eventually, there will be a noticeable change in the company. It will be clear who the customers are, what problem you are solving for them and how much you should be charging. This is called *product–market fit*, which indicates that the product you are offering is fit for purpose. At this point, the focus shifts towards making repeatable sales.

Rule 4: understand that things feel messy in the early stages of the startup and focus on building momentum.

5. UNDERSTAND AND LEARN FROM CUSTOMERS

Understanding who your customers are and what they are struggling with is vital. Deep empathy is needed, and it is all too easy to believe that you know best; it also takes humility to admit that you can always learn and improve.

Two books that are useful in building this capability are *The Lean Startup* by Eric Ries and *The Mom Test* by Rob Fitzpatrick. Both will help you ask the right questions so you can gain the insight to build a better product.

Rule 5: learn from your customers continuously.

6. MASTER THE STORY OF THE BUSINESS

While it's true that a startup is 1 per cent inspiration and 99 per cent perspiration, in the earliest days of starting a company, it feels like the idea is so valuable that it cannot be shared! And if you do share it, you're scared someone will be so overwhelmed by the genius of it that they start working on it immediately. The reality is that people are lazy – they will not steal your idea. In fact, you will probably have to convince people that it has any merit, so be prepared to talk about it extensively.

You will need to tell the story of your business again and again (and again). You want to make sure that the team is aligned. You want to hire great employees. You need to sell to customers. You want to get the best suppliers. You may want to raise money from investors. But all of these accomplishments need a great pitch, and you should devote time to crafting the best way to tell the story.

Sequoia Capital, an incredibly successful venture capital fund, has a standard structure that it recommends for presenting a business:

- State the problem.
- Articulate the solution.
- Explain why now is the right time to bring the product to market.
- Explain the market size.
- Demonstrate that you understand the competition and why you are better.
- Give the details of the product.
- Explain how you make money.
- Demonstrate that you have the very best team.
- Explain the financial model.

This structure is focused on fundraising, but it can be modified for other purposes, such as sales or hiring.

Rule 6: pitch your business brilliantly.

7. RAISE MONEY (AND AVOID HAVING TO IF YOU CAN)

The best money to fund your business is money from customers! It seems obvious, but often entrepreneurs lose sight of this and can waste enormous amounts of time and effort trying to raise money from investors. However, they could have spent that time acquiring customers who would then help them develop the product.

Of course, it is not always possible to generate revenue without a product, so many startups will need to raise money.

DocSend, an investment document management system, analysed the fundraising process for 220 startups. On average, each company contacted 60 investors and arranged 48 meetings. The time and effort involved is significant: it takes three to six months to raise a funding round and normally takes the most important person (i.e. the chief executive officer) away from the business.

To minimise the impact on the business, there are several steps that can make fundraising more efficient:

- Decide whether you really need to raise money – avoid it if you can.
- Determine the amount to raise.
- Spend time creating a target list of investors.
- Prepare all the materials you will need for the process – the pitch document, the financial model, the employee contracts and intellectual property agreements.
- Engage lawyers and make sure that you have the right legal documents in place.

You should then manage the fundraising process with extreme precision. It is easy to be haphazard, but if that happens, it will take longer, and you will give up more of your company. Ideally, you will have several investors interested at the same time, which will allow you to bring the fundraising round together swiftly.

Once a fundraising round is complete, it is easy for an entrepreneur to take that as a sign of success. While it is indicative that someone believes in your business, it is not a success in its own right. The real work of building the business continues.

Rule 7: run fundraising with precision.

8. SELL, SELL, SELL

Entrepreneurs sometimes fall in love with their ideas and believe that everyone will understand just how valuable they are. In reality, change is hard for your customers, and they will still take convincing even if you can do something for them better, faster and cheaper.

Many founders are in their comfort zone when building their product. They don't spend enough time speaking to customers and may even regard selling as somehow 'dirty'. Nothing could be further from the truth: without customers, there is no business. And those customers will take convincing.

Rule 8: take every opportunity to make a sale.

9. GET THE BEST ADVICE

When you start a business, you cannot know everything that you need to – it simply is not possible. So in those areas where you have gaps, you will need to get the best advice you can.

The great news is that there are many people – mentors – who will happily guide you at no cost. Mentors can have a magical effect on your business. They know how hard you are working and want to pay it forward. At Techstars, we describe this as #givefirst, and mentors are a vital part of our accelerators. Treat mentors with respect, and you will be amazed at the support they will give you.

Beyond a core group of mentors, you should also develop a broad network that will support you in a multitude of ways. This may be through introductions to potential customers, feedback on a pitch deck or simply moral support. Take time to build and maintain a diverse network.

All startups need is to have the right company structure in place. You will need employee contracts, supplier contracts and customer contracts. And you will need to comply with data protection requirements. Setting up your company structure requires sound legal advice, so make sure that you meet with several lawyers and choose the one with whom you have good chemistry. The effort used to find a great lawyer at the early stage will be paid back many times over.

Employees are another great source of advice. Make sure that you are working with the very best people for the job. Amazon uses the concept of 'bar raisers' – people who will increase the quality of a team. Make sure you are hiring bar raisers.

Rule 9: surround yourself with the people who can give you the best advice.

10. BE A GOOD STARTUP CITIZEN

Being an entrepreneur is hard, and the people who know this best are other entrepreneurs. You will find that if you ask for help from the startup community, you will always receive it. It is very rare that you are actually in direct competition with another startup, so it is a great idea to share. You'll find it will come back to you tenfold. Again, #givefirst.

There are a few basics to being a good startup citizen:

- Do not expect people to sign non-disclosure agreements. You will only need these when you start doing deals with corporates.
- Find a person in your network who can introduce you when you want to make a new contact – these are called *warm introductions*.
- Limit buzzwords and jargon. Often, the only person you are fooling is yourself.
- Never lie. It just never works out well.

Rule 10: make a positive contribution to the startup community.

The dream of a startup is freedom, flexibility and the opportunity to make an impact. While this can be achieved, you will need to deal with the difficult times as well. We hope that these 10 rules will help you with that reality.

THE 10 RULES TO OVERCOME THE CHAOS OF THE EARLY STAGE STARTUP

1. Create a business with a clear purpose that you are committed to.
2. Be prepared to commit at least a decade of your life to your startup.
3. Build a strong founding team.
4. Understand that things feel messy in the early stages of the startup and focus on building momentum.
5. Learn from your customers continuously.
6. Pitch your business brilliantly.
7. Run fundraising with precision.
8. Take every opportunity to make a sale.
9. Surround yourself with the people who can give you the best advice.
10. Make a positive contribution to the startup community.

GOOD LUCK ON THE JOURNEY!

Starting a company takes suspension of disbelief – many will fail. Yet *every* entrepreneur believes that their business will be one that succeeds. Being an entrepreneur takes heroic efforts and deserves respect.

Creating and building an early stage startup can and should be rewarding. You will learn so much as you navigate the highest highs and lowest lows. It is exciting and challenging in equal measure. Remember to enjoy the journey and good luck!

4

FUNDING YOUR STARTUP

LLOYDS BANK AND BANK OF SCOTLAND

Gareth Oakley, *Managing Director, Business Banking*

Starting a business can be one of the most fulfilling things you do with your life. If you succeed, you'll not only be helping yourself, you'll also be supporting your local community by creating jobs and economic growth, which will in turn help Britain prosper.

There are over 5 million small and medium-sized enterprises (SMEs) in the UK, according to the Federation of Small Businesses – a figure that has increased by a massive 2 million since 2000 – and many of these are started by people who are going into business for the first time. Every year, around 400,000 new businesses spring to life. But unfortunately, government statistics show that about 350,000 businesses come to an end. The good news is more businesses are thriving now than ever before, and there are many things you can do to ensure success.

To get your business off the ground, you will probably need to find a way to fund it. Here we look at some of your options and the best way to approach funding your startup.

FUNDING YOUR AMBITION

If you are starting or building a business, you'll need cash. But if you are unable to secure investment or invest your own money, you can run out of cash quite quickly.

Putting together a comprehensive business plan is one of the most important first steps. It should detail the why, the what and the how of your business. Make sure it's thorough – it will act as your roadmap to get you from where you are now to where you want to be in the future. The clearer you are about the market fit for your product or service – that is, the problem you're trying to solve – the easier it will be to work out exactly how much funding you'll need.

Be clear in your plan about what you want your borrowing to do for your business. Be realistic about your cash flows too – in my experience business owners are naturally optimistic and don't always plan for the unexpected. But potential funders will want to see that you've had the prudence to plan for things that could go wrong. Show that you have contingencies in place, making sure your plan details how you will keep enough cash in the business to cover costs and borrowing.

If you're not quite sure how to put your business plan together, don't be afraid to ask for advice. If you have a strong business idea, even if it's not fully formed, banks and other professional advisers, mentors or business bodies will happily help you turn it into a proper business plan. With a good timeline and the right support, many

problems that might seem insurmountable can be resolved.

In my opinion, the most successful entrepreneurs tend to be those who take on a wide range of advice to support their business plan. Remember that even after you start trading and building up your business, it's a good idea to give your business plan a regular review. The plan is something you can always refer to as a blueprint as your business grows and evolves – for instance, when the time comes to diversify your customer base or to expand into a new territory or product area.

GO IN WITH YOUR EYES OPEN

When considering your funding options, it is crucial you understand what the return on any investment will be and how that will work for you when you account for borrowing costs.

Many startup owners struggle to escape the day-to-day pressures of running a business and don't think more strategically about the impact of funding on their growth until the situation becomes urgent. But if you intend to make well-informed decisions about the business, it's vital to step back and take in the bigger picture from time to time.

Surveys of people about to start a business often show that they overestimate their chances of success. Remember, business failure rates remain significant, and frequently this is because owners overlook the things that can go wrong. The more prepared you are for things not going to plan, the greater your chances of success. And that starts with cash flow.

MANAGING CASH FLOW

One of the most common reasons for business failure is lack of cash, so however you source your funding, good cash flow management is essential. Potential funders and lenders will look for evidence that you have developed a strong discipline in this area.

There are two aspects to cash flow discipline. The first is to pay close attention to creditors and debtors to make sure there is always enough cash in your business. Examine your payment terms: how do the credit terms of your suppliers compare with those of your customers? It's easy for these two time frames to get out of balance, especially in the busy early stages. You may be heavily reliant on one customer, or you may feel reluctant to push new customers too hard to pay their debts. For example, if you're paying out within 15 days while having to wait 60 days to collect, you can see how this can quickly get out of hand.

Without strong cash flow discipline, you won't be able to predict cash inflows and outflows or pay your employees and suppliers on time. It's essential to business survival.

The other common issue with cash flow is overtrading. This is when you win a big contract without considering its impact on the cash flow cycle. Say, for example, that you win a new order or a contract to develop a new product. The promised revenue is tempting, but have you factored in how to pay suppliers and staff while waiting for the work to be fulfilled or the product to be developed? Many businesses run afoul of this early on and run out of cash.

Enforcing payment terms for customers and suppliers may feel uncomfortable at first, but it's simply good business practice, and good suppliers and customers – as fellow businesses – will understand your situation. Without strong cash flow discipline, you won't be able to predict cash inflows and outflows or pay your employees and suppliers on time. It's essential to business survival.

UNDERSTANDING YOUR FUNDING OPTIONS

Different goals and stages require different forms of funding, so it's no surprise that businesses typically benefit from a mix of funding types during their life cycle, from a simple overdraft facility to private equity.

Remember that every business is different and there's no single path to funding. Someone who has started out as a painter and decorator has very different needs compared to a management team that has just acquired a well-established manufacturing business, for example.

EARLY STAGE SOURCES OF FUNDING

In the beginning, often your own money or funds from family and relatives will help kick things off. As the business gets going, you may start looking for the business to sustain itself and introduce other ways to manage your cash flow, such as an overdraft facility.

If you have the funds you can, of course, continue with a self-funding approach. When you self-invest you won't pay any interest premium and you will keep full control over the business. However, once the money is invested, it is effectively unavailable to you or to the business as contingency, so you'll need to be sure that your business has access to enough cash from other sources to keep going.

Self-investment is sometimes done in the form of a loan: the director of a company lends money to their own business, and then takes it out again later instead of wages. If you are considering this, you should always talk with your accountant first.

ASSET FINANCE

You may need to acquire assets that need financing, such as vehicles or machinery. In these cases, the asset itself can sometimes be used as collateral, which reduces the risk for the lender. This is often referred to as asset finance and avoids the need to acquire the assets with cash. Instead, you fund the purchase over an agreed period of time, which protects your cash flow. Other financing of this type includes contract leasing and hire purchase.

BANK FUNDING

Bank funding, such as a loan, often comes into play when you need an injection of extra cash into your business. Banks generally work with more established businesses or individuals with a track record, so they are taking lower risks than alternative lenders, and this should be reflected in the interest rate they charge.

But that doesn't mean startups are excluded from bank funding. Banks tend to base loan decisions around the individual's application. Your personal credit record and experience is likely to be factored in, and they may also want reassurance that you have committed some of your own funds too. This demonstrates confidence in your venture.

Another potential upside of borrowing from a bank is that while sometimes you may be asked to provide collateral or security to support the loan, the bank is unlikely to take equity in a small business, so you retain full control.

Understandably, banks may want to keep an eye on their loans to some degree, perhaps by asking you to supply management accounts or regular cash flow forecasts. For very large loans, some banks may put covenants in place, which are conditions that must be kept to maintain the same lending terms. However, covenants are rarely used for small businesses.

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GRANTS

Depending on your business type and sector, you may also be eligible to apply for government grants. Grants are often aimed at not-for-profit businesses, but for-profit companies can sometimes benefit as well. There are also a wide range of government enterprise schemes offering grants, guarantees or alternative sources of finance.

The British Business Bank channels government funds into making startup loans available to small businesses. It can also provide a guarantee to the bank on your behalf through the Enterprise Finance Guarantee Scheme.

Experienced investors can even choose to put funding into businesses through tax-efficient enterprise investment or seed schemes.

It is worth noting that grant application processes and other government schemes can take time and contain additional fees or commitments, and the eligibility criteria may not align with your planned business direction. In order to have a chance of qualifying, this may necessitate shifting your planned offering away from its original focus.

THIRD-PARTY EQUITY INVESTORS

A small, service-based business where you are offering your own skills to the consumer doesn't need a massive amount of cash to launch. But if you were starting a brand new product or service that required a high degree of research and development, like creating new software or an online service, you would almost certainly need equity investment. Banks don't tend to get involved in this type of funding and alternative lenders are unlikely to provide sufficient capital.

There are various types of third-party equity funders, each offering injections of funds into your business in exchange for partial ownership. The upside is that there's no immediate interest payment, and such investments may also bring with them expert advice and support. However, you'll no longer be the full owner of the business and, if you're successful, the equity you've given up could become quite expensive if you want to buy it back again.

Business angels, venture capital firms (VCs) and independent investors come in at different stages of the business cycle. Angel networks and individual investors invest early but usually want more equity because they are taking a higher risk. They are often sophisticated investors with a passion for your sector, so you can also benefit from their experience.

VCs look for better-established businesses with potential for higher, long-term growth. They invest with the intention of getting out over a relatively short time period. VCs can provide significant funds to the right businesses for their profile, and can provide access to expert advice, mentors and a network of contacts. The caveat is that you will be giving up an element of control, and VCs may even intervene if they are unhappy with the emerging direction of the business.

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Other types of equity investments include crowdfunding platforms, peer-to-peer lending and peer-to-business lending. The principle is for third parties to front the cash through a fund or other investment vehicle in exchange for a return, not necessarily equity.

For more about your options for funding growth, see Chapter 12 'Going for Growth'.

FRANCHISING: A DIFFERENT MODEL

Franchising – where trading occurs under the licence of an existing business – is increasing in popularity among startup owners. There are about 50,000 franchise businesses in the UK, a figure that has been steadily growing over the past three years. Around 700,000 people are employed in franchising businesses.

Franchise businesses have a higher-than-average chance of succeeding, not least because they can lean on an established model for advice and support, and they come with a ready-made business plan, including market research and advertising. Franchisees usually have a much better understanding of cash flow as well.

WHAT LENDERS EXPECT FROM YOU

Funders look for evidence of whether the owner has invested any of their own funds or put up collateral, whether there are alternative income streams and whether there is enough cash in the business.

Lenders want to know you're not relying exclusively on the success of one project. They will look for evidence of robust planning in case something goes wrong, such as how you would go about cutting costs or diversifying your customer base in a downturn.

Your business plan should be as transparent as possible when you apply to a lender for funding. The organisation will also pick up a lot of background information through your accounts and their credit-scoring processes.

Business owners can expect to be questioned by funders about the investment profile and ownership of their business. Banks must also undertake an element of due diligence to mitigate money laundering. And they will also have their own contingency plans in place to help them recover their money if things don't go according to plan.

PLANNING FOR SUCCESS

When you look at a lot of business plans and ideas, you start to see the commonalities shared by successful entrepreneurs. You should try to apply these insights to your business to maximise your chances of success.

Much depends on you, the business owner – your attitude, the type of business you want to start and what you want to achieve. But on a very practical level, much also depends on an informed, proactive approach to business funding – whether there is going to be enough cash to get the business off the ground, safely navigate those all-important early stages and stay afloat in times of adversity.

The macroeconomic environment is always difficult to plan for. Unexpected events can have unforeseen effects: you don't know if your biggest customer or supplier is about to start trading in another country, go out of business or be acquired by another firm.

Much depends on you, the business owner – your attitude, the type of business you want to start and what you want to achieve. But on a very practical level, much also depends on an informed, proactive approach to business funding.

But you can minimise the potential impact of such risks by maintaining close relationships with customers and suppliers, practising strong cash flow discipline and securing funding that enables you to plan for the unexpected.

Careful planning and an informed approach to your funding options can make a massive difference to your chances of success. And with that in mind, best of luck with your venture.

5

CRITICAL FRIENDS: HOW PEOPLE OUTSIDE YOUR BUSINESS ARE KEY TO ENTREPRENEURIAL SUCCESS

LEVEL39

Ben Brabyn, *Head of Level39*

There was a time in our industrial history when standing alone was considered king, when every business strived to be the biggest and only fish in the pond. It was the golden age of the laissez-faire entrepreneur, a zero-sum game in which another's gain was your loss.

But it seems that game is changing. We have entered a new age of commercial warfare – one where friend and foe can be one and the same, where entrepreneurs find support and success among their competitors. New marketing strategies will have to be devised across the nation in response to this paradigm shift in thinking.

The cluster model has taken root in the business landscape. For example, companies with similar target customers that set up shop alongside one another, entering into an understanding of competitive collaboration.

These clusters are made up of like-minded entrepreneurs who elect to work in close proximity. They benefit from environments that have been built to create the best possible conditions for success.

Clusters can be groups of companies in broadly similar sectors, such as the software startups that gravitated towards East London's Old Street Roundabout at the start of the 2000s. They can also be specialised experts within a niche field; think of the concentrations of spin-outs that emerge from high-performing university departments – gaming in Edinburgh or biotech in Cambridge. Or, in the case of Level39, they are startups and scaleups within related industries – cybersecurity, Fintech, blockchain – that literally sit alongside one another in a coworking space.

The benefits of building a business within a startup cluster are not what they first seem. The ostensible purpose of the cluster is to offer a central clearing function for the talent, innovation and expertise that are housed there. Under this guise, the role of the hub is to help make connections within the community, which is quite often the primary reason entrepreneurs join a hub. In this sense, the business cluster is seen as a corporate matchmaker – the hub's infrastructure is there to introduce A to B. Many entrepreneurs have long considered the reason for founding or relocating within a business cluster is so that someone else can bring along their next customer or ask for their elevator pitch – the expectation being that this will prove to be a

resounding success and that will simply be the Series A (first-round) funding round sorted. Surely that's the point?

Perhaps not. A business cluster should not be designated the responsibility to proactively take over business development functions, and it simply cannot produce the most optimal outcomes or create the best matches for its participants. The chances of building an effective partnership, collaborating to innovate or even securing a transaction become surprisingly low when the participating company expects to sit back and wait for the cluster to bring opportunities to it. The central hub is simply not effective at matchmaking and in the long run will do little to improve an entrepreneur's chances of success. The most progressive business clusters are keenly focused on delivering what is actually required to help businesses grow.

THE NEXT GENERATION OF BUSINESS CLUSTERS

Business clusters are moving away from linear structures. Picture an environment where I introduce one entrepreneur to another, cross my fingers and pray they hit it off. Hubs like ours are now helping companies meet the people most optimised for their success and encouraging them to interact with relevant people in a way that guarantees the higher probability of an end result. These hubs are creating conditions for growth, moving away from the hub-and-spoke model towards a model more akin to an enhanced periphery.

The collective of firms within the hub now form a central critical mass in which members effectively interact with one another and their partners (e.g. customers, investors, new recruits, academic partners, international partners, regulators, policy makers). The cluster becomes a place where participants maximise the value of interactions. It is under these conditions that businesses find opportunities to scale and realise growth potential. Here, the hub plays an important role in brokering new relationships – as an enhanced periphery, it creates a 'peer-to-peer' effect inside the cluster.

HOW? REPUTATIONAL BROKERAGE

Reputation is paramount in business, and 21st century enterprise has been largely defined by the increasing transparency of commerce. We can now look up, review and engage with companies 24/7, which has dramatically altered how firms build and manage their reputations. The single greatest challenge any entrepreneur will face when entering a new market and developing a new technology, product or offering is in establishing a credible reputation and, most importantly, creating a reputation for trustworthiness. It is a battle of reputation that is currently threatening to put the brakes on some of the world's biggest businesses – the tech titans find themselves swimming against a tide of public backlash for the way they have managed user data. In today's business environment, where firms can access and target enormous audiences in a few clicks, creating and destroying reputations has never been so easy. Trust is at the heart of the new cluster model – this is where its members find true success.

At this stage, let me make one very clear distinction – trust and transparency are not the same. I am not saying that being part of a business cluster makes a company more accountable. For example, in developing new forms of cybersecurity protection, I do not need to know or care how the system that safeguards my business works, just that it does. The transparency of the business really doesn't matter here; what matters is that customers trust it.

The hub plays an important role in brokering new relationships – as an enhanced periphery, it creates a 'peer-to-peer' effect inside the cluster.

The most reliable way of creating a reputation for trustworthiness for emerging technologies is through third-party review. Means of digitally

reviewing a product or service is central to the business model of some of the world's biggest multinationals. Take Uber or Deliveroo, for example. The trust I put into the quality of my Friday night takeaway or in returning home safely is founded on market consensus – the ruling of the silent majority.

By assigning drivers and food outlets with visible ratings, we perceive to have bypassed, even cheated, the misinformation that is inherent in these markets. We make decisions to buy because we feel safe in the knowledge that the thousands who have come before us have given the product or service a five-star rating. We get in the back of the car because others have validated the driver's capacity to get us home without a hitch. If you scale this concept, the peer review model is applicable to the environment found in a cluster of businesses, and it leads to an important variation in competitive behaviour.

Third-party review within the hub creates new incentives for working alongside similar companies, even those earmarked as competitors, taking us far beyond the traditional view of incubators. This is often seen as counterintuitive and returns us to one of our original questions – why set up shop next door?

Popular sentiment will tell you that vendors and customers approach each other on a purely transactional basis – buyer and seller – which is where your matchmaking business clusters fit in. However, in a space like Level39, we have found that the way businesses view their competitors has changed. Often, entrepreneurs will forgo a short-term opportunity and broker a relationship with a competitor to foster an optimised relationship for the long term. The two competitors are now investing in their reputations, placing greater emphasis on long-term growth.

For a single transaction, the optimal behaviour is to maximise its output. However, if you have a series of transactions in the pipeline, it makes more sense to ensure that you win where you have strengths and avoid expending unnecessary effort and resources where you do not. What I observe at Level39 is that entrepreneurs who are looking to scale and have long-term growth ambitions will often not compete within specialisms that are not their fiercest offering and alternatively refer the prospect to another business – yes that's right, to a competitor. This is reputational brokerage, and it presents a unique opportunity to reduce the cost of customer acquisition.

Often entrepreneurs will forgo a short-term opportunity and broker a relationship with a competitor to foster an optimised relationship for the long term.

The enhanced periphery has created the conditions in which an exercise of quality discovery takes place, and the results lead to the establishment of the most valuable commodity for an entrepreneur – trust. The benefits extend far beyond the buyer as these new behaviours prove extremely advantageous to firms, customers and investors alike by acting to shorten cycles.

Competitor referrals reduce sales cycles because people introduce each other to potential customers. It shortens tech development cycles because there are more opportunities for collaboration. It shortens investment cycles as companies introduce investors to better portfolio fits. There is even evidence to suggest that within a business cluster, where the conditions for competitor referrals are ripe, recruitment cycles also fall in length. It becomes significantly easier for potential employees to establish a clear and dependable picture of a potential hirer when they see the context in which they operate and meet their peers operating within the organisation around them.

WHY?

Such is the vital commercial significance of building trust, the startups and scaleups based in Level39 will establish a reputation for credibility even before establishing a name for themselves within a specific technical competency or market offering.

The most fruitful behaviour for individual operators working within a cluster of businesses is to become an effective and trustworthy referee for competitors. The prevalence of these behaviours and their merits and payoffs are even more profound within a market where knowledge is very asymmetric. Of course, a disparity in knowledge exists within almost every transaction, whether talking to potential customers, investors or recruits. Establishing trust is the bedrock of these relationships and the foundation of commercial triumph.

Let's return to the example of cybersecurity – a critical piece of the UK economy and a topic climbing up boardroom agendas. The consequences of getting this wrong are more severe and potentially catastrophic than ever. Cybersecurity has now affected every industry, including those that have traditionally veered away from digitalisation. It has led to a precarious situation whereby leadership teams rarely have the expertise to make sophisticated buying decisions as they simply do not understand the nature of the threat or the risk it poses to their organisation, let alone the quality of the responses that are available to them.

Typically, in asymmetric markets where the knowledge resides in abundance with one side of the deal, solutions come about when government regulates either directly or through setting minimum standards and implementing control bodies. Alternatively, potential procurers seek to transfer a risk to the insurance industry. The most popular response traditionally resides within the market, to buy from a trusted supplier and help stack some of the chips back in your favour – also known as the 'no one got sacked for buying from IBM' effect. Yet this is particularly challenging when looking at cyber threats, which move fast and break things, certainly faster than some of the incumbent providers. The great news is that as a buyer, coming to a connected community like Level39 reduces the issues of asymmetric market knowledge as one can exploit reputational brokerage to very good effect.

By using the cluster to bring competitors within the market together, the rivals effectively hold each other up to the same light and it becomes within their interest to give the most honest and candid picture of their relative strengths and weaknesses.

To imagine the behaviour in practice, consider a scenario in which one inexpert customer comes into the cluster looking to purchase a cybersecurity solution that can safeguard their organisation from malicious threats. An inexpert customer interacts with two providers of cybersecurity but cannot tell what they need or who is best suited to provide it. The best bet is for the buyer to bring both parties together as expert competitors in the field and invite them to craft a quality solution that meets the needs of their company. By using the cluster to bring competitors within the market together, the rivals effectively hold each other up to the same light and it becomes within their interest to give the most honest and candid picture of their relative strengths and weaknesses – critically revealing which is the most relevant fit for the buyer's needs.

The outcome comes down to one of three choices: the customer ends up buying from one of the businesses, the two companies agree on some form of collaboration, or no one works together. In a modern economy where markets are defined by the significant transmission of information, including your reputation, it is beneficial for a vendor to help the buyer find the best answer, even if the result is to forgo a single transaction. A credible reputation is formed because the incentive is to operate in good faith; reputation depends on it. And customers approach you within a cluster precisely for that reason.

CONCLUSION

Business clusters are evolving to meet the needs of the modern economy, where reputation and trust are the most valuable commodities formed

by the very fact that entrepreneurs surround themselves with competitors. An optimised business cluster works as an enhanced periphery, where competitor referrals are the catalyst for building a trustworthy and credible reputation.

At a time when the world is rediscovering borders, entrepreneurs are proving time and time again that they flourish when presented with constraints, blurring boundaries between competitor and collaborator, and rewriting the rules of lead generation, business development and marketing in the process.

In the pursuit of entrepreneurial growth, brokerage and reputation are the keys to success.

6

BUILDING AN IP STRATEGY: IP AS INVESTMENT

HALEY GIULIANO

Joshua Van Hoven, *Counsel*

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As an early stage company, you may be a disruptor or seek to advance a key technology in which your team has particular expertise. No matter the driver, even the most idealistic startups fail to achieve their goals if they do not position themselves for investment funding of some kind. Those investments are typically based on the potential financial return of a subsequent acquisition or public offering.

At each stage of the investment cycle, your investors and business partners will scrutinise your people, technology and operations. A robust intellectual property (IP) programme will ensure that the efforts of your people are owned by your company, that your technology is safe from theft or copying and that your operations (such as branding, goodwill and customer relationships) are protected from free riders. In short, a sound IP strategy adds value to your business – IP is an investment, not a cost, if handled well.

The first two sections of this chapter, 'Establishing IP Best Practices' (Section 1) and 'Acquiring IP Assets' (Section 2), detail the steps of building an IP programme. Follow the principles outlined in these sections, and you will be well positioned for funding events, third-party IP issues and IP disputes (Sections 3–5).

1. ESTABLISHING IP BEST PRACTICES

Founders often think of IP in terms of monopoly rights, such as patents and trademark registrations. In fact, virtually all early stage agreements a company will sign – whether with founders, employees, contractors, business partners, suppliers or customers – will have a core IP element. An established recognition of IP in your systems and business practices, from founding through funding, will dictate whether the benefits of your business-building efforts accrue to your company, other companies or the general public.

The following are subjects to address with founders, employees and contractors:

- If possible, obtain a forward-looking assignment of all pre-existing IP that is related to the company's business. As a second-best option, obtain a licence to use the IP. Otherwise, the IP holder may hold the company hostage later, particularly if relationships sour.
- Obtain assignment of all IP developed by personnel while employed or retained by the company. If possible, include related developments from employee side projects.

- Require confidentiality and non-disclosure obligations for any non-public information related to the company or derived from company information.
- Where allowable (check laws in local jurisdictions), obtain a reasonable non-compete clause (reasonable as to time, scope and geography) at the beginning of engagement to address subsequent separation from the company. Depending on local laws, consider limitations on the use of retained information in human memory (residuals).
- Require ongoing obligations to co-operate in the acquisition, enforcement and/or defence of IP.
- Require compliance with approved device policies that limit where, how and with what devices employees can access company information.
- For contractors, ensure by contract that any creative works (including source code) are explicitly works made for hire on behalf of the company.

All of these rules are equally likely to also apply to agreements with third parties, such as suppliers, joint venture and business partners, distributors and customers. In addition, you should also consider the following:

- disclosure of IP and establishment of licences to use IP of suppliers, joint venture partners and other business partners;
- allocation of jointly developed IP rights for joint venture and business partners – either ongoing rights to use or co-ownership;
- indemnification and defence obligations for infringement due to company use of supplier and business partner products and technology, and for infringement by business partners and customers through use of the company's products and technology; and
- limitations on liability incurred due to IP indemnification, IP defence or breach of any other obligations.

Suitable agreements can be provided by your business or IP counsel. As a practical matter, early stage companies are generally able to obtain pragmatic IP terms from employees and contractors, while larger established firms often attempt to impose unfavourable IP terms on early stage companies. In the latter instance, the established firms' lengthy 'form' documents often include onerous buried terms that may compromise your company's core IP. Identifying and addressing those terms can secure the company's long-term prospects. In our experience, most large firms know that some of their terms are onerous (even unenforceable) and are willing to walk those terms back during negotiations. If an agreement sacrifices too much of your company's IP and the large firm is unwilling to negotiate, you must be willing to walk away.

While the right agreements establish that you own and control your IP, proper business practices are key to creating IP in the first place. Section 2 addresses the types of IP and how they are established in more detail, but as a general matter the company should consider at least the following steps:

- Establish and enforce standards for electronic storage systems, physical document retention and device usage.
- Document code and product development activity and revisions, and establish protocols for storage and maintenance of these materials.
- Maintain reasonable access controls to facilities and documents, particularly for key technology, customer lists, supplier information, business plans and financial data.
- Establish onboarding and exit procedures to ensure that employees sign required agreements, have appropriate access to company-related information and remain informed of their ongoing obligations to the company.

While the right agreements establish that you own and control your IP, proper business practices are key to creating IP in the first place.

- Establish branding and marketing guidelines that ensure consistent messaging, provide notice of copyright and trademark ownership and prevent inadvertent loss of trademark rights through dilution.
- Establish invention disclosure processes to establish a record of invention, and initiate reviews for considering patent versus trade secret protection.
- Perform pre-disclosure reviews before technology is disclosed to any third party or prior to any sales efforts (even under a non-disclosure agreement [NDA]) to prevent inadvertent disclosure and loss of trade secrets or patent rights.
- Periodically monitor for third-party use of company IP (including by business partners) to identify problems early, when resolution is more likely and less costly.

One brief note on dealings with investors: venture capital firms (VCs), and even seed investors, do not typically sign NDAs. It is therefore recommended that you work with your IP counsel to distinguish your business idea from your 'special sauce' that uniquely addresses that business idea. The former is suitable for initial discussions, while the latter should either be covered by a patent filing prior to discussions or held for a later meeting, when the investors are willing to sign an NDA that protects your trade secrets and potential patent filings. As with all bad business deals, if a VC requires that you give away your special sauce to get a meeting, you need to stand your ground.

2. ACQUIRING IP ASSETS

You might ask: why address IP best practices before introducing the different types of IP assets and how they are acquired? The simple answer is that companies automatically acquire most IP as a result of following these best practices. As for IP that requires the grant of rights from a government agency (e.g. patents) or that is enhanced by such approval (e.g. trademarks, design rights and sometimes copyright), following these best practices establishes the baseline for registration.

For each of the four core types of IP, we provide examples of protected subject matter, how the IP rights are acquired and international considerations in Table 1.

Assuming a company establishes and maintains IP best practices, the next step is to establish a strategy for securing IP by patents, trademark registrations, copyright registrations, design rights and domain name registrations. This strategy will vary depending on the technology area, type of business and available funding. The IP strategy should be developed with an IP professional to provide a realistic cost–benefit balance. As a rough rule of thumb, a product company will typically file provisional patent applications prior to product release or sales efforts, obtain trademark clearance for company and product names well before launch, and register core trademarks, domain names and copyrights as necessary. Most international filing regimes provide a grace period (around 6–12 months) from an initial filing, and international protection is typically pursued as these deadlines approach and the company has further considered product development and its likely international footprint.

While the basic concepts of protecting IP around the world adhere to a common format, there are wrinkles that can trip up the unwary. For example, the average US company will often want to rely on the protection afforded under US patent law on the effect of the sale of goods subsequently covered by a patent application. However, much of the rest of the world (China, Europe, Japan and Korea, for example) will regard such sales as a potentially public disclosure of the invention, which could invalidate patent rights. The general advice is not to assume the law is uniform and check with IP counsel in advance.

If a VC requires that you give away your special sauce to get a meeting, you need to stand your ground.

TABLE 1. Types of IP: What they protect, how they are acquired and international considerations

IP right	What is protected?	How is it acquired?	International considerations
Trade secrets	Confidential information that has value to the business, such as source code, schematics, business plans, customer lists, suppliers and sourcing and pricing. Trade secret rights last as long as the information is kept secret.	The company must engage in reasonable commercial efforts to keep the information secret. No government registration is available. Trade secrets require documentation of efforts to maintain secrecy, including agreements and business processes.	Standards of proof and enforcement mechanisms vary worldwide. When partnering with overseas firms, consider local trade secret provisions before disclosing secret information, even under NDAs or other conditions of confidentiality.
Patents	New inventions in technological fields, including electronics, software, pharmaceuticals, compositions, biotechnology and mechanical devices. Patents are a monopoly right with a limited term (typically 20 years).	The company must apply for a patent by filing an application prior to a filing by a third party and prior to any public disclosures of the invention, often including sales. Patent filing and examination is generally not cheap, although there are strategies for deferring costs until later in the patenting process.	An initial filing in an appropriate country (consult an IP attorney on foreign filing licence requirements) can serve as the basis for follow-on filings worldwide.
Trademarks, design rights and domain names	Branding and goodwill from company name, advertising, taglines, product design, user interface design and domain names. Trademarks may be maintained as long as the mark is in use and used properly, while design rights have a limited term.	Some jurisdictions establish 'common law' rights through use in the jurisdiction, with enhanced rights through registration and notice. Other jurisdictions require registration as a prerequisite to bringing a trademark action. Design rights and domains typically must be registered, but exceptions exist.	International treaties are in place that establish mechanisms for filing for these forms of IP in numerous jurisdictions around the world. Coverage is not universal, and time limits counsel for early consideration of the IP's likely international footprint.
Copyright	Creative works, photographs, videos, source code and unique user interface elements. Copyrights have a limited term, but that term is lengthy in many instances.	Copyright is established with the creation of the work and enhanced in some jurisdictions through registration and notice. Costs of registration are generally minimal, although costs can escalate for businesses with an extensive corpus of creative content.	International treaties are in place that establish mechanisms for recognising these forms of IP in numerous jurisdictions around the world.

3. FUNDING EVENTS

Fancy lunchrooms and company jackets aside, founders, early stage employees and investors are compensated and motivated by an eventual return on their company stock due to acquisition or a public offering. But until that day comes, the company's operations must be funded. At each stage of your journey, from notes on a napkin to acquisition or initial public offering (IPO), sophisticated third parties considering investing will scrutinise your IP.

The level of scrutiny will vary depending on the stage of your company and the investor or purchaser. For example, early stage investors typically know or are connected to the founders and may be willing to sign on to convertible notes (a type of 'loan' in which the investor receives equity instead of principal and interest in return) on a handshake or based on a high-level view of the IP position. By the time of your first venture capital roadshow, expect to get into the weeds on your IP portfolio and operations. The company may be expected to make numerous representations and warranties, for example:

- ownership of IP, including IP developed by employees, contractors, joint venture partners, etc.;
- confirmation that employees and third parties are subject to appropriate confidentiality obligations;
- licences necessary to operate the company's business, and a lack of obligations to third parties who may compete with or impede the company's operations;
- non-infringement of third-party IP, particularly in technical areas related to the company's core business and technology; and
- IP rights obtained to create barriers to entry for third parties, IP rights obtained legitimately from the relevant IP authorities and IP rights still being valid.

It may be entirely reasonable to include a qualifier (e.g. 'To the company's knowledge, it does not infringe . . .') for any of these representations and warranties, which, if incorrect, can form the basis for a later lawsuit against the company.

Depending on the transaction, the company may also be required to provide detailed schedules listing relevant IP assets, pending or threatened infringement litigation, employment status of key inventors and key licences.

Particularly for later venture capital rounds, acquisition or IPO, companies will typically work with outside IP counsel to negotiate the IP portions of the deal and put together these schedules. The counterparty will scrutinise your disclosures very closely, typically with a team of lawyers and consultants. Particularly in the US, a company's IP disclosures may also be reviewed by national regulatory agencies, such as the Securities and Exchange Commission.

Many companies have failed to attract funding or suffered a significant drop in valuation due to a lack of attention to the IP details. Investing in an IP strategy early more than pays for itself.

> At each stage of your journey, from notes on a napkin to acquisition or IPO, sophisticated third parties considering investing will scrutinise your IP.

4. THIRD-PARTY IP ISSUES

Consider third-party IP issues before investing significant capital in your brand, technology and people. Does your trading style infringe on third-party trademark rights in the jurisdictions where you are likely to do business? What is the patent landscape like in your field? Before they begin working on your products, code or sales, are your key employees subject to non-compete obligations to third parties? Are they relying on third-party trade secrets? Does your business plan rely on use of copyright-protected third-party materials that may attract regulatory scrutiny? Are you using open-source software or having to adhere to specific technical standards? Any of these issues may compromise your freedom of movement.

Implement appropriate action early to address third-party IP issues. Although the 'better to ask for forgiveness than permission' approach sometimes works for high-growth companies,

it is not recommended unless you want to risk buying your way out of trouble and paying large legal bills in the process. The better approach is to work with IP counsel early to perform a comprehensive IP analysis, consider potential design-arounds, monitor competitor hires and onboarding, build compliant copyright practices into your business, and set up safeguards to make informed decisions about the use of open-source software and participation in standard-setting organisations.

Your early stage company does not exist in a vacuum. However groundbreaking your technology or business may be, you stand on the shoulders of the inventive individuals and companies that came before you. In an interconnected global economy awash with liquidity, not only are there likely to be early stage and established competitors pursuing the same market as you, but those competitors could also be well funded. By taking early steps to create a convincing IP position, an early stage company can focus on beating the competition in the market, rather than battling them in court.

5. IP DISPUTES

As a startup, your company is always at risk of being on the receiving end of a writ for IP infringement. IP litigation is expensive and consumes company resources that are better dedicated to building and selling your product. Thus, IP assertions for early stage companies should generally be avoided, or at least limited to 'bet-the-company' disputes typically involving patents or trade secrets for core technology. Particularly if you have followed the steps outlined in this chapter, other IP issues, such as trademark, copyright, unfair competition and non-core technology disputes, can typically be handled through negotiation by competent counsel at a fraction of the cost of litigation.

Lawsuits by patent trolls – companies that do not sell products but file nuisance lawsuits in large numbers, each with a low damages demands – are a receding but irksome menace, particularly in the US. They can typically be handled at minimal cost or disruption by competent IP counsel.

By taking early steps to create a convincing IP position, an early stage company can focus on beating the competition in the market, rather than battling them in court.

When settling IP disputes as a defendant, consider the impact on your future business. Early stage companies can be tempted to settle on a royalty based on a percentage that is inconsequential to the current business, but that will bite with a vengeance when the company grows. Make sure the settlement is also to the benefit of any third party acquiring your company in the future. Numerous other considerations come into play, such as exclusivity, field of use, sublicence rights, remedies, rights to pursue litigation and restrictions on challenges to the licensed IP. Better to have a clean break with no comeback later on.

Gradually, as your company gains traction, the shoe may be on the other foot. You may want to dedicate a portion of your funding to an active campaign to notify other companies that entry into your space will involve significant IP hurdles. If you invest in your IP processes and portfolio, you should be at a significant advantage against latecomers seeking to attack a market that you have built.

The keys to an effective IP strategy are early stage adoption and clarity. Good luck – the rewards are likely to be worth significantly more than the investment costs.

7

WHY IT WILL PAY TO TAKE WELLBEING SERIOUSLY IN YOUR BUSINESS

MENTAL HEALTH UK

Brian Dow, *CEO*

Gillian Connor, *Head of Policy & Partnerships*

Starting your own business is a life choice. You've probably chosen this path knowing that most new businesses fail, that the buck stops with you, and that it will be a hard but worthwhile slog. But the chances are that you are very driven – a trait you're relying on to see you through what is likely to be a bumpy ride.

That ride may involve worrying about other people, your family, your business partners, your staff and money. You may need to make some difficult decisions along the way, like letting people go. And all of this may be from a solitary desk, without reliable people to advise on ideas and worries.

Success may follow, but there may be pressure to scale up – and the slog will continue if you let it.

You're probably aware of these risks, yet something is compelling you anyway. But all the above can be a toxic cocktail for extreme stress and poor self-care. It's not surprising then that stress and poor wellbeing – even burnout – can be high among leaders of small and medium-sized enterprises (SMEs) and micro-businesses. The following statistics speak to the lack of self-care among SME owners:

- 55 per cent of entrepreneurs said that running a business has had a negative impact on their mental health.[1]
- 41 per cent say they don't have enough time to sleep properly, and 31 per cent run out of time for exercise.[2]
- 39 per cent say they have felt lonely since becoming their own boss.[3]

Our work can impact our wellbeing; it can both trigger and aggravate poor mental health. Mental Health UK observes the effects of this in our day-to-day work with businesses across the UK. We also know how stigma around mental health and the notion that discussing stress and wellbeing in the business environment can make you seem 'weak' prevent many people from seeking help. Additionally, some people do not always report positive experiences at work when they do seek help and ask for more flexibility. This may explain why official figures suggest that more and more people with mental health conditions decide to be their own boss.

The mental and physical stress of running your own business – the responsibility and long hours involved and the sometimes less-than-healthy lifestyle that goes along with it – may make small business owners more vulnerable than most to poor

mental health. And if you employ people, that makes your staff more vulnerable too.

WELLBEING IS FAR FROM 'NICE TO HAVE' – IT WILL MAKE YOU MORE PRODUCTIVE

You might be thinking: so what? You have a business to run and a livelihood to develop – sacrifices will need to be made. You can catch up on your 'wellbeing stuff' later, right?

However, we know that good mental health (which is basically about 'feeling good and functioning well') is closely linked to optimal productivity.

We also know that showing up for work when you're not well (presenteeism) is a false economy – it's bad for productivity. In fact, presenteeism is worse than being off work sick, because it prevents you from being your best and delays or even impedes the recovery process. Research by Deloitte found that the cost of people being at work when their mental health was poor was more than double that of sickness absence and staff turnover combined.[4]

There's a clear lesson then: it doesn't pay in the long run to skimp on mental health. Our charity has encountered numerous people who have pushed themselves to the point of physical and mental burnout and are forced to take time off.

> While stress is not the same as mental health conditions like anxiety or depression, excessive or long-term stress can increase your risk of developing a mental health condition.

MENTAL HEALTH AFFECTS ALL OF US, LIKE IT OR NOT

You might also be thinking that you've never had 'mental health issues', that stress can be a good motivator, and that burnout could never happen to you. That you're tough and strong, and that the people you work with are of the same ilk.

The reality is we all have mental health. Yes, all of us. Much like good physical health, we can't take good mental health for granted. At least one in four people is likely to experience a mental health problem in their lifetime, including common mental illnesses like anxiety and depression. A challenging event, an unexpected trigger or a combination of pressures could tip the balance into being overwhelmed, especially if we don't already have good coping mechanisms to help us manage our wellbeing. People who experience burnout often say they didn't see it coming.

Stress is a typical response to the pressures and demands of business and life. Some stress is good for us, but excessive stress happens when the demands put upon you are greater than your capacity to manage them. While stress is not the same as mental health conditions like anxiety or depression, excessive or long-term stress can increase your risk of developing a mental health condition.

If you can identify the telltale signs of worsening mental health in yourself, you are more likely to be able to do something about it and keep your stress at a healthy level.

Some of the early warning signs and symptoms may include:

- physical changes (feeling tired, headaches, not sleeping or stomach problems);
- cognitive changes (trouble focusing on tasks or finding it hard to make decisions);
- emotional changes (being unusually tearful or angry); and
- behavioural changes (snapping at people, avoiding social situations or turning to alcohol to cope).

You may not always be able to spot these early signs yourself, or associate them with stress, especially when you're experiencing them. Sharing what you know in advance with someone you trust can help, and being more aware of your own warning signs may also make you more aware of your coworkers' struggles. You may be willing to risk your own

health, but others around you may not be as emotionally invested in your business or as resilient.

RESILIENCE IS SOMETHING WE CAN ALL LEARN AND DEVELOP

A common misconception is that being resilient is the same as being 'tough'. Actually, it's about being able to respond to life's pressures and learning from these challenging experiences. 'Toughing it out' limits our ability to learn and grow so that we can respond well when life gets tough again.

You may be thinking that you're either resilient or you're not, or perhaps you're unsure how to become more resilient. But resilience – which goes hand in hand with self-awareness – is a skill.

You, and those you work with, can learn resilience. We all have different tipping points, and it is important to be non-judgemental and understanding about this. If a situation is affecting someone's mental health negatively, that impact needs to be taken seriously. Smaller companies are often thought of as more tight-knit and nurturing, but they may also feel the pinch of understaffing and are sometimes guilty of pressuring people to come into work, or back to work, before they should.

> Committing to a mentally healthy workspace (whatever that means for you) will allow you to make the right decisions and help you with the day-to-day running, operation and performance of your business.

There is a growing expectation around wellbeing – and an expectation to be nurtured – in the workplace these days, particularly from millennials. This requires leaders and business owners to be more 'emotionally intelligent' – self-aware and socially aware. Emotional intelligence is about having the capacity to notice, control and express our emotions, as well as being able to handle interpersonal relationships fairly and empathetically. These skills are an important and increasingly valuable asset in the business world. They can also help you with your clients and others outside your business.

EMBRACING A POSITIVE MENTAL HEALTH AGENDA IS A SHREWD INVESTMENT

This is not 'nice-to-have' stuff. Applying this agenda and committing to a mentally healthy workspace (whatever that means for you) will allow you to make the right decisions and help you with the day-to-day running, operation and performance of your business. Try to note the following:

- Knowing what keeps you mentally well and being disciplined about your self-care management strategy is key to allowing your business to thrive.
- The ability to spot when others are struggling (which may not be obvious) will help you retain and grow a productive, innovative and resilient workforce able to sustain change.
- Resilience and emotional intelligence will help you in your external business relationships (including clients and suppliers). One in four of them are likely to experience a mental health problem in their lifetime, after all.

WHAT YOU CAN DO

TRULY BE YOUR OWN BOSS

Being your own boss is a key driver for why people like you break out on their own, right? So be your own boss in your personal life too. Take active control of your wellbeing and be disciplined about anything that may compromise it. It starts with you, the boss, leading from the top.

- *Get to know yourself.* Actively think about what makes you personally flow. You may find it useful to use Mental Health UK's Wellbeing Plan to help you work on your own personal strategy. Our Stress Bucket tool can help you think about what affects your stress levels and resilience and how you can address this. This can include addressing negative thoughts that impact our feelings and behaviour (we have a

cognitive behaviour therapy tool that can help with this).

- *Start as you mean to go on*. This starts with the obvious – taking more time off, reducing weekly hours, setting reasonable personal deadlines and delegating more. Even seemingly unimportant things can help, such as having office quiet spaces, reducing noise and increasing light levels.
- *Reach out*. If you work alone, you don't necessarily have colleagues to notice changes in your mood. Tell friends and family about what stress and poor mental health looks like for you, so they can spot any warning signs. Encourage healthy dialogue with your colleagues or business partners.
- *Be authentic*. You're embarking on a challenging task. It is okay to be open about the pressures and challenges you face. It tells people you're approachable and that it's acceptable for them to not be okay as well.
- *Continue to learn*. Understanding yourself and having the tools to keep yourself well is an ongoing journey, so make it an item on your daily to-do list to check in with yourself and to get clued up on new ideas and resources that will help you and others around you get better at managing your wellbeing.

HAVE A PLAN FOR THE PEOPLE YOU WORK WITH

Consider the type of organisation you want to build and how a wellbeing foundation can help you achieve it. You may not employ anyone right now, but picture what you want your workplace to look and feel like.

- *Get to know your staff*. We can spot changes in others and help them reach their potential when we know them better. Incorporate regular check-ins and reviews to address wellbeing.
- *Model good self-care practice*. Staff will take this agenda seriously if you do.
- *Share what you know*. Support your colleagues with tools that can help them maintain and boost their own resilience.
- *Encourage a supportive and open culture*. Encourage staff to look out for each other and share how they're doing. Asking "how are you?" – and meaning it – is a natural opener. The Ask Twice campaign run by Time to Change has some great tips on how to do this efficiently. Some companies have specific volunteer champions who are taught to do this within a clear framework. We helped Lloyds Banking Group develop and deliver their Mental Health Advocates programme.
- *Consider training and other outside support*. Business owners do not usually have access to the kind of HR support an average line manager would, so think about how you can optimise external resources.
- *Create an inclusive culture*. Look at how you can offer flexible working practices, including flexible start and finish times and the option to work from home.
- Incentivise and provide training on physical and mental health and the link between them. This could include cycle-to-work schemes or mindfulness training.

BE PROUD ABOUT TAKING MENTAL HEALTH SERIOUSLY

There is a good chance this agenda will resonate with your suppliers, stakeholders, clients and customers. Again, one in four of them is likely to experience a mental health issue in their lifetime, so tell them about what you're doing and why. Use digital platforms and other channels to share how you and your company are focusing on mental health.

TAKING WELLBEING SERIOUSLY WILL BE ONE OF THE BEST INVESTMENTS YOU'LL MAKE

Consider managing your mental health and creating a positive mental health working environment as an investment.

Ask yourself: at what cost are you prepared to pursue your entrepreneurial journey? Are you really your own boss when it comes to your wellbeing? Spend time now to think about what you want for yourself and others when it comes

to quality of life. Think of it as an 'invest-to-save' approach.

And remember: a resilient you will help you create a resilient business.

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8

DEVELOPING A FIRM'S CAPACITY TO INNOVATE SUCCESSFULLY AND SCALE

ASTON BUSINESS SCHOOL

Mark Hart, *Deputy Director of the Enterprise Research Centre, Associate Director of the Centre for Growth*

Paula Whitehouse, *Associate Dean for Enterprise and Director of the Centre for Growth*

Small businesses have the potential to contribute to UK economic growth by stimulating innovation, spurring competition and accelerating productivity. Growth rates among small businesses that innovate are significantly greater than those that do not. In fact, many studies show a positive relationship between innovation and higher growth rates, and there is even some evidence of a positive relationship between both product and process innovation and productivity growth. Innovative small and medium-sized enterprises (SMEs) are also more likely to operate in export markets, which leads to economy-wide productivity benefits as these companies gain market share.

The importance of innovation for productivity growth is evident in the data. Innovation at the firm, industry and national level accounts for up to 70 per cent of the UK's long-term economic growth and around half of its labour productivity growth.[1] When it comes to business, performance is influenced by the company's ability to adapt to changes in the external environment or disrupt the status quo. This relationship contributes to productivity growth in three main ways:

1. There is a positive relationship between innovation and firm performance. Across all sectors, product and process innovation has led to greater productivity, which has allowed for substantial growth in employment and/or sales.
2. Businesses that innovate successfully are more likely to survive. Since the financial crisis in 2008, firms that prioritised innovation were better able to adjust when market conditions became challenging.
3. Innovative companies are more likely to establish external relationships and therefore gain access to external knowledge. Smaller firms have been shown to take greater advantage of these external resources than their larger counterparts.

However, compared with other countries in Europe, the evidence suggests that UK businesses – particularly small businesses – are lagging in terms of innovation.

DEFINING INNOVATION FOR BUSINESS

Enhancing leadership, management and entrepreneurial skills within a small business creates the foundation for developing an innovative mindset, which then supports sustainable long-term growth. Entrepreneurs and business owners should consider enrolling in programmes to develop these skill sets for the sake of company growth. Effective programmes typically encourage participants to review their current products, services and internal processes to ensure that they are competitive in their markets, and to consider new opportunities for growth and establishing a culture of innovation.

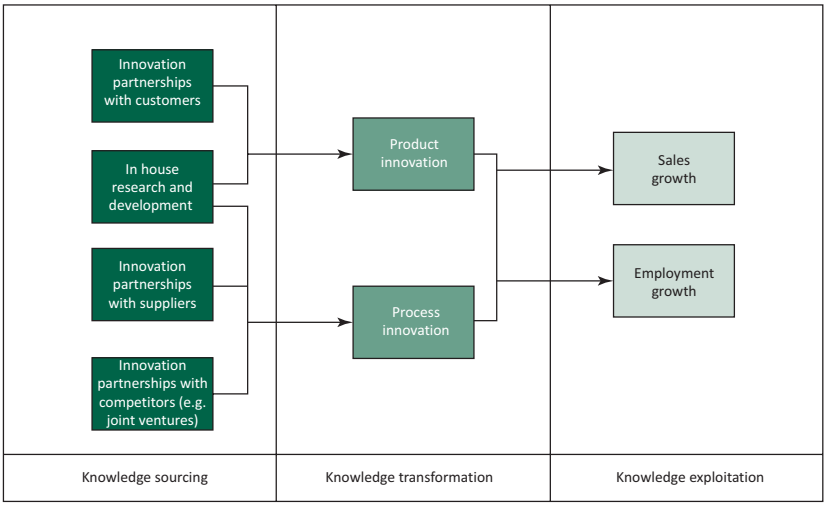
While many business leaders are familiar with the traditional definition of the innovation value chain (i.e. knowledge sourcing, knowledge transformation and knowledge exploitation), it is important to 'translate' the concept into activity, which is more practical for a small business (Figure 1). The successful commercialisation of new ideas – whether new to the firm or new to the market – is central to the innovation value chain.

While strategic innovation has been discussed at length, there has, however, been less attention paid to the strategic capability required to enable it. We need innovation to respond to market changes and competitive threats, which involves listening to customers to discover recurring issues and opportunities. Of course, successful innovation also entails gauging the impact of the Internet of Things and Industry 4.0 with its associated data analytic toolkits of artificial intelligence (AI) and machine learning. Innovation takes time and requires trial and error and experimentation. As a result, the small business leader needs a lot of patience and greater tolerance for failure. Nevertheless, digital technologies can transform the workplace and make a definitive impact on performance.

A recent large-scale survey of micro-businesses (i.e. a business with fewer than 10 employees) in the UK focused on digital adoption.[2] According to the results, digitalisation has increased sharply in recent years:

- More than 40 per cent of micro-businesses use web-based accounting software and/or cloud computing.
- Ecommerce is used by 30 per cent of firms, with 25 per cent and 18 per cent using computer-aided design and customer relationship management (CRM) software, respectively.

FIGURE 1. The innovation value chain



*Adapted from: Roper, S., Du, J., and Love, J.H., Modelling the innovation value chain, *Research Policy*, 37, no. 6–7 (2008): 961–977.

- 9 per cent of firms use machine-learning technologies, and only 3 per cent of micro-businesses use AI.
- Almost one in four micro-businesses (25.3 per cent) use none of these digital technologies.

Adoption of these digital technologies is strongly linked to sales per employee, a measure of productivity:

- Use of cloud-based computing generally leads to an increase of 13.5 per cent in sales per employee after three or more years, while using a CRM system adds 18.4 per cent in sales per employee over three years.
- Ecommerce adds 7.5 per cent in sales per employee over three years.
- Web-based accounting software increases sales per employee by 11.8 per cent over three years.
- Computer-aided design has a slightly smaller impact, increasing sales per employee by 7.1 per cent.

While innovation is imperative to create a competitive advantage, it is important to remember it must be customer-centric and focused on solving problems in the business that ultimately allow for future growth. The bottom line is a focus on delivering incredible value to customers. Innovation, therefore, is a fancy word for problem-solving, or asking if there is a better way of doing something in your business. In some ways, it is also a contact sport: collaborating and democratising strategic thinking throughout the entire organisation (or 'open innovation') are crucial if small businesses want to close the innovation gap with larger firms.

Innovation cannot occur in isolation within the business. It must be embedded in the business model so that it can deliver value at an appropriate cost and still meet the *real* needs of customers

Small businesses can also look outside the company for inspiration. Through external innovation, companies can discover new ideas by searching the technological environment in a systematic fashion and accessing new or improved digital technologies developed in other business settings. It also stimulates creativity, reduces risk and accelerates or upgrades the quality of existing innovations.

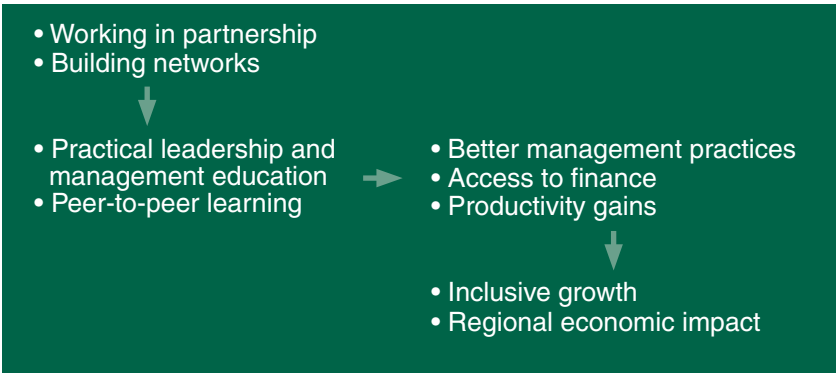
Innovation cannot occur in isolation within the business. It must be embedded in the business model so that it can deliver value at an appropriate cost and still meet the *real* needs of customers, not just what the company thinks they need. This is where small businesses can have an advantage in the marketplace: they can be more flexible and agile in listening to their existing and potential customers.

CENTRE FOR GROWTH – A MODEL FOR BUSINESS INNOVATION AND TRANSFORMATION

Aston University launched a new strategy in 2017 that focused on outcomes for students, businesses and our region. Aston Business School sought to establish the Centre for Growth as the regional specialist in scaleup support for high-growth businesses, including social enterprises and marginalised business communities. The Centre is firmly embedded in the regional business support ecosystem as a strategic partner in the Greater Birmingham and Solihull Local Enterprise Partnership Growth Hub.

The aim was to create impact for all the University's beneficiary groups. The Centre provides targeted support from startup to scaleup, connecting business leaders and giving them the tools to tackle challenges through different stages of growth. Businesses benefit from faster growth; entrepreneurial students benefit from contact with high-growth business leaders; and society benefits from sustainable job creation, graduates who remain in the region, increased gross value added per head

FIGURE 2. Centre for Growth - Delivering impact



and inclusive growth. Figure 2 illustrates how the Centre's programmes are structured to deliver impact for the individual businesses and the wider regional and national economy.

Since 2014, the Centre for Growth has provided specialised growth support to over 1,000 SMEs and delivered over 23,000 hours of peer-to-peer learning through courses such as Productivity through People, the Aston Programme for Small Business Growth, the Department for Business, Energy & Industrial Strategy Growth Vouchers programme and the Midlands' regional Goldman Sachs *10,000 Small Businesses* programme.

The Centre has put over 100 entrepreneurs in front of investors through the Pitchfest programme hosted by Venturefest West Midlands, helping them secure over £3 million of angel investment.

One such entrepreneur is Byron Dixon OBE who founded Micro-Fresh. Micro-Fresh is an award-winning technology company set up in 2006 designed to give long-lasting freshness to homeware, footwear and a variety of other products. The company is headquartered in the UK, but offers its technology all over the world with offices in China, India, Portugal, Vietnam, Singapore and the US.

Micro-Fresh was originally developed to prevent the growth of mould on products in transit from the far corners of the world. Micro-Fresh also has additional properties that prevent pathogenic bacteria. An innovative and invisible technology that eliminates odour-causing microorganisms even at low wash temperatures, the product is used in the home (towels and bedding), out and about (children's shoes) and on the go (aerobic sportswear).

As a constantly innovating company, Micro-Fresh has collaborated with Aston University to take advantage of recent scientific breakthroughs to ensure the successful commercialisation of the technology. Aston supported Micro-Fresh through the Goldman Sachs *10,000 Small Businesses* programme in 2012. They continued their relationship with Aston Business School through the Centre for Growth, encouraging the company to enter its technology in a pitching competition at the inaugural Venturefest West Midlands exhibition for entrepreneurs in 2015, which they won. They are actively involved in the work of the Centre and regularly give back to staff and students at the University after the Centre appointed the CEO, Byron Dixon OBE, as a Visiting Industrial Fellow. More recently, Jigna Varu, Global Commercial Director of Micro-Fresh, completed the Productivity through People programme in the Midlands, developed in partnership with the private sector initiative Be the Business to ensure key leadership skills are at the core of the business, therefore connecting the process of innovation to strategic thinking and decision making. Only by placing innovation alongside the value

proposition and revenue model of the business can it deliver the returns demanded by the management team.

CONCLUSION

Firms' ability to innovate successfully plays an important role in their ability to sustain growth and remain competitive. Government policies have also increasingly recognised the benefits of supporting firms' research and development (R&D) and innovation initiatives. In the UK, for instance, research and innovation have been placed at the heart of industrial strategy, receiving investments of around £3 billion per annum.

However, investment in innovation in isolation from developing leadership and management competencies will fall short of the expected returns. Developing a culture of innovation in the business, in addition to leadership and management skills, is as vital as the innovation itself when it comes to ensuring the future success and sustainability of the business. Without this, the UK government's innovation and R&D targets will not be achieved.

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9

WHAT'S MY STARTUP WORTH?

DRAPER ESPRIT

Simon Cook, *CEO*

Startup valuation is not an exact science – let me say that up front. Venture capital is invested in fast-growing, often immature companies with subjective and forward-looking agendas such that the main drivers of valuation have little to do with detailed calculations. Potential variables include technology risk, market-timing risk, management assessment, future financing requirements and an unknown competitive landscape. Perhaps a chapter focused on negotiation skills would be more suitable for explaining the rationale for venture capital investment valuations – a valuation approach seen on the BBC TV programme *Dragon's Den*. However, it is important to understand the financial objectives of a venture capitalist to provide a framework for valuation and negotiation.

OBJECTIVES OF A VENTURE CAPITAL FUND

A venture capitalist's role is to channel capital to entrepreneurs, allowing them the opportunity to create a successful new business while generating an acceptable risk-based return for their capital providers, who are often limited partners in a venture capital fund. Entrepreneurs typically do not have sufficient cash flow or bankable assets from their existing operations, perhaps because they are a startup or their growth has been constrained due to their current business size and limited free cash flow. The entrepreneur makes a calculated assessment that the dilution that results from selling an equity percentage is a fair trade-off for the significant value a successful company could return through accelerated growth. After multiple funding rounds, the stake an entrepreneur holds in a typical venture-backed business can often be less than 30 per cent at an exit, and therefore the reward must be significant enough to match the level of dilution.

Because venture capital firms (VCs) are usually invested in high-growth, young companies with significant potential based on innovative new technology, it is often considered an exciting asset class. Some significant household names, such as Microsoft, Apple, Vodafone, Skype and Google, raised venture capital in their early years and have since generated massive wealth for their early investors and founders. In addition, new growth companies have a positive effect on a country's economy and create new jobs.

People are constantly innovating, inventing technologies and business models that create new markets or dramatically disrupt existing ones. This constant stream of human innovation creates venture capital investment opportunities and persists regardless of the macro economy. The barriers to entry for venture capital investments are few, as there is always a surplus of entrepreneurs

looking for capital to fund their ideas and companies. Conversely, there are many barriers to consistently making successful venture capital investments across multiple then-year funds, and only a few VCs are successful over the long term.

PERCEPTIONS OF RISK

In spite of the excitement surrounding startups and their potential for job creation, there is also a perception of significant risk in venture capital investing. Clearly not every business that raises capital is successful – company failure is a natural part of venture capital. Attitudes towards risk play an important role in portfolio strategies and therefore the types of companies venture capitalists target. Fundamentally, investors in venture capital funds often seek an increased return (i.e. 25+ per cent internal rate of return [IRR], 10–20 per cent above publicly listed equity targets) based on the perception of additional risk in the event of company failure. In order to generate a net 25+ per cent IRR over five years, a fund must return a minimum of three times the invested capital net of fees and incentive payments, as shown in Table 1.

MULTIPLE TRANCHES AND MILESTONE-BASED INVESTING

An entrepreneur without tangible proof of their startup's future success will likely have some difficulty approaching VCs and asking for very large sums up front. Therefore, venture capital is often raised in multiple rounds of smaller amounts over time. The amount raised in each round typically relates to the current commercial profile of the business such that the amount of dilution in each round is between 10–50 per cent. This is done to avoid levels of dilution that would otherwise demotivate entrepreneurs and existing backers from striving for success. Multiple funding rounds also allow the valuation of a business to progress upwards as commercial milestones are reached, lowering the cost of capital. Such milestones might include the first working prototype, the first successful customer sale, a launch in a new country or a level of repeat orders that would suggest a sustainable business model.

Predicting the timing of market uptake – and therefore determining the numbers of rounds and total capital required – can be difficult. Accordingly, it is common for a venture capital investment to be split among several VCs, either together in shared rounds or over time in different rounds. Such syndication is a common feature of venture capital deals, and while no one VC typically holds a controlling 50+ per cent stake, it is common for VCs in aggregate to hold the majority of the shares in a business.

Sometimes, companies also suffer setbacks, and not every venture-backed business raises new capital at ever-increasing valuations. Occasionally, a company will have to raise capital at a price lower than in previous rounds,

TABLE 1. Generating a net 25+ per cent IRR over five years

Multiple	0.5x	1.25x	1.5x	1.75x	2x	2.5x	3x	4x	5x	6x	7x	8x	10x
Year 2	–29	12	22	32	41	58	73	100	124	145	165	183	216
Year 3	–21	8	14	21	26	36	44	59	71	82	91	100	115
Year 4	–16	6	11	15	19	26	32	41	50	57	63	68	78
Year 5	–13	5	8	12	15	20	25	32	38	43	48	52	58
Year 6	–11	4	7	10	12	16	20	26	31	35	38	41	47
Year 7	–9	3	6	8	10	14	17	22	26	29	32	35	39
Year 8	–8	3	5	7	9	12	15	19	22	25	28	30	31
Year 9	–7	3	5	6	8	11	13	17	20	22	24	26	29
Year 10	–7	2	4	6	7	10	12	15	17	20	21	23	26

which is known as a 'down round'. This is also seen in listed companies. However, it is worth noting that the types of shares invested by VCs are rarely common equity shares like those a public company might typically offer. Much of the valuation of a venture deal is related to the complex individual terms applicable to the class of shares issued at that particular time.

EXIT VALUATIONS – CONSIDER BEFORE VCs INVEST

As described previously, the value of any stake in a venture-backed business can only be determined when a definitive price is put on the business and the rights of each share class are determined against that outcome. There are a wide range of scenarios that make assessing the value of a holding very difficult at any given time prior to an exit. In the past, venture capital investments were held at cost until an exit materialised, and the cash-on-cash returns at the end of a fund were the ultimate value determinant. Given sudden uplifts of 10x or more at exit (or conversely, major down rounds in tougher times), the venture capital industry has sought to smooth this curve and determine valuations during the lifetime holding period of an investment. In a private equity buyout, companies' profit multiples are often used to determine values. However, venture-backed businesses are usually loss-making and fast-growing, and may not have any similar companies to compare themselves with. Often when valuing venture businesses for an exit, pre-money valuations or fair market assessment, *revenue multiples* are used. It is important to note that revenue multiples as a concept are meaningless and suggest only a prediction of the future profitability and growth of the company. Table 2 shows how a strong operating profit margin and growth rate can raise revenue multiples from 1x to 8x. Therefore, when assessing the value of any venture-backed business, the key value drivers are the potential growth rate and the strength of longer-term operating margins. Clearly, companies in market-leading positions, with large markets to address and strong barriers to entry for competition due to patented technology, are likely to suggest high revenue multiples.

A NEW COMPANY IS FOUNDED: FIRST VENTURE CAPITAL ROUND TO EXIT

The following is an example of a startup business and how the share structure and valuation of the business develop over multiple fundraisings and exits. The valuation

TABLE 2. Revenue multiples in valuing a venture-backed company

Revenue	Operating profit margin (%)	Post-tax profit	Growth rate	Price to earnings ratio	Enterprise value	Revenue multiple
100	10	7	10	10	70	0.7
100	20	14	10	10	140	1.4
100	30	21	10	10	210	2.1
100	40	28	10	10	280	2.8
100	10	7	20	20	140	1.4
100	20	14	20	20	280	2.8
100	30	21	20	20	420	4.2
100	40	28	20	20	560	5.6
100	10	7	30	30	210	2.1
100	20	14	30	30	420	4.2
100	30	21	30	30	630	6.3
100	40	28	30	30	840	8.4

of a business immediately prior to closing an investment round is known as the *pre-money valuation*, and the valuation after investment is called the *post-money valuation*.

In this scenario, an entrepreneur decides to start a new Internet company, StartupCo. The company offers 10 per cent to the chief technology officer and retains a 90 per cent stake in the business as shown Table 3; this is known as the capitalisation table or 'cap' table.

TABLE 3. Cap table for StartupCo

	Common shares	Holding (%)
Founder 1	90,000	90
Founder 2	10,000	10
Total	**100,000**	**100**

THE FIRST VENTURE CAPITAL ROUND

Seed angel investment is used to fully develop the website, and the trial beta customers seem excited about the company's offering. These customers also suggest some improvements and new features. The company decides to conduct a full commercial launch after adding these features, which requires hiring more developers and marketing staff. A Series A venture capital round is sought by approaching several VCs.

The company receives an offer from VC1 to invest £2 million at a pre-money valuation of £3 million. This is in *Series A preferred shares*. These shares will have additional rights to the common shares – economic rights, control rights and information rights. While every venture deal is different and can result in a broad range of economic outcomes, including those with special economic rights to shares, venture capitalists tend to use similar instruments. The economic rights include a preferred return such that the cost of the VC's investment is paid in priority in the event of a sale. Sometimes this also includes a preferred payment on an initial public offering (IPO) below a certain valuation. Other rights typically include accumulating dividends, anti-dilution protection and/or redemption rights at a future date. Control rights may include early access to detailed monthly financial information or a seat on the board, from which you would have the ability to veto specific commercial decisions (e.g. to sell the business or take on significant debts).

The £2 million Series A investment is split into two tranches. The first £1 million is invested on closing the deal. It is agreed that the second £1 million is invested only after the company reaches specific milestones. In StartupCo's case, the additional £1 million will be invested after six months, assuming all new features have been added to the website and are performing correctly, and that the target number of enlisted customers has been reached. Terms will often be established in the event that milestones are not met. For example, the pre-money valuation may be adjusted downwards if milestones reach lower target levels. Such valuation adjustments based on future outcomes are known as *ratchets*.

In addition to the shares the VC purchases, new share options will be issued in an employee share option scheme at the time of the VC investment. This is to help the company attract the best managers and employees it can get. When compared to incentive packages from larger companies, the rewards from options in a successful venture can be very lucrative, which helps attract high-quality employees. The rules around the share option scheme can be complex and cover vesting, price and duration, and are very often structured for specific tax regimes. A typical option pool is between 5 per cent and 20 per cent in common shares.

Following the Series A venture capital round, the capitalisation structure is shown in Table 4. Note that this assumes the milestones for the second tranche have been met and the full £2 million has been invested.

The £2 million invested at a £3 million valuation offers 40 per cent equity, which is a negotiated balance of how much dilution the founders are prepared to take versus the perception of the current value of the business. A typical rule of thumb is that a technology business that grows at 30+ per cent and has strong gross margins to support a future EBITDA (earnings before

TABLE 4. Capital structure following Series A venture capital round – StartupCo

	Pre-round		Series A round			
	Common shares	**Holding (%)**	**Amount (£ million)**	**Shares issued**	**Total shares**	**Holding (%)**
Founder 1	90,000	60			90,000	33
Founder 2	10,000	7			10,000	4
Angel	50,000	33			50,000	19
VC1			2	100,000	100,000	37
Option pool				20,000	20,000	7
Total	**150,000**	**100**			**270,000**	**100**
Valuation (£ million)						
Pre-money	3					
Invested	2		Per share		£20.00	
Post-money	5					
Fully diluted	5.4					

interest, taxes, depreciation and amortisation) profit margin of 20 per cent would raise an approximate six times gross margin (see Table 3). Thus, for a £3 million valuation, the VCs would expect StartupCo to achieve a gross margin of £500,000 in the forecast year growing at or above 30–50 per cent going forward. If the business had 50 per cent gross margins, it would need £1 million in revenues in the year forecast.

THE EXIT

Let's assume the next three years are a rollercoaster for the company, but the team raises three rounds of venture capital (Series A, B and C). StartupCo becomes the market leader in their home country, reaching £10 million in revenues and growing at 20 per cent, which should turn a profit the next year. Now that the business has a largely stable fixed cost base, the profitability is predictable, and long-term operating margins should reach 20 per cent. Consequently, the board decides to seek an exit. At this stage, the holding structure looks like Table 5.

After hiring an investment banker to explore options, the company is presented with two exit opportunities. The first is a trade sale

TABLE 5. Presale capital structure of StartupCo

	Presale					
	Common shares	**Series A preferred shares**	**Series B preferred shares**	**Series C preferred shares**	**Total shares**	**Holding (%)**
Founder 1	90,000				90,000	16
Founder 2	10,000				10,000	2
Angel	50,000				50,000	9
VC1		100,000			100,000	18
Option pool	50,000				50,000	9
VC2			62,500		62,500	11
VC3				187,500	187,500	35
Total	**200,000**	**100,000**	**62,500**	**187,500**	**550,000**	**100**

TABLE 6. Holdings in StartupCo prior to an IPO

	IPO: £60 million (pre-money); £80 million (post-money)					
	Common shares	**Series A preferred shares**	**Series B preferred shares**	**Series C preferred shares**	**Total shares**	**Holding (%)**
Founder 1	90,000				90,000	12
Founder 2	10,000				10,000	1
Angel	50,000				50,000	7
VC1	100,000				100,000	14
Option pool	50,000				50,000	7
VC2	62,500				62,500	9
VC3	187,500				187,500	26
IPO investors	183,250				183,250	25
Total	**733,250**	**0**	**0**	**0**	**733,250**	**100**

TABLE 7. Value split between various StartupCo shareholders

	IPO: £60 million			
	Preferred amount	**Equity amount (£)**	**Total proceeds**	**Proceeds (%)**
Founder 1		9,818,182	9,818,182	16
Founder 2		1,090,909	1,090,909	2
Angel		5,454,545	5,454,545	9
VC1		10,909,091	10,909,091	18
Option pool		5,454,545	5,454,545	9
VC2		6,818,182	6,818,182	11
VC3		20,454,545	20,454,545	34
Total		**60,000,000**	**60,000,000**	**100**

to a larger Internet company for £30 million in cash, based on 3x the current revenues. Alternatively, the banker suggests that the company could IPO on the Alternative Investment Market at a higher valuation since the stock market is in a buoyant mood. A valuation based on a price to earnings ratio of 30 on the following year's forecast and a profit of £2 million would suggest an IPO pre-money valuation of £60 million, raising £20 million of new capital. The IPO at this level would trigger automatic conversion of all preferred shares to common shares and remove any preference rights. The holding and proceeds under such a scenario are shown in Table 6. Note that the proceeds for the IPO are based on the value of the shares after 12 months, as the bank has insisted that a 12-month lock-up period is applied to existing shareholders. The board must consider that the shares may not perform well over the next 12 months if the wider stock market sentiment changes or if the company underperforms against expectations.

The proceeds or value split between the various StartupCo shareholders following the IPO would be as shown in Table 7.

CONCLUSION

Whether an IPO or trade sale is effective depends on a variety of factors: current market sentiment, understood strategic value of the product or company and how well the company is currently performing. A successful exit requires good judgement of market conditions, as well as strong negotiating skills.

But before you get to the exit stage, you have to make sure you're creating value for your shareholders. The StartupCo example in this chapter is a great starting point for entrepreneurs to understand a typical valuation and investment process. Once you know what investors are looking for in exchange for financing, you will be better prepared when meeting and negotiating with VCs.

10

BUSINESS IMPROVEMENT STARTS WITH ONE SMALL STEP

BE THE BUSINESS

Hunter Ruthven, *Senior Content Manager*

James Gribben, *Senior Corporate Affairs Manager*

Since 2008, productivity in Britain has risen by an average of 0.2 per cent per year. To put that into context, the pre-recession rate was 2 per cent. Our productivity shortcomings mean UK wages are, on average, £5,000 lower than where they should be; when you line us up against our economic rivals, Britain has fallen from sixth to eighth in the World Economic Forum's Global Competitiveness Report.[1] Britain has a productivity problem, and it's not getting any better.

So what can be done to turn this around? Boosting infrastructure and education can help, but improvements like high-speed rail and super-fast broadband can take a generation for their benefits to be felt. These are also improvements that individual business owners can't control. However, what leaders of businesses can control is what happens within the four walls of their firms.

After all, what is productivity but the cumulative output per hour of all companies' employees? Increasing productivity and becoming more competitive doesn't have to be about asking your people to work harder and longer. There are thousands of businesses throughout the UK that are blazing a trail for others to follow. According to analysis by McKinsey & Company, using 2013 data from the ORBIS database and the Organisation for Economic Co-operation and Development, if the bottom 75 per cent of our businesses were able to match the performance of those businesses ranked 10 per cent above them, it could be worth £130 billion to the UK economy every year.[2]

Taking a business-led approach to solving Britain's productivity issue enables us to focus on where we can produce the biggest uplift – management and leadership of small and medium-sized enterprises (SMEs).

Our extensive research has shown there are five key areas for improvement:

- leadership and strategy;
- people and team;
- planning;
- sales and growth; and
- digital readiness.

These five themes are the backbone of Be the Business's free benchmarking tool, a digital service that helps UK firms discover where their key areas for improvement lie.

Knowing where to start is one thing, taking action and implementing a change is another. That's why we are sharing in this chapter some of the improvement efforts SMEs around the UK have been making in these five areas. We examine common issues facing a broad range of businesses and the corresponding solutions taken by leadership teams. We explore the results to not only gauge success, but also determine how future changes might be made.

LEADERSHIP AND STRATEGY

Leadership and management skills are positively linked to turnover and productivity, as well as being key drivers of business performance and growth. But how do you grow as a business leader? Whether it is hiring staff, motivating teams or translating strategy into objectives, leadership can be an overwhelming experience. But great leadership isn't about getting everything right the first time – it's about continually developing your abilities and recognising and working on your weaknesses.

> Business leaders should establish goals that are relevant to everyone in the company and that can 'translate' across functions.

CASE STUDY: BEATING A DIVISIVE CULTURE HELPED US IMPROVE AS LEADERS

The Problem

The pork scratchings company Snaffling Pig faced a challenge when trying to reconcile a divisive culture among its staff. With office and warehouse staff working in separate buildings, an 'us versus them' mentality had taken root in the company. For chief operating officer Udhi Silva, it was crucial that staff united behind the same vision to help the business move forward.

The Solution

Snaffling Pig recognised that because the warehouse and office had completely different cultures, the same leadership style could not be applied to both. The first step was to ensure management teams were rolling their sleeves up and getting involved in every aspect of the organisation, demonstrating to staff that they understood the day-to-day challenges of all their employees. As Silva had identified, it is important for employees to recognise that leaders are not far away in an ivory tower.

The next step was to ensure the company-wide values were relevant to everyone. The values at the office were not particularly applicable or motivating for the warehouse staff, so Snaffling Pig worked on creating a 'big hairy audacious goal': to one day be as big as Walkers and as loved as Lego. This provided a more tangible goal for staff across the company to work towards.

Silva also examined how other business leaders worked and brought those findings back to Snaffling Pig. By spending time with other brands – most recently the company Innocent Drinks – he also gained inspiration on how the company could improve further.

The Results

Snaffling Pig's retention levels improved significantly after addressing its divisive culture. The company now relies less on agency staff because the 11-strong team of permanent staff are motivated to take on additional work. Silva is also more confident in stepping back and delegating if leadership becomes overwhelming – he is sure people will step up to claim extra responsibility.

Business leaders should establish goals that are relevant to everyone in the company and that can 'translate' across functions. Frequently, this results not only in an inclusive culture, but better overall performance for the company.

PEOPLE AND TEAM

Having engaged and motivated employees requires a clear goal-setting and incentive structure. Whether it is feeling inspired by where their career is going or achieving the kind of work–life balance they want, motivation must be approached on an individual basis and tailored accordingly.

CASE STUDY: OUR APPRAISAL PROCESS LEFT US STRUGGLING TO COMPARE EMPLOYEE PERFORMANCE

The Problem

Retail services firm Suresite wanted to measure individual performance and dedication to company values. While regular appraisals should measure progress against targets and align managers and employees in their approach to their work, Suresite realised that its appraisal process was too vague to provide any real insights on company-wide performance. The annual appraisal form was brief and limited to strengths and weaknesses, which were judged subjectively, and many of its values were open to interpretation. This meant that the appraisal and review process lacked buy-in from managers, who struggled to see the benefits, and the process became a very subjective rather than objective review of performance.

The Solution

Suresite started by clearly defining the behaviour it wanted to encourage by implementing a behavioural competency framework. The framework clearly related to the company values and detailed associated and expected behaviours. Rather than leaving values to be interpreted by each manager, management standardised definitions across the company.

The next step was to revamp the appraisal form. The form originally asked vague and confusing questions that did not get to the core of staff performance. Suresite added elements more specific to staff roles, like the quality of work, efficiency and teamwork. The new process assigned specific objectives and key performance indicators (KPIs) based on company goals and areas for improvement. This helped give both staff and managers a clear idea of what each employee should be working towards.

The Results

Since reworking the appraisal process, Suresite has greater clarity on individual performance against a clear competency framework that is applicable to all staff. This enabled them to identify high performers and future talent, as well as potential skills gaps where further training could be required. By defining good performance across the company, the firm no longer compares personal management opinions as each manager works within a set framework.

Set your team up for success by clearly defining KPIs and the behaviours that uphold the company's values. Your employees can only be more productive if you give them the right resources and feedback to do so.

PLANNING

Business leaders are often driven by ambition. They want to build an enterprise, solve problems customers care about and make an impact. However, that ambition is more powerful when combined with a systematic approach to planning, engaging employees and utilising external contacts. Small businesses in the UK can do more to create a structure in which they can quantify growth and justify investment.

CASE STUDY: SEPARATING TARGETS BY DIVISION GAVE US GREATER CLARITY OVER OUR GOALS

The Problem

At vegan fitness brand TRIBE, the business is divided between selling a range of energy bars and running fundraising events for the TRIBE Freedom Foundation, a charity set up to tackle human slavery and trafficking. Each part of the business feeds into the other – one penny of the proceeds from each energy bar goes to the foundation, and its fitness-led fundraising events raise awareness of TRIBE products.

While the complementary nature of the business works for their brand, it was challenging for the leadership team to set and keep track of

Small businesses in the UK can do more to create a structure in which they can quantify growth and justify investment.

targets. KPIs needed to cover their online and in-store markets, products and events, as well as revenue and community building.

The Solution

The team started by setting goals using the objectives and key results (OKRs) framework that would allow them to monitor retail performance. Revenue had to be prioritised, and success in stores like Boots and Sainsbury's would provide them with the foundations to grow elsewhere.

"It's where we really get into the mass market. We appeal to the next wave of adopters who don't necessarily have that interest or initiative to search things out online," Guy Hacking, co-founder of TRIBE, explained.

The next step was to create a separate set of targets for their foundation, typically a source of future customers. By forming a handful of overarching OKRs that would then trickle down to each department (e.g. the amount of funds raised or charities involved), qualitative targets could be analysed to assess brand and community engagement.

To ensure nothing was missed or misinterpreted, TRIBE separated the people responsible for delivering results and those responsible for analysing them.

> Make sure that each business unit or function knows their assigned role within the company and how it fits in with the overall strategy.

The Results

The process of dividing up targets for revenue and community has helped TRIBE identify future goals for their product range and foundation and how to divide up responsibilities for their team.

"We really benefitted from having that separation," Hacking said. "It gave us some transparency and meant people were less likely to brush things under the table. I think by having someone you're accountable to, it helped people be less afraid of missing the results because they were always encouraged to be open about it and learn from it."

Proper focus and structure can improve productivity. Make sure that each business unit or function knows their assigned role within the company and how it fits in with the overall strategy.

SALES AND GROWTH

From technology to consumer expectations, the art of attracting and retaining shoppers changes daily.

CASE STUDY: WE INVESTED IN AFTER-SALES SUPPORT TO CREATE A SUSTAINABLE BUSINESS

The Problem

WhoCanFixMyCar.com, a Newcastle-based car repair marketplace, faced the challenge of building a sustainable business in an industry with a high customer churn rate. Clients were usually small garages that could be booked up for a month and then suddenly disappear from the website – meaning the WhoCanFixMyCar.com sales team struggled to build lasting relationships.

The Solution

After three years in business, the firm realised that simply having a sales team was not going to work. The key to customer retention was not the initial sales conversations, but account support – something the company saw as another sale.

Led by co-founder Ian Griffiths, WhoCanFixMyCar.com expanded its sales team to include a 'bridge team'. This group of employees was responsible for solidifying loyalty from (thereby retaining) existing customers. Unlike the main sales team, who had financial targets, the bridge team was evaluated on relationships and customer retention.

The company gave free 30-day support to every mechanic who signed up for an annual subscription to kick off the new process. The bridge team would help customers set up profiles, and offer advice.

This new sales team was also responsible for segmenting customers who had left the site. Customers were segmented based on activity,

and the team looked at how often those garages were winning quotes. Before the customers became exasperated with the lack of business, the company could step in and provide help or advice.

The Results

WhoCanFixMyCar.com saw an instant increase in customer activity and success after adding the bridge team to the sales department. The firm now attracts 75,000 consumer jobs every month.

Headcount has swelled to 30 staff, with the bridge team expanding from one employee to six in less than three years. In the next year, Griffiths wants to triple the size of the team. "It was one of the best moves we've made," he said.

"With sales teams, it's all about the support, account management and regular contact," Griffiths explained. "As soon as a garage becomes inactive, we just need to give them a brief call – to be a voice at the end of the phone. We're in a competitive market, so it's important to support customers through the entire life cycle."

Business owners can improve performance by re-evaluating their company's relationship with customers. Examining the various 'touchpoints' the customer has with the business may lead to new opportunities for growth.

DIGITAL READINESS

From customer relationship management systems to cloud-based support, keeping up with the rate of technology innovation can seem like a full-time job. However, rather than thinking about a complete technological overhaul, improvement is best felt when businesses take a targeted approach and identify a particular issue the business can improve by adopting a digital solution.

CASE STUDY: USING A SPREADSHEET TO MANAGE STOCK WAS NOT WORKING ANYMORE

The Problem

Baby clothing company Cheeky Chompers relied on Excel to manage manufacturing, stock and customer orders. This made it difficult to deal with a complex supply chain and keep on top of orders, particularly when the company began to grow.

The team became overwhelmed when the business reached 100 product varieties and a significant export business. The spreadsheet had become unmanageable, and the procurement manager had little time to focus on the longer-term procurement strategy for the business.

The Solution

When the challenge was identified, the IT department was tasked with testing the different systems that were available.

Cheeky Chompers buys individual components and manufactures the clothing in Glasgow. The new system had to account for the inventory held in different locations around the world, manufacturing and processing orders from retailers, distributors and direct customers.

The solution was to make a significant investment in material requirements planning software that could manage the process from manufacturing to delivery, allowing different team members to use the same system.

The Results

The software has helped with everything from stock control to customer service. For example, it can automate communication with customers and knows exactly how much fabric is required and when. It has also created more capacity in the procurement team so they can take on a more strategic role in the business.

Rather than thinking about a complete technological overhaul, improvement is best felt when businesses take a targeted approach and identify a particular issue the business can improve by adopting a digital solution.

Having all of the information in one place has allowed Cheeky Chompers to generate business reports that has given them valuable insight about their operations and enabled them to take advantage of new opportunities they may not have been aware of before. For example, it can now tell that a particular dinosaur print is the most popular in a particular location or which product has the best margin.

The company has since grown to 130 varieties and has sold over 1.4 million products across 35 countries. It has 11 staff at the head office and about 25 others who are employed by the brand's manufacturer. This growth would not have been possible without the processes the new software has streamlined.

"The investment felt like a risk at the time, but we were starting to creak at the seams with the spreadsheet," said Director Julie Wilson. "You need to be at the right scale to do it, and there are so many choices out there."

New technologies frequently help businesses improve efficiency by consolidating and sharing information with necessary stakeholders. If keeping up with all the technological innovations seems daunting, focus on updating just one area of your company at a time.

CONCLUSION

While some of the case studies discussed in this chapter are more ambitious than others, it really does come down to making small changes so leaders can free up time to work on their business, rather than in it.

Working *on* your business means asking yourself what you could be doing differently to lead and manage better. If the changes you know need to be made feel too big to tackle, start small. Break it down into incremental changes that can make the way you work simpler, easier and smarter.

Incremental gains, the half per cents here and there, are realised by engaging employees, actively listening to their ideas and giving them the autonomy to be self-starters and lead improvement efforts.

As an organisation dedicated to providing the inspiration, tools and resources that leaders need to improve the competitiveness of their firms, Be the Business is committed to shining a light on the way British SMEs lead the way by thinking small and improving performance. From restaurants to recruiters and from campsites to construction firms, the inspiration is out there to direct your future efforts.

No matter how small, one change can set you on a path to transform your business and help overcome the productivity challenge.

Start your journey at *bethebusiness.com* today.

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SCALE UP

11

THE UK SCALEUP ECOSYSTEM: THE IMPORTANCE OF SCALEUPS, THEIR CHALLENGES AND SOLUTIONS TO HELP GROWTH

THE SCALEUP INSTITUTE

Irene Graham, *CEO*

Josh Robson, *Head of External Affairs*

The ScaleUp Institute was established by the private sector with the mission to make the UK the best place in the world to not just start but also scale a business. Its core focus is to turn evidence and data, gathered through research and analysis, into robust practical actions to remove the challenges of scaling businesses when it comes to talent, leadership, markets, finance and infrastructure.

From the outset, the ScaleUp Institute has built alliances and co-operated with the diverse range of ecosystem players (e.g. corporates, financiers, educators, entrepreneurs, policy makers and local leaders) to break down barriers faced by the UK's scaling companies in their local communities, so they can seize opportunities of continued growth. It is imperative that the scaleup challenge across the country is grounded in local solutions and services that really make a difference in our scaling community.

WHY SCALEUPS MATTER

Scaling companies are the engine of growth for the UK economy. They create high-quality jobs and generate new tax receipts, lead business investment and innovation and drive productivity. Scaleups have the potential to give the UK a competitive advantage for generations to come. It will be scaleups that lead any export drive – they are already twice as likely to be international, hungry to expand further overseas and into new markets.

Scaleups are also more likely to be innovative than the typical firm. Our 2018 Annual Scaleup Survey found that 79 per cent of scaleups introduced a new or significantly improved product, process or service in the last three years, while 68 per cent invested in areas such as internal research and development (R&D) or training. And they are not small firms: we also found that 52 per cent of scaleups had been trading for 10 years or more; 10 per cent had a turnover in excess of £25 million; and 28 per cent had more than 50 employees.

THE SCALEUP CHALLENGES

There are five key challenges that scaleups face:

- talent and skills;
- access to markets;
- leadership capacity;
- access to finance and risk capital; and
- infrastructure.

TALENT AND SKILLS

Talent and skills can come in many forms, such as the social and technical skills of the workforce, the ability to recruit from overseas or the talent to secure international business. Whatever the definition, scaleups have consistently highlighted the ability to attract and hire employees with the right skills and experience as the biggest challenge to their future growth. In our 2018 Annual Scaleup Survey, 8 out of 10 singled this out as the most significant barrier. In particular, they identified the key skills for scaleup employees as critical thinking (64 per cent) and a service orientation (44 per cent). Seven out of 10 scaleups with overseas staff say it is vital that they can continue to bring in this talent.

ACCESS TO MARKETS

Access to markets (either in the UK or abroad) is identified as the second most important hurdle to growth. In our 2018 survey, it is ranked almost equal with talent and skills. Many scaleups already do business with large corporates and/or government and other public sector bodies, but they cite similar barriers to gaining further work with both groups. Selling into both government and large corporates is made more complicated by complex procurement processes (50 per cent), the time needed to win a contract (36 per cent) and the ability to spot relevant contracts up for bid (36 per cent).

According to the scaleups surveyed, the two key barriers to access international markets are a lack of people experienced at winning overseas sales and the inability to find appropriate overseas partners.

According to the ScaleUp Institute's Procurement Index, compiled in partnership with Tussell, public sector bodies awarded £895 million worth of contracts to 423 scaleups in 2018. More remains to be done as scaleups only accounted for 1.2 per cent of the total value awarded. In particular, central government has room to improve: scaleups represent only 0.3 per cent of the total value of all contracts awarded in 2018.

Two thirds of scaleups are involved in international trade, which places them firmly in the vanguard of the UK's trade ambitions. Among those who currently do not trade internationally, more than a quarter plan to start. Scaleups are already doing business across the world and want to do more in regions such as the Middle East, Australia, Latin America and the Asia-Pacific region. According to the scaleups surveyed, the two key barriers to access international markets are a lack of people experienced at winning overseas sales and the inability to find appropriate overseas partners.

LEADERSHIP CAPACITY

Building their leadership capacity is the third most important issue for scaleups. They want solutions for leadership development delivered at a local level, with local access to mentors and peers who have the experience of growing a business, as well as surrounding universities and business schools. In our survey, scaleups said they look for support from people who know what it is like to grow a business, whether as employees (46 per cent), a network of peers (36 per cent) or as non-executive directors (27 per cent). Scaleups also want to develop their existing leadership team (57 per cent).

FINANCE AND RISK CAPITAL

While access to the right combination of finance and risk capital is not seen as the main obstacle to their growth – and about three quarters of scaleups use external finance – 4 out of 10 do not feel they have the right finance in place for their business's current ambitions. Regional disparities continue to be noticeable, with scaleups in London and South East England much more likely to use equity finance than those elsewhere.

Reservations about the use of equity finance remain (i.e. fears of having to 'give up control' or a simple lack of knowledge). A quarter (25 per cent) of scaleups are currently using equity finance, and 8 per cent plan to use it in the near future. Those who have not sought external funding (67 per cent) attribute that decision to a fear of losing control, thinking it is not a suitable form of finance or not really knowing much about equity finance. Scaleups also want easier access to public sector funding for innovation and R&D, general business support, Growth Hubs and Innovate UK.

INFRASTRUCTURE

Having the space to grow consistently remains a growth barrier for scaling businesses. It is an issue that must be considered alongside other barriers as a complement to a thriving scaleup ecosystem. Infrastructure – particularly physical space – is a critical component to get right for our fast-growing companies. Scaleups are seeking greater university support for space and R&D facilities.

THE SCALEUP LANDSCAPE

The ScaleUp Institute's analysis of the latest data released by the Office for National Statistics (ONS) in December 2018 showed that there were 36,510 scaleups in the UK in 2017. This data uses the Organisation for Economic Co-operation and Development's high-growth (scaleup) definition of firms: growing employment numbers and/or turnover by more than 20 per cent a year over a period of three years, with at least 10 employees at the start of the period. The ONS data shows 13,165 scaleups with increasing employment numbers, 30,650 growing their turnover and 7,305 growing both turnover and employment numbers.

The total number of scaleups in the UK has increased by 3.7 per cent since 2016 and by 35 per cent since 2013. The national annual growth of scaleups between 2013 and 2016 was 9.3 per cent, so while the new data shows encouraging continued growth – with some very positive local trends – there has been a national slowdown of the growth rate momentum.

The proportion of scaleups in the UK that are scaling their turnover continues to increase, with turnover scaleups now representing 84 per cent of the total figure. This compares to 36 per cent of scaleups scaling their employment and 20 per cent of scaleups scaling both their turnover and employment figures.

In 2014, more than half (52 per cent) of UK scaleups were scaling their employment numbers, whereas the most recent data shows only 36 per cent. This decline in the proportion of scaleups increasing their employment could result from a lack of available talent and skills, thereby limiting their ability to expand or, alternatively, reflect their desire to primarily increase turnover through greater use of technology or innovative product developments rather than through increasing the number of employees.

Scaleups employed 3.4 million people in 2017, generating a total turnover of £1.3 trillion for the UK economy and an average turnover per employee of £380,000. This turnover is more than half of the total turnover generated by the total population of small and medium-sized enterprises and represents a year-on-year increase of 34 per cent. This diverges from the recent trend of relatively stable turnover across all scaleups from 2013–2016.

Based on sectoral data from the ONS, we can see which sectors were responsible for the greatest scaleup growth. Health and social work, the largest sector for scaleups, saw a slight decline in 2016–2017 (following a large increase in 2015–2016). Professional, scientific and technology were the sectors that showed the largest gains. Data continues to show how scaleups in the UK exist across a broad range of sectors.

The proportion of scaleups in the UK that are scaling their turnover continues to increase, with turnover scaleups now representing 84 per cent of the total figure.

Scaleups continue to be more productive than their peers across almost every sector of the economy. In the construction and transport sectors, scaleups were more than twice as productive as their peers, and the average productivity premium across all sectors was 42 per cent.

Looking across the local areas and devolved nations of Scotland, Wales and Northern

FIGURE 1. Programmes that have proven helpful to growing firms

	NEW CASE STUDIES FOR 2018	CURRENTLY ENDORSED CASE STUDIES
TALENT AND SKILLS	Careers & Enterprise Company Generator Digital Scale-up	Freeformers Founders4Schools Google Digital Garage LifeSkills, created with Barclays
ONE TO WATCH	Teach First: Careers Leader Programme	
LEADERSHIP	MIT: Venture Mentoring Service Vistage	British Library: Innovating for Growth Cranfield School of Management: Business Growth Programme Goldman Sachs *10,000 Small Businesses* UK London Stock Exchange ELITE The Supper Club
ONES TO WATCH	Cambridge Network: School for Scale-Ups Entrepreneurs' Forum: Scale-up Leaders' Academy Lazaridis Scale-Up Program The Platinum Group Productivity through People Strathclyde Business School: Growth Advantage Programme	
ACCESS TO MARKETS	Corporate Stars	Go to Grow: Mayor of London's International Business Programme Sharing in Growth (SiG) Silicon Valley Comes to the UK (SVC2UK)
FINANCE	Accel Balderton Capital Crowdcube Draper Esprit Eight Roads Index Ventures IP Group, including Touchstone Innovations LDC Notion Partech Santander Growth Capital Breakthrough programme	Barclays: Venture Debt BGF British Business Bank: Enterprise Capital Fund Octopus Titan VCT
INFRASTRUCTURE	Alderley Park Babraham Research Campus Barclays Eagle Labs	Cambridge Cluster Map Engine Shed Google Campus
ONES TO WATCH	FCA Regulatory Sandbox Level39 NatWest Entrepreneur Accelerator	
INTERNATIONAL	MIT: Venture Mentoring Service	Endeavour Manizales Mas Scale-up Milwaukee
ONESTO WATCH	Lazaridis Scale-Up Program	

Ireland, 28 out of the 41 local areas have increased the growth rate relative to their 2013–2016 rate. The 2017 data showed that there were no scaleup 'cold spots' (i.e. local areas showing annual growth of less than one scaleup per 100,000 people). However, some regions are only marginally above the threshold, and variation in scaleup growth across the local enterprise partnerships (LEPs) persists.

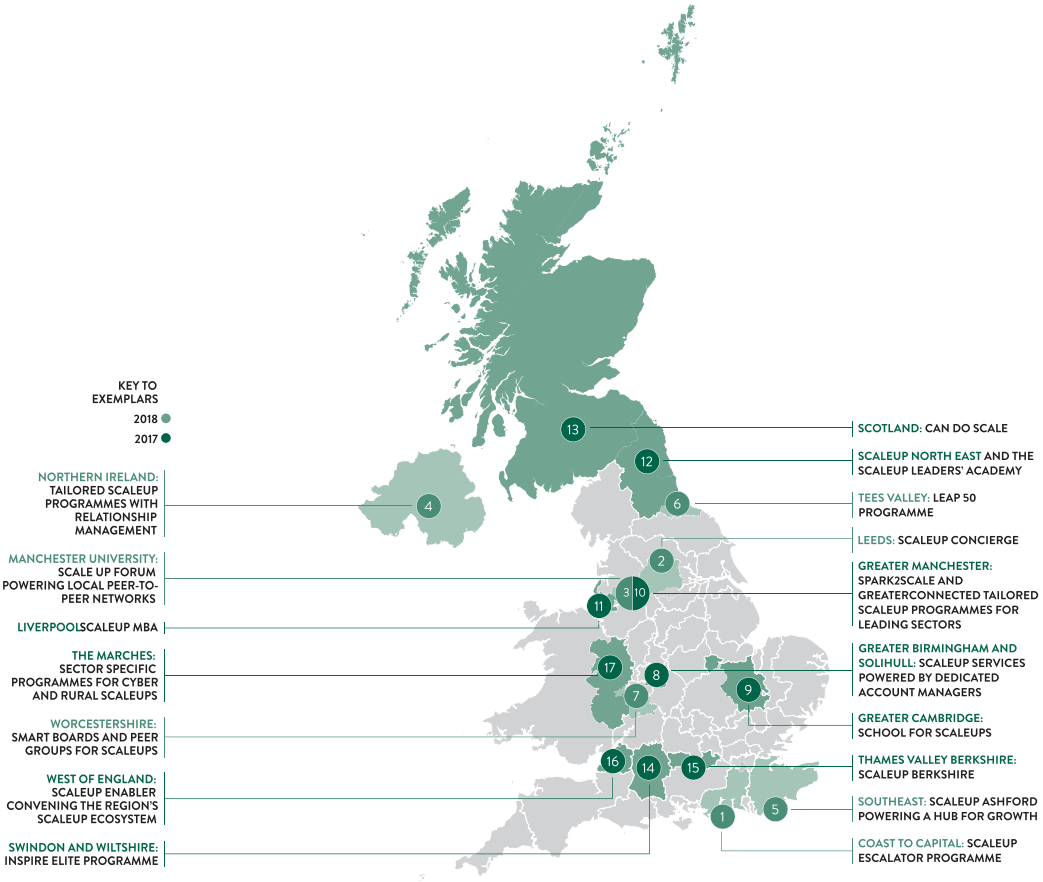
The top five LEPs/devolved nations for growth in turnover scaleups were Buckinghamshire Thames Valley; Thames Valley Berkshire; York, North Yorkshire and East Riding of Yorkshire; Cheshire and Warrington; and London. The top five LEPs/devolved nations for growth in employment scaleups were Oxfordshire; Swindon and Wiltshire; Greater Cambridge and Greater Peterborough; Northern Ireland; and Hertfordshire.

NATIONAL AND INTERNATIONAL PROGRAMMES THAT WORK

Scaling companies can benefit from, and are hungry for, appropriate programmes designed to break down the barriers they face. But for many time-poor, fast-growing scaleups, it is difficult to identify which programmes meet their needs and which programmes really work.

It is a central part of the ScaleUp Institute's mission to identify what is working well in both national and local programmes, and to share emerging good practice and insights from the UK and abroad. Figure 1 lists programmes that have been endorsed by the ScaleUp Institute.

FIGURE 2. Scaleup programmes and initiatives by region



LOCAL GROWTH PROGRAMMES ACROSS THE UK

Although more programmes focussed on scaleups have emerged, considerable local and regional disparities persist. The provision of scaleup support is variable across the country – yet scaleup business leaders primarily value local resources and services.

The ScaleUp Institute has worked with a number of communities on the evolution of local initiatives to address the needs of scaling businesses (a sample of these programmes are highlighted in Figure 2).

BUILDING A SCALEUP NATION: THE NEXT STEPS

As the UK creates more opportunities for scaleups, we as an ecosystem have our own responsibilities:

- Act at a local level to overcome continuing disparities, and act in a targeted manner to convert scaleup 'cold spots' into 'hot spots'.
- Unleash the most up-to-date data so that we can be more effective in our engagement with scaleup businesses and leaders and harness our resources with greater impact and investment.
- Develop better-segmented, scaleup-centric and hubbed solutions. An effective segmentation of the UK business population and a client-centric approach to solutions for scaling firms must be at the heart of ongoing intervention and developments.
- Collaborate more effectively across markets. Large corporates, business schools and universities can still do more with local scaling businesses – for example, work with local authorities to foster talent, extend R&D facilities and create opportunities to enter new markets. Both public and private sectors can be more transparent by making their procurement processes simpler and easier to navigate for scaling businesses. They can also be more proactive in collaborating with local scaleup initiatives to promote opportunities.
- Connect scaleups with capital and local spaces so that they can grow faster.

It is imperative that the public and private sector – in every locality – continue their scaleup focus.

SCALING UP YOUR BUSINESS?

Scaleup companies throughout the country can proactively access support from developing and endorsed programmes delivered by a range of local and national providers. However, it can be difficult to identify which programmes will meet your needs and really work. To help with this confusion, the ScaleUp Institute is continuing to monitor and assess the outcomes of different programmes to see which are working well. As such, the ScaleUp Institute has developed a map of the national and regional initiatives that are currently available for scaling businesses. This mapping tool can help businesses search for growth programmes, including those endorsed by the Institute for their proven impact, operating near their local area and focused on specific challenges associated with scaling up. Go to the ScaleUp Institute website to learn more about these programmes and get in touch with us at *info@scaleupinstitute.org.uk* if you would like to be considered for one.

12

GOING FOR GROWTH

LLOYDS BANK AND BANK OF SCOTLAND

Paul Gordon, *Managing Director, SME & Mid Corporates, Commercial Banking*

Over their lifetimes, most businesses will go through many cycles of growth, all of which tend to be powered by either equity or debt funding with third parties. The key challenge for a growing business is managing the balance between debt and equity in a way that best aligns with the entrepreneur's personal ambitions and evolving business goals.

ORGANIC GROWTH AS EQUITY INVESTMENT

Though they may not think of it in these terms, nearly all businesses launch with a form of equity funding – the founder's. Simply put, entrepreneurs put their own money into their businesses, and in return they get to own them.

The same principle applies to small businesses that grow organically. Organic growth is still an investment choice: essentially, the owner is choosing to reinvest their own profits back into the business rather than seeking some form of third-party investment. That's still equity investing, and it's an obvious and attractive option for many businesses, especially in their early years.

Many smaller businesses choose such self-funded organic growth at first so founders can maintain control over their businesses and the choices that are made about their directions, rather than diluting control by divesting equity to others. Businesses go through many highs and lows as they forge a path through their marketplace. The lows can be accompanied, or even created, by a stressed cash flow position, so it's not surprising that we meet many business owners who want to achieve financial self-sufficiency. This can naturally translate into a mindset of prudence – a desire to pay your own way and not have to depend on others.

MOVING BEYOND SELF-FUNDING

At a certain point, many successful small businesses will start to look beyond self-funding or money from friends and family. In terms of size, there's no hard-and-fast threshold as to when this is most likely to happen. Much depends on the sector, market, and context of opportunities and risks relevant for any individual business.

I've seen plenty of businesses that have successfully benefited from an organic growth strategy for 5 or 10+ years, maintaining steady growth and reaching a healthy balance sheet and profit performance, before looking at more radical expansion. Then again, a fast-growth tech startup might need to look for funding within one or two years to capitalise on the market opportunities of the intellectual property it is developing.

The trigger point for a business switching from an organic growth model to external funding is often a change of ambition, possibly due to a change in ownership or shifting market conditions. Taking on new personnel to bring in fresh perspectives may prompt a rethink of the current business model, which can lead to a change in funding strategy.

The trigger point for a business switching from an organic growth model to external funding is often a change of ambition, possibly due to a change in ownership or shifting market conditions.

Opportunism is another common trigger – particularly among smaller businesses of £1–3million turnover. Typically, a business gets sight of a promising new contract, market or product and needs to respond quickly in order to capitalise on the opportunity. It will need to invest in whatever is needed to meet the challenge, typically some combination of equipment, assets, people, resources and working capital. An injection of external funding may well be essential here: if the business were to rely solely on existing cash flow or organic growth to provide funds, the opportunity might pass, and the business could miss out.

What's most important when considering how to fund growth is the entrepreneur's mindset and purpose. And that, of course, can change radically over time. Perhaps when you (the entrepreneur) started, you were just glad to have a business up and running that could pay its way. But a few years down the line, with a lot more experience and a track record of trading success behind you, your ambitions have expanded. All of this should be captured in an evolving business plan.

A PLAN FOR GROWTH

Every SME should have a business plan that is regularly revisited and reassessed as the business and market evolve over time. As we've seen, plenty of businesses organically generate enough cash and capital to sustain themselves and meet the owners' needs. Some owners may be quite happy with this scenario, so their business plan doesn't have to be a growth plan, but it does have to be kept alive to adapt to changing market conditions.

On the other hand, a robust growth plan is essential for a business looking for external support to help fund its growth. This plan needs to demonstrate a deep understanding of the market, the customers and the business model – including brand, product, pricing, service proposition, etc. – that will meet the needs of those customers. It should also have an operating model, which typically includes supply chain, operations, production, financing, etc., to explain how the business plans to deliver its product or service proposition to customers.

When considering growth plans, prospective investors (e.g. banks) look at risks, such as the potential for disruption to your cash flow, exposure to exchange rate risk and debt affordability under stress that might be caused by rapid expansion. They will also look at the business's capability and experience, as well as what we call the 'adjacency' growth of the proposal – that is, how much of the proposal is a natural extension of what the business does already in terms of product, service or geography. They will also assess whether the proposal looks like too much of a stretch from what we might consider the business's sweet spot, its strength and assets.

Investors know that businesses tend to be good at judging the risks associated with new operating areas. They know that most business owners have a deep understanding of their business's strengths and weaknesses, and of what works in their market and what doesn't. Better still, where the business already has an established track record, it can show investors that it understands its market and can deliver on customer needs. (In investment terms, a 'track record' means trading for a minimum of one year, but at least two to three years of trading is more common.) This is important

because it proves that the business can operationalise an idea built on customer needs and execute an outcome that generates a commercial return.

EXTERNAL FUNDING STRATEGIES FOR GROWTH

Businesses will typically use both external debt and equity funding partners at different points in their life cycles to fund their ambitions. Let's look at each of these strategies in turn.

DEBT FUNDING

Debt is the main source of funding for businesses in Europe. In general, debt funding is used for defined purposes such as working capital to support general cash flow or asset finance, in which an asset has a defined purpose and useful life, as well as some form of residual value.

As we discussed earlier in this chapter, many entrepreneurs are uncomfortable with the idea of giving up even partial ownership of their business, for both emotional and commercial reasons. To that end, many would rather take on a business loan from a lender, make debt repayments and cover the interest than give up a share of equity. In practical terms, too, the mechanics of debt and interest are more predictable, whereas the value of any portion of equity can vary enormously over time.

The mechanics of debt and interest are more predictable, whereas the value of any portion of equity can vary enormously over time.

Asset-backed debt funding is extremely popular in the UK, whether secured on property, fixed assets or stock. Many businesses and business owners have assets such as premises or personal property in the background that they can make available to banks and other debt providers to release capital to fund an expansion. The released funds can be used for things like developing business premises or production facilities, branding or product development.

EQUITY FUNDING

Then again, there are also situations where equity funding is more appropriate. If a business wants to accelerate growth by retaining as much cash as possible over the short to medium term, for example, it might prefer to give away a share rather than commit to debt repayments. If an entrepreneur was launching a new business line or expanding into a new territory, they may be more likely to seek out some form of equity funding to avoid starving an existing business line of cash.

In addition, a business may reach a point where its founders realise that they need some intellectual capital – not just cash capital – in order to grow. One way to do this is to recruit investors who understand the market and business, and are prepared to put some cash in. Investors who are investing their own money – who have 'skin in the game', as they often put it – will naturally be well-disposed to making their intellectual capital available to the business and offering up their networks as needed.

Equity funding can take the form of business angels, venture capital or private equity investment. Key variables here are the stage at which investors want to get involved, the amount of equity required and the extent of hands-on involvement in the running of the business that investors will expect and that the owner is comfortable with.

One benefit of equity funding is partnering with investors who are often experts in a specific marketplace and in what's required to take a business to the next level of growth. And as equity owners, they have a powerful vested interest in doing everything they can to help the business succeed. Entrepreneurs may be prepared to give up a portion of their ownership or control in order to strengthen their business, diversify their income streams or generate a higher level of absolute profit.

BANK SUPPORT

There is a scale point for every business, varying across sectors and industries, where banking needs become more complex. It could be a

need to invest in new plants and machinery, undertaking a foreign exchange transaction, trading with partners in other countries and currencies or hedging for commodities for the first time. Suddenly, the business will start to face situations it has never encountered before, and the business owner will want the support of an experienced relationship manager from a bank.

For experts these processes aren't particularly complicated – setting up a letter of credit with a third party, for example – but they can be a bit unnerving for first-timers. So this is a time when a bank can really add value in terms of the support and services it can offer.

As businesses get bigger, with multiple suppliers and customers, their cash flow and transactional banking needs become more complicated too – from the way they handle supplier payments and invoices to their processes for getting cash from customers and paying suppliers. Business owners should know that their business processes are optimising their cash position and controlling cash flow, which may mean investing in additional infrastructure and resources. In these circumstances, it is worth asking banks for help. For example, banks can assist with digital invoicing and payment solutions, removing the need for hundreds of paper invoices and payment instructions. Invoice discounting and debt factoring can be extremely useful options here as well, if a business needs to accelerate cash collected from customers.

DOING WHAT YOU DO BEST

The ease with which an entrepreneur can grow their business comes down mainly to the quality of the people they bring into the business and the degree to which these people know they can trust and rely on their judgement and complement the owners' skills, knowledge and capabilities.

Many owners find it hard to let go of the reins. In financial terms, they really understand the importance of cash, margin and the discipline of cost, and want to stay involved in conversations about cash flow and investment funding. Enlightened owners quickly realise, however, that in order for their business to survive and thrive, they will need to continue to focus on whatever brought their business success in the first place, rather than getting sucked into the administrative burden that comes with a growing business.

Entrepreneurs don't want to be dealing with the back office of their business. They want to be dealing with what generates top-line growth – customers, deals, revenue and so on. Getting appropriate funding options and bank support in place when it is needed will enable them to focus on what they do best.

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HOW TO RAISE EARLY STAGE VENTURE CAPITAL FOR YOUR STARTUP IN EUROPE

BALDERTON CAPITAL

Suranga Chandratillake, *Partner*

Rob Moffat, *Partner*

If you're currently the founder or chief executive officer (CEO) of a tech startup in Europe, your experience in attracting venture capital funding would be remarkably different from the one you would have experienced just 10 years ago. In that time, Europe has moved into a position where the continent rivals the US and Asia as a hub for tech entrepreneurship, producing billions of dollars at a rate 15 times higher than a decade ago. In 2018, there were over 60 European tech companies worth more than $1 billion. Tech hubs are growing beyond the leading triumvirate of London, Paris and Berlin, making the choice of selecting a venture capital firm (VC) for early stage capital in Europe increasingly complex.

Building a strategic plan for your fundraising is critical because the process is incredibly time-consuming.

HOW TO MAKE A VC SHORTLIST

BY SURANGA CHANDRATILLAKE

In Europe, it is important to look at how the potential firms on your list compare to other European VCs. An early stage, European-founded startup will likely be seeking a European-based VC to lead their early funding rounds because they better understand the challenges of building fast-growth startups in Europe, can devote more time to startups in the same time zone and offer more opportunities for ecosystem networking.

You may also be inclined to reach out to as many firms as possible, thinking that it's simply a 'numbers game' – the more VCs you connect with, the higher the chance of success. But it doesn't work that way. It is important to connect with a firm that's a good match and spend quality time making the connection work successfully.

First, get to know the top-tier firms. Top-tier firms regularly and consistently raise funds for investment at a regular pace, have backed successful firms early on and have a credible leadership team, in terms of board positions and their own careers.

Second, understand the VC's motivations and investment thesis. The startup journey is tough. You want a firm that is on your side through thick and thin – from startup through global growth. Find out what the firm believes in, what motivates them and

how they have dealt with adversity. Perform your own due diligence by reviewing what the firm's leadership team have written and spoken about in public forums. Does their motivation match yours? Their investment thesis should be clear from their website and portfolio lineup.

> While you have to build your product and company first, it is worth spending some of your time with investors before you actually need to raise money.

Finally, find out if the firm will provide the kind of support you believe you need. Will your potential board member understand your challenges? Do they have prior relevant experience? Outside the partner-to-founder support, do they offer help with other functional areas, such as talent, finance, legal and marketing? Do they offer opportunities for you to meet and network with peers in their portfolio and in the industry? Do they have access to a global network of industry leaders and later stage VCs? (See the section 'What Should You Expect From Your VC? The Seven Benefits Your VC Should Offer' to guide your thinking.)

In this chapter, we share our personal insights into:

- how the venture fundraise process works from the venture side of the table;
- the value you should look for and expect from your VC; and
- what venture capital investment teams look for and listen to when you pitch them.

HOW THE SERIES A FUNDRAISING PROCESS WORKS: THE VENTURE CAPITALIST VIEW

BY SURANGA CHANDRATILLAKE

Every VC has its own process for sourcing, vetting and deciding on venture investments. The following section will provide useful advice on how to navigate this process, based on our experiences at Balderton.

WHAT TO EXPECT

Fundraising is an important part of most entrepreneurial journeys. If you are an entrepreneur, the standard process followed by many VCs is well worth knowing. While every case is unique, understanding the key stages means you will have a sense of where you really are, what you have achieved and what is left to achieve in order to secure funding. A good investor will take the time to understand your business, and you need time to see if they are the right team for you too.

The following are the eight stages that many VCs will go through.

Stage One: Pre-raise

A good investor will know about you, your company and your market before you speak to them for the first time. Good VCs track services like AppAnnie, Alexa, LinkedIn, GitHub and ProductHunt to spot interesting companies and monitor trends. They also keep up to date with highly rated angel investors, syndicates, seed funds and incubators to ensure they hear about the companies and founders who are impressing other investors they respect.

On the entrepreneur side of the conversation, you can start early too. While you have to build your product and company first, it is worth spending some of your time with investors before you actually need to raise money. Find out where the firm's partnership is speaking and if they host ecosystem networking events. Get yourself invited.

Stage Two: Initiation

Depending on the situation, either the company or the investor can start the fundraising process. If you want to make the first move, send a personal note to the investors who you already have a relationship with, indicating that you are thinking of raising money.

For those you don't know, avoid a cold email and either build a quick relationship (e.g. meet in person at an event) or use your network (e.g. angel investors, employees, friends) to get warm introductions. With that said, some of our most

successful investments have come through a cold email, so if all else fails, that method can work.

Do not offer up too much information via email either – it is always more powerful to give your 'pitch' in person or even over the phone.

Sometimes an investor who has been tracking a company closely (in some cases they are already an investor, in other cases not) will pre-empt a fundraising process. Candidly, this is because they are excited by your company and want to own part of it before it becomes bigger or better known. You need to decide if this aligns with your needs.

Stage Three: Early Process

If a VC is interested, many people at the firm will now get to know you. Expect to go through your presentation two or three times as you meet a combination of partners, principals, associates and analysts. Be sure to know what each of these people do and how they will play into any final decision-making processes.

During these meetings, you will answer a lot of questions on your background, your team and what the company and its products do. Be prepared for people to dig deep into the specific challenges that face your sector.

For example, if you run a delivery marketplace, you will be asked about unit economics; if you have built an advertising technology company, you need to know what Google and Facebook are doing; and if you are the CEO of an open core software company, you will be asked about your engagement with developers and your conversion rate to premium software.

After you have run this gauntlet of questions, your answers will be reported back to the firm. An internal discussion, sometimes enhanced by external expert opinions, will take place. Ultimately, this results in a decision of whether the VC wants to dig deeper.

Stage Four: Deep Process

More than one partner usually gets involved at this stage – usually just two, but sometimes (in smaller firms) all of the partners will participate. You will be expected to go into significant detail, so make sure you know the finer points of your company and your market.

The objective of this stage is to really get to know each other. If an investment occurs, you may work together for many years to come, so it is important for both sides to get a feeling of how that could work.

Articulating goals, hopes and concerns is important – it is much better to have these priorities understood and agreed upon at this stage, rather than run into issues with them further into the relationship.

Typically, there will also be a lot of third-party due diligence, and the investor will probably ask for references – both on the founders as individuals and from customers and partners of the company.

Meanwhile, the partner you're spending the most time with will be preparing a lengthier investment memo or dossier that contains all the information that has been gathered, along with his or her view on each aspect.

If an investment occurs, you may work together for many years to come, so it is important for both sides to get a feeling of how that could work.

Stage Five: Partner Meeting

You will then be invited to meet the whole team. This may be done over video conference, but usually it will be face-to-face and – wait for it – you'll do your pitch again. Expect many questions. Many of these are factual in nature in order to understand the product and the company, but many are also intended for the potential investor to better understand you, your team and your personalities. The way you answer the question is as important as the answer itself.

Feel free to ask your own questions. You should already know one of the partners extremely well, but what do you think of the rest of the firm?

At the heart of a great investor–entrepreneur relationship is a mutually respectful, two-way dialogue. Today is the day to start that dialogue.

Stage Six: Term Sheet

Assuming you impressed the team at the partner meeting and the firm has decided to invest, you will be issued a term sheet. A term sheet is a high-level document that sets out the proposed investment, the valuation of your company, the terms pertaining to the investment and what you can expect from the firm in addition to financing. Often, these are only one or two pages long. Chapter 20, 'The Term Sheet', goes into more detail on term sheets, including common terms and what to expect.

If everyone is happy, all parties sign the term sheet, indicating that they want to participate. You're almost done!

Stage Seven: Post–Term Sheet Diligence

This part of the process is highly detailed but straightforward. The diligence will involve lawyers, accountants and security, identity and technology experts who will ensure that everything you represented during the early part of the process was accurate. Assuming you didn't lie, you should have nothing to worry about. Minor misunderstandings are common and usually cleared up quickly.

In parallel, longer documents will be drafted to detail the basic terms contained in the term sheet. Lawyers lead this part of the process, but it is key for both the entrepreneur and the VC to remain engaged.

Stage Eight: Close

When diligence is completed and no major questions have been raised, the documents will be signed, and the cash will be wired. This is when it starts to get really interesting.

WHAT SHOULD YOU EXPECT FROM YOUR VC? THE SEVEN BENEFITS YOUR VC SHOULD OFFER

BY SURANGA CHANDRATILLAKE

THE LONG HAUL

Mileage may vary, but you can assume that your Series A venture investors will be on your board for five to nine years. That's about the same length as the average marriage in the US. In other words, it's a long time, which means you need to build a relationship.

Like any relationship, you need to start with a positive attitude and work to dispel any 'niggles' in the early days. I've seen entrepreneurs immediately slap a new investor with unexpected terms after a term sheet is signed. I've seen investors turn up to the first board meeting and demand that every aspect of the business be run a different way, before they even attempt to understand the company's current cadence.

My advice to both is: go slower. There's plenty of time.

THE NETWORK

Venture capitalists tend to be networking machines. Their success often depends on it, and the day-to-day reality of their work means that they meet up to 10 new people every day.

In addition to this level of 'exposure', VCs occupy a unique position as a 'gateway' to new technology and cutting-edge industry trends. This means that they are usually able to lean on people they don't know and often get a meeting if needed.

Before every board meeting or conversation, think of who you need to meet. Use LinkedIn and discover who your investor knows and ask them to put you in touch. As an entrepreneur, you should exploit this network unashamedly!

THE NEXT ROUND

It may seem early, but at some point, you may have to raise another investment round. This may be another private venture round or a public offering. As most investors focus on particular stages of investment (seed, Series A, etc.), they are likely to have worked with companies at a similar stage to yours who went on to raise additional funding. (See Table 1 for a definition of Series A in Europe.)

Capitalise on that experience. Ask your current investor what your next investor is likely to look for. Ask for access to presentations that worked well in the past (assuming confidentiality can

be lifted or sensitive information redacted), and most importantly, before you start your next fundraise process, ask to present to your existing investors. Their feedback will be invaluable.

THE CRITICAL HIRE

The typical venture investor usually has a slightly higher-level understanding of any given company. Therefore, venture investors are genuinely rather good at painting the big picture of the company. This skill can be useful when convincing that critical senior hire to join your company. I've helped CEOs with this, and nothing feels more satisfying than knowing you're helping build the team.

THE CRITICAL SALE

At some point, you will have a large potential customer who needs some extra reassurance from someone who ultimately has your company's back (financially). I have found this to be especially crucial for enterprise software companies. As you can imagine, if you're selling your solution to a large corporate customer, they often need convincing that you are not going to fail next year. Your investor is often the most authoritative voice on this topic.

THE COUNSELLOR

No investor or board member can tell you what to do. That is the great (and terrifying) thing about being a CEO. Ultimately, the buck stops with you.

However, a good investor is an experienced professional and will have been through many of the same trials and tribulations you'll find yourself battling. Some will have done it all before as entrepreneurs themselves – which is one of the reasons our firm has always had a healthy balance of entrepreneurs on the team – and others will have seen it as an investor with other CEOs. The good investors spot the patterns and can be thoughtful and engaged listeners as you talk through an issue and decide how to deal with it.

On a human level, this can be a rewarding part of the investor–founder relationship. Of course, there are many conversations on topics such as pricing strategies, marketing ideas or human resource issues, but the most memorable conversations are always personal. Dealing with an employee who is facing a difficult situation at home, working through the aftermath of a founder leaving the company, and confronting failure are tough circumstances, but they all happen, and a good investor will be by your side when you confront them.

THE EXIT

Whether you're selling to another company or taking your company public (which may or may not really be an exit), good investors will have the necessary experience. Again, the best firms will have a mix of people who have experienced an exit as an investor working with other entrepreneurs and those who have done it themselves.

> A good investor is an experienced professional and will have been through many of the same trials and tribulations you'll find yourself battling.

I took my company public, so I can talk people through my experience on a personal level, but one of my partners advised on over $500 billion of initial public offerings and mergers and acquisitions over his career as a banker, which gives him an entirely different perspective on the process.

Great firms will have investors with extensive experience in this area and will be an invaluable resource when you hit that point of your company's progression.

The best entrepreneurs are resourceful and pull in whatever they can from those around them. While this must be moderated in the case of employees, where there is an obvious power differential, I always encourage CEOs to exploit their venture investors. Let's be honest: we are perfectly capable of taking care of ourselves!

Of course, the investor starts by providing the capital your company needs to grow, but the right kind of investor should deliver more.

TABLE 1. Series A in Europe: By the numbers

In 2019, London-based LocalGlobe published data in collaboration with Dealroom.co that analysed over 22,000 European funding rounds between January 2012 and September 2018, re-labelling them as follows to gain consistency in terminology.*	
Round name	**Size**
Pre-seed	≥ $0.25 million
Seed	≥ $1 million
Bridge	Anything between Seed and Series A
Series A	≥ $4 million and < $15 million

*Wijngaarde, Y., Puls, J. and Micajkov, G., 'The journey to Series A in Europe: Fundraising benchmarks for founders of early stage companies', Dealroom.co in partnership with Atomico and LocalGlobe. Available at: https://blog.dealroom.co/wp-content/uploads/2018/11/The-Journey-to-Series-A-in-Europe.pdf.

HOW TO CONDUCT FIRST MEETINGS WITH VENTURE INVESTORS

BY ROB MOFFAT

I have been in venture at Balderton since 2009, and since then, I've met thousands of company founders. The first in-person meeting is when I decide whether to take the next step: an introduction to my partnership. So I try to learn as much as I can, as quickly as possible.

WHO TO BRING TO THE FIRST MEETING

Many times, I've been pitched by the founder/CEO one-on-one. On other occasions, I have been confronted by as many as eight people: founders, co-founders, employees, advisers, angel investors – everyone trying to grab my attention. My advice is this: success in pitching directly correlates to the number of people in the room. The fewer the better.

A venture capitalist decides to invest in a company because of exceptional founders. A good founder/CEO should be able to answer 95 per cent of the questions posed by a venture investor. The rest can be deferred.

> Success in pitching directly correlates to the number of people in the room. The fewer the better.

The more people in the room, the harder it is to get to know how the founder thinks and what motivates them. An investor is looking to create a genuine personal bond. But this works the other way too: it's equally important for a founder to decide whether the investor across the table is someone they would like on their board for the next five to 10 years.

Additionally, I want a discussion, not a pitch. I learn much more about a person and their company by asking open and unexpected questions and delving deep into a couple of key areas, rather than trying to methodically cover every point in an hour. The more people in the room, the more likely the meeting slips into watching slides, with participants filling silences with repetitions and additions.

An exception to the one-on-one rule is in the case of co-founders with complementary skills. A two-on-one meeting can work very well, especially if the team has great rapport and energy. Just make sure you give the venture investor a chance to participate in the discussion and the time they need to think through what you're saying.

Later in the relationship, I will want to meet other founders and key employees without the founder/CEO present.

Finally, I'm never a fan of other investors and/or advisers in a meeting. They have a critical role to play in helping craft a story and prepare answers, but they never need to be in investor meetings.

WHAT INVESTORS LISTEN TO IN MEETINGS

It is a rare person who can concentrate 100 per cent of the time in any meeting. I admit I can't, no matter how much coffee I drink. Our brains naturally filter out irrelevancies so we can focus on what matters. During investor pitches, I pay close attention to:

- the pain point being solved;
- the product demo;
- traction;
- the pricing model, including why it's disruptive and why it's great value for clients;
- bottom-up addressable market;
- founders' roles and how they work together; and
- a balanced discussion of the closest startup competitor(s).

Alternatively, I tend to filter out the following:

- biographies of team members, beyond their single most impressive achievement;
- anything about an advisory board;
- top-down market size and growth stats;
- anything about sector exits and valuations;
- truisms such as 'we use agile', 'we are fully in the cloud', 'we are a lean startup', 'we can move more quickly than Google because we are small';
- a detailed description of the tech stack (this should be discussed in a later meeting);
- anything about competitors, before I've understood the product;
- product demo and/or sizzle reel videos (these can be shared later); and
- everything said by non-operational people (advisers, non-execs).

At Balderton, we receive thousands of emails every year with investment pitches. While we are careful to spend time with each one, the first step to increase your chances of getting noticed is to do your own due diligence first. You will want to focus your pitch so that it resonates with the firm's investment team. Get to know the firm's investment thesis. Learn the background of all the partners, principals and associates. Read everything they've written. Find common connections for introductions. Go out of your way to introduce yourself at events and meetups. Your own due diligence is the best method you have to ensure you match with a firm that can deliver what you need: a committed, experienced and supportive partner who will help you with every step of the journey, from startup to global giant.

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ATTITUDES TOWARDS AND AWARENESS OF FINANCE AMONG UK SMALLER BUSINESSES

BRITISH BUSINESS BANK

Fiona Morrill, *Economist and Senior Manager*

According to the SME Finance Monitor, half of smaller businesses fund their growth internally, and most prefer not to use external finance. Since 2015, the share of businesses that are happy to use finance to aid growth and development has fallen from just under half (45 per cent) to just under a third (31 per cent) in Q2 2019 (see Figure 1). Furthermore, almost three quarters (73 per cent) would accept slower growth rather than borrow, and 80 per cent restrict their plans for expansion to self-funded limits.[1] Attitudes to finance vary across the business population; we have examined this in more depth in our Small Business Finance Markets 2018/19 report, which segments businesses for a better understanding of their views and use of finance.

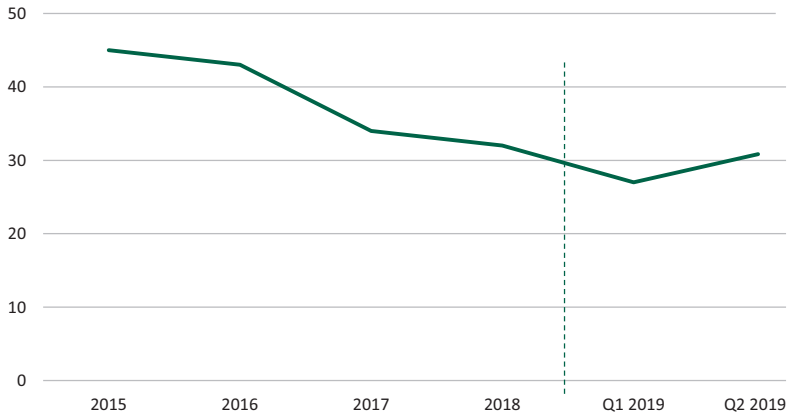
Reluctance to use external finance could reflect recent increases in uncertainty as well as longer-held attitudes about using finance. Businesses may be exercising caution due to feeling uncertain about the future; over half (54 per cent) surveyed agree with that statement. Confidence among smaller businesses has been negative for four successive quarters, with more businesses expecting prospects to worsen rather than improve over the next three months.[2] Uncertainty in the economic landscape has been cited as a key barrier to growth, and it is likely that this has reduced the demand for finance to support growth.

Unfortunately, business owners and decision makers may be missing out on potential revenue increases due to a reluctance to borrow or seek external investment. A longitudinal small business survey by the Department for Business, Energy & Industrial Strategy found that businesses that use external finance are more likely to grow their business by 20 per cent or more in subsequent years. They are also more likely to innovate and develop new products and services, which could also boost revenue in the longer term.[1]

For businesses that are open to using external finance, choosing the most appropriate funding source is important. Whether by providing additional funding for businesses to invest in new machinery or technology, taking on new staff, developing a new product or service, expanding overseas or helping to manage day-to-day cash flow, there are a range of finance options available to help businesses grow.

Almost all businesses are aware of core debt products like overdrafts, credit cards and loans, which explains their high use among businesses (used by 25 per cent, 20 per cent and 9 per cent, respectively). However, as businesses have become increasingly

FIGURE 1. Percentage of smaller businesses agreeing they are 'happy to use finance to grow'



Dotted line represents start of quarterly, as opposed to annual, data.
Source: BVA BDRC, SME Finance Monitor, 2019. Available at: https://www.bva-bdrc.com/products/sme-finance-monitor/. Reproduced with permission.

innovative and diverse, so too have financial markets, increasing the range of products, providers and delivery methods available.

Crowdfunding can enable businesses to reach a wider range and higher number of investors, some of whom may also be current or future customers. Products like mezzanine finance, which combine debt and equity, can provide a more flexible form of finance tailored to specific risks and opportunities for a business, while challenger banks and asset or asset-based lenders may be able to offer niche debt products not available from some of the larger banks. Increased competition and developments in business models and technology have created new opportunities for entrepreneurs and decision makers to benefit from improved terms, ease of access and better access to information to understand the finance most appropriate for their business.

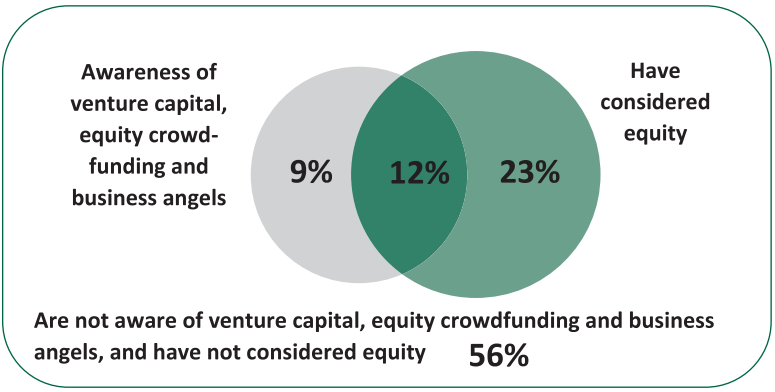
Increasing awareness of alternative finance options is a key part of our mission to make finance markets work better for smaller businesses. The British Business Bank provides impartial information to businesses for exploring the full range of alternative options available, whether it is debt, equity or a mix of both. The British Business Bank's Business Finance Guide, produced in association with the Institute of Chartered Accountants, features tools and ideas to help businesses plan how they will finance expansion, drawing on the expertise of many contributors including advisory firms and finance providers.

FEWER BUSINESSES ARE AWARE OF EQUITY FINANCE OPTIONS, BUT INVESTORS CAN HELP ACHIEVE A HIGH-GROWTH STRATEGY

Despite recent uncertainty, many UK businesses aspire to grow. In the first half of 2019, a significant proportion of UK businesses classified themselves as being prepared to take risks to become more successful (41 per cent) and having long-term ambitions to be significantly bigger businesses (38 per cent).[1] Just under half (46 per cent) of businesses surveyed in Q2 2019 stated that they expect to grow over the next 12 months.[2]

Use of equity finance is correlated with higher turnover and/or employment growth and has been increasing among businesses, as has the value of those investments.[3] However, two thirds of businesses say they don't know anything about equity finance, and those that do may be unaware of the range of equity finance options available.[1] Almost a quarter (23 per cent) of businesses have considered using equity without knowing about venture capital, equity crowdfunding and business angels (see Figure 2).[4]

FIGURE 2. Smaller businesses' awareness of venture capital, crowdfunding and business angels, and consideration of using equity



Source: British Business Bank analysis of SME Finance Monitor, four quarters ending Q2 2018. Reproduced with permission.

This suggests that an 'equity information gap' exists, and it may be preventing interested businesses from seeking equity investment or finding the type most appropriate for their needs. The British Business Bank's Finance Hub provides impartial information on different types of equity finance options alongside examples of businesses that have used it to grow or develop.

Of those who have considered or applied for equity, the most frequently cited barrier was reluctance to give up control of the business to investors (62 per cent of businesses) as well as difficulty finding a like-minded investor (58 per cent).[5] Others point to the short-term focus of investors (47 per cent) and difficulty putting together a proposition (43 per cent).

These barriers are more frequently cited by high-growth segments. This suggests that information focused on preparing a proposition and where to find aligned investors could help businesses achieve their growth potential.

SHOPPING AROUND FOR DIFFERENT PRODUCTS AND PROVIDERS CAN ENSURE THAT BUSINESSES BENEFIT FROM INCREASED CHOICE IN THE MARKET

The pace of change in financial markets means that businesses that are considering using finance may not be exploring all available options. When businesses first identify a need for finance, the most common first port of call is their main bank, with a third of businesses going straight to their bank.[5] Banks and finance providers also tend to have the largest influence on which type of finance businesses go on to apply for (cited by 20 per cent) as well as being the top influence on which provider to approach (29 per cent).

This influence is reflected in current use of finance types. Bank overdrafts and credit cards remain the most commonly used forms of finance, with 19 per cent and 14 per cent of businesses using them, respectively.[1] While these products may be particularly suited to shorter-term cash flow management, they may not be the most appropriate option for businesses looking for finance over the longer term or for the purchase of assets. Businesses could benefit from exploring options beyond core debt products to those products more relevant to their business model and growth ambitions.[6]

Approximately one half of small businesses tend to consider just one provider, and the most commonly cited reason for selecting a finance provider is a pre-existing relationship.[5] In addition to trust, confidence can also be an important factor in decision making. Businesses report feeling more confident in assessing the advantages and disadvantages of finance products offered by their own bank than those

offered by other finance providers. This could explain why many small businesses go straight to their main bank with a financing need and cite their existing relationship with their provider as a key reason for choosing them.

An increasing share of businesses are now researching finance products online, with 14 per cent of businesses citing this in 2018, an increase from 10 per cent in 2016. Speaking to a supplier or manufacturer about available finance options is also popular, with 11 per cent of businesses citing this option.[5] Exploring the full range of products, providers and delivery models available could increase the suitability of finance for businesses through more appropriate qualifying requirements, improved duration or repayment terms and accessing finance faster or more conveniently.[6] Researching options online and/or with alternative providers could help ensure that the product chosen is the best suited to a business through increased awareness of options like asset finance, invoice finance and asset-based lending, for example.

This evidence indicates that there is an appetite for considering a range of options, but the majority of businesses may not be receiving impartial information on the wider range of products and providers available.

HOW TO IDENTIFY THE RIGHT TYPE OF FINANCE

This evidence indicates that there is an appetite for considering a range of options, but the majority of businesses may not be receiving impartial information on the wider range of products and providers available. They may not have the time or resources available to shop around for finance products to get the best deal for their business. The British Business Bank's Finance Hub looks to address this information asymmetry by providing information on the full range of options, and lists finance experts who can be contacted for further guidance.

CONCLUSION

External finance can help businesses innovate and grow by providing the capital to acquire new equipment, expand into new markets, take on new staff, develop a new product or service and manage uneven cash flow. While most businesses are aware of their debt finance options, they may not be taking advantage of the many other choices in the market, such as different types of equity, alternative finance options and a diverse range of providers and platforms. Shopping around and comparing options can help firms find the most appropriate type of finance for them.

The British Business Bank's Finance Hub provides a range of tools to help businesses identify which type of finance is right for them and how to apply. The Finance Finder Tool matches business needs to the most appropriate type of finance. It features examples of successful businesses that have used finance to help their business grow. It also includes tips from investors on how to get 'investor ready' before an equity finance application.

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15

A NEW AGE OF INVESTMENT: WHY EQUITY FUNDING IS ON THE RISE FOR UK SMEs

BGF

Stephen Welton, *Founder and CEO*

For many entrepreneurs, there comes a time when they need and want to push hard to scale their business and help realise its value and potential. They want to provide opportunities for staff and secure their future as well as the future of their families.

There are around 6 million small and medium-sized enterprises (SMEs) in the UK, representing 60 per cent of all employment and 99 per cent of all businesses. However, only about 30,000 of these SMEs are growing at a rate of over 10 per cent a year and employing more than a handful of people. We should be able to do better.

I meet many founders and entrepreneurs across the UK and Ireland and am always surprised by how many have never even considered seeking investment. While lifestyle businesses are the backbone of the economy, a belief that growth is for other entrepreneurs, different sectors or better economic times is one of the most significant threats facing the future of British business. Now, more than ever, we need to scale up, in terms of both capital and ambition.

In this chapter, I will explore the new age of equity funding, questioning why there has been such a significant shift and examining why equity is both an exciting route for accelerating growth and a vital tool for powering the future of the UK economy.

CONSIDERING FUNDING FOR GROWTH

Most founders and business owners tend to know their companies and markets like the back of their hand, so they often have clear ideas of how growth can be achieved. But larger scale expansion plans often need additional and different support.

One of the biggest considerations comes down to funding growth, and the decision around who or where to get investment from is frequently an emotional one. Getting the right backing at the right time is crucial to the success of any enterprise, but with so many options, how do you choose?

THE CHANGING FUNDING LANDSCAPE

The financial crisis brought the lack of equity capital for SMEs in Britain into sharp focus and spurred significant change throughout the funding landscape. The UK had to rethink how it was backing businesses across the country and supporting entrepreneurs with growth capital at a time when global financial markets were faltering.

Today, some form of debt – usually through a traditional bank loan – is still the default choice for too many companies. Most businesses only think to approach the same high-street institution that provides their day-to-day banking facilities for the cash. Yet, all too often, this option is being used by those with higher risk profiles or projects for which equity investments could be a more appropriate choice.

If you decide to take a bank loan, expect to have your business finances very carefully examined and prepare for regular repayments from the very first month, which most lenders will be looking for. While you won't be expected to give up a percentage of your business, bank loans will not be limitless, and are often not enough to support capital-intensive growth plans.

In recent times, plenty of business owners have had first-hand experience of the importance of a strong, well-capitalised balance sheet and no longer want to build their business on debt alone. Operating without any margin for error in terms of capital and headroom is incredibly risky. Indeed, for many companies, growth is often funded by a combination of debt and equity – the two can go hand in hand.

It is important to recognise that the business environment has changed, even down to the way we define success. Business leaders are no longer satisfied with just a healthy balance sheet, they are also striving to make a positive difference in society. There is renewed confidence in the impact that innovative, scaling businesses can have on the world around them. This shift is starting to extend throughout supply chains and is helping to bring different kinds of funding partners on board who have a similar outlook and longer term vision.

WHAT IS EQUITY INVESTMENT?

An alternative to funding through debt is to exchange investment for equity. Equity investment provides businesses with capital to support ambitious plans.

Equity capital can be one solution for a business whose growth plans contain a level of risk that a bank is unable to fund (for example, modern technology companies that do not have physical assets to mortgage).

Equity investment can enable businesses to

- expand internationally and export;
- grow their teams;
- make acquisitions;
- invest in infrastructure and operations;
- take advantages of more opportunities; and
- invest in research and product development.

WHAT TYPES OF EQUITY INVESTMENT ARE THERE?

Different types of equity funding are available depending on both the stage of the company and the investment requirement. All have different approaches to value creation, and all have a role to play in the way we fund businesses in Britain. The key is finding the right partner at the right time for your business.

The main sources of equity investment are seed capital, venture capital, growth capital and private equity.

WHAT ARE THE BENEFITS OF WORKING WITH AN EQUITY PARTNER?

Done well, an injection of equity investment from the right investor (with the right expertise at the right time) can play a fundamental role helping a company to accelerate its growth trajectory when the opportunity is present.

Working with an equity partner can provide the following advantages:

- capital to accelerate growth;
- expertise and support;
- professionalisation and business governance;
- greater debt capacity; and
- improved exit prospects.

THE RISE OF EQUITY INVESTMENT

With a need for more investment options and better understanding of the different types

of funding available, the UK equity market has undergone a renaissance. We are now witnessing record levels of equity finance invested in high-growth UK SMEs as well as an abundance of capital in the market ready to be invested in pioneering, great British businesses.

With the supply of equity investment increasing, so is the demand. There is an ambition among many businesses that are marching ahead with their growth plans, undeterred by market sensitivities and wider political or economic fears.

The UK ecosystem is better able to support fast-growth businesses with whatever they need. In this ecosystem, regulators understand the pressures faced by business founders, investors have the appetite and means to make capital more readily available, and there is a community of experienced business leaders to be found in every sector and every region of the country.

THE TOP FIVE MOST COMMON MISCONCEPTIONS ABOUT EQUITY INVESTMENT

While we are clearly seeing greater awareness of equity investment as a source of funding, there remains an aversion to diluting equity among some business owners. This stems from the reputation of traditional equity investors, who typically invest in companies for a majority stake. Moreover, in some of these majority-stake deals, private equity funds may push chief executive officers and management teams to exit to fit in with the funds' timetable, not the management's.

In addition to a lack of awareness about the differences between different types of equity investment, it is hardly surprising that entrepreneurs, who have built their businesses from scratch, are reluctant to consider equity as an option. However, this can often mean missing out on far more rapid growth.

MYTH 1 – EQUITY MEANS GIVING UP CONTROL OF MY BUSINESS

While it is true that many larger private equity investors will be looking to take a majority stake in a business, there are plenty who specialise in taking minority stakes.

These investors are focused on backing the management team and are therefore keen to leave them with a majority share ownership and the incentive to continue growing the business. The alignment is therefore much stronger.

MYTH 2 – EQUITY IS MORE EXPENSIVE THAN DEBT

It is true that equity investors assume more risk than debt providers and, as a result, they expect to be compensated for this higher risk through a better return than a debt provider would demand.

However, the form of that return differs between debt and equity. Lenders expect regular interest and full repayment of their loan in a fixed time period. Equity investors, by contrast, do not require such regular cash payments. They are rewarded with dividends, which are generally only taken when there is a surplus of cash over the capital needs of the company; in other words, they are rewarded only when the company has been successful. Ultimately, they benefit from capital gains just as the owners do.

MYTH 3 – EQUITY IS RISKIER FOR THE BUSINESS OWNER

The idea that equity is riskier than debt for the business owner is far from the truth. In the case of bankruptcy, debtholders have priority in the order of repayment over and above shareholders. If the value of a company decreases as a result of poor performance, equity value is hit before debt. The more debt a company takes on, the greater the risk of financial distress if it cannot meet the terms of the loan. In the extreme, this could include the lender forgiving some of the debt in exchange for a stake in the company. Moreover, lenders will often take security against the assets of the company and sometimes personal guarantees.

MYTH 4 – EQUITY INVESTMENT IS BEST SUITED TO 'TRENDY' TECHNOLOGY COMPANIES

This is a myth often based on the US experience, but equity investment can enable businesses of any size and in any sector to accelerate growth and expand their operations. At BGF, for example, we invest across all industries, from

kitchen door manufacturers to care providers and restaurants, as well as technology and life sciences at the other end of the spectrum. If you have ambitious growth plans and a strong and passionate management team, then you are already a good basis for investment in our eyes.

MYTH 5 – EQUITY MEANS I WILL HAVE TO EXIT MY BUSINESS IN THE NEAR FUTURE

Many larger private equity investors will want to realise their investment in three to five years, but again, not all investors require such a fast exit.

BGF is a patient capital investor with the flexibility and balance sheet to hold investments for the long term and can also provide further funding as the company continues to grow. It is, however, important to show that you realise an investor needs a return on their capital and that you have thought about how that might happen.

WHAT IS PATIENT CAPITAL?

Patient capital is investment provided for growth over a longer term, without the expectation of immediate or short-term returns for investors. It provides entrepreneurs and management teams with the capital to scale their own businesses, but it also enables these organisations to collectively drive economic activity and thereby increase employment, exports and growth.

A patient approach to investing in companies creates value through building scale rather than stripping back. Time allows management teams to go for the right type of exit at the right moment and the right price for the entrepreneur and the economy. With patient capital, businesses can better focus on their long-term strategy without worrying about switching to a bigger investor once they reach a certain size or milestone in their journey.

Patient capital investors are also willing and able to continue to provide follow-on funding to support a business's growth over an extended time period, minimising dilution as company value grows.

What are equity investors looking for?

- A product or service with a strong selling point
- A clear strategy for achieving growth and knowing what is required to do so
- A solid and supportive management team, or an understanding of what is needed to improve the team
- Adequate processes and systems that ensure that the correct key performance indicators are being produced to run and grow the business effectively

ARE YOU READY FOR EQUITY INVESTMENT?

Equity investment is not being directed to just any UK business – it is heading to the high-growth and the ambitious, those that are working hard to be globally competitive, innovative and resilient. So if you are innovating the old or inventing the new and have a strong balance sheet and ambitious plans for growth, then equity investment is right for you.

CONCLUSION

The scaleup success stories across the UK don't just want to shift more units; they fundamentally believe that they are pioneers of British innovation. They believe that their products will improve lives and that they are creating real wealth and opportunities for their teams – and, more importantly, for the economy as a whole.

For the UK to create, nurture and build the big businesses of tomorrow, we need to be ambitious and fearless. Now is the time to take the risk and settle for nothing less than success and realising your full potential.

With investment and connections comes confidence. The success of Britain's entrepreneurs depends on having a robust support infrastructure and on finding the right partners at the right time.

16

THE MOST IMPORTANT QUALITIES TO LOOK FOR IN LEADERSHIP TEAMS

SEEDCAMP

Carlos Eduardo Espinal, *Managing Partner*

Seedcamp is a European-focused seed fund that has been investing over the last decade in more than 300 founders addressing huge global problems at the very beginning of their journeys. As such, my perspective on the most important qualities to look for in leadership teams is filtered through the eyes of pre-seed and seed-stage founding teams. (Although the definition of rounds can be somewhat fluid, generally speaking, pre-seed rounds are when companies are just starting out, while seed rounds are for when companies have launched a product but may not have revenue). These teams are usually fewer than 10 people and have many challenges to address organisationally, such as what kind of culture they want to develop, in addition to finding products that fit the market. Therefore, leadership teams of startups aren't constant; people's roles inevitably change over time, even if their titles don't.

Nevertheless, it's likely a good exercise to consider the common attributes great leadership teams have and how a founder/chief executive officer can foster an environment where a strong team can flourish.

EMOTIONAL AND RELATIONAL INTELLIGENCE

Let's start with what I believe to be the basic foundation of a great founder: having high emotional and relational intelligence. A lot has been written about emotional intelligence and likely less about relational intelligence, but in summary, these qualities manifest in founders by being able to attract the best in human and financial capital. However, one thing that is often misunderstood is whether having high emotional and relational intelligence forcibly represents itself by being 'soft' rather than 'hard' in style. Style and culture are not areas I want to cover as part of this chapter, but suffice it to say that a founding team or founder with high emotional and relational intelligence might choose a range of styles to represent their vision and desires rather than relying on just one.

RELATIONSHIP

Moving on from the foundation, another attribute that helps define a great startup leadership team includes the maturity of the relationship. Navigating the chaos of early days in a startup is very taxing. There are endless amounts of uncertainties and usually very limited cash to help soften the blow of mistakes or missed pay slips. Teams with founders who have just met each other struggle to navigate the relationship difficulties that come with spending many hours together as well as

making decisions that can affect personal life outcomes. These teams can also sometimes find themselves in situations where one founder discovers that startup life is not for them and subsequently leaves the other founder(s) high and dry, with a void in their operational capability. Ultimately, that relationship maturity matters, as without it, it's hard to really confront the constant change in how a company interfaces and interacts with its customer base throughout its evolution.

DIVERSITY

Diversity is another area of importance in leadership teams. The word *diversity* means many things to many people, but it largely comes down to not only functional diversity (not everyone has the same type of capability), which is pretty self-evident, but also thought diversity. This diversity can be invaluable in conversations about how to solve key problems by providing different perspectives on the same issue. However, it goes further than simply problem solving. One key attribute of successful teams is fully understanding the needs of their customers. Most customer profiles are behaviour- or need-based and, as such, are inclusive of many different types of people who share a common problem. By having a diverse leadership team, there can be a deeper and more insightful connection with the customer base.

CLARITY OF ROLES

Clarity of roles is an additional factor to consider when either joining or investing in a leadership team, as role overlap is one of the factors we have seen create issues. While it is true that many early stage companies experience role overlap as everyone pitches in where needed, the problem is more apparent when there is a 'final call' to be made. This is where someone with the perception that they have authority over a decision can be put off by someone else who also perceives they have a clear say in the matter. These kinds of situations happen all the time, and by not addressing them early, you create the foundation for resentment, which can become evident to investors in early meetings and, more importantly, to potential new hires. That's not to say that there isn't value in having and fostering conflict within a team, but you also need to be able to move past that conflict in a clear direction and with no hidden resentment that can bite you later.

One tool I've found useful to address this issue of role clarity is building a responsibility assignment matrix with your team and assigning roles according to their key functions as classified below:

R = Responsible (also recommender)
Those who do the work to complete the task. There is at least one role with a participation type of *responsible*, although others can be delegated to assist in the work required.

A = Accountable (also approver or final approving authority)
The one ultimately answerable for the correct and thorough completion of the deliverable or task, the one who ensures the prerequisites of the task are met and who delegates the work to those *responsible*. In other words, an *accountable* must sign off on (approve) the work that *responsible* provides. There must be only one *accountable* specified for each task or deliverable.

S = Support
Resources allocated to *responsible*. Unlike *consulted*, who may provide input to the task, *support* helps complete the task.

C = Consulted (sometimes consultant or counsel)
Those whose opinions are sought, typically subject matter experts, and with whom there is two-way communication.

I = Informed (also informer)
Those who are kept up to date on progress, often only on completion of the task or deliverable, and with whom there is just one-way communication.

Within a startup, which usually suffers from a lack of staff, sometimes roles can be clearly defined (e.g. developer vs. sales), or they may be so vague (e.g. the founding team does everything) that running this exercise may seem futile. In order to adapt the exercise to the needs of a startup, it helps to think more about the products you have internally and then see how your team feels about where they fit in the roles of RASCI. For example, in product decisions, does the co-founder who helps with finance feel they should be looped in simply as an informed party or more as consulted or support? By addressing these assumptions early, you effectively nullify the opportunity for people within the team to 'get on top of each other' when trying to move quickly.

EQUAL VS. EQUITABLE

Following role clarity, another factor that can create internal pressure within a leadership team is the unfair distribution of equity:cash ratio. This is a really tricky issue because 'fair' is different for different people. Factors like 'who put in cash' versus 'who put in more work' can be reasons why arguments drag on for months on end. However, what is clear is that in a startup environment where there is very little revenue or cash to distribute, everyone wants to be treated fairly and feel like what they do has meaning that deserves compensation. What the outcome is matters less than how you got there and whether everyone is happy with that process. In many ways, that's also part of the foundation of a company's culture. If the very exercise of compensation is driven solely by one person, then we're no longer talking about a leadership team. Again, a key thing to factor in here is how someone's contribution is accounted for as part of the equity/cash, and that is not simply a matter of going 50:50 with everyone. You have to consider many things, including how each member of the team feels about risk and when they feel they might leave if things aren't going well. One outcome of this exercise, if done well, is the creation of a reverse-vesting schedule that will affect everyone in the leadership team, such that if someone feels that they don't want to work together anymore or is no longer performing, there is an orderly way of addressing the issue of 'who gets what for how much time'. If you want to learn more about reverse vesting or want to download an agreement that can be used prior to incorporation to help with this, check out *www.seedsummit.org* for the Founders Collaboration Agreement.

> 'Fair' is different for different people. Factors like 'who put in cash' versus 'who put in more work' can be reasons why arguments drag on for months on end.

CONCLUSION

It might seem like the previous factors – emotional and relational intelligence, diversity, role clarity and having frank conversations about being equal versus being equitable – represent the full spectrum of what defines a great leadership team, but I acknowledge that, of course, this is simply a slice of the factors to consider. However, I feel these factors represent the core elements of what creates a great leadership team. Without these you have an inherently unstable arrangement, and thus other factors such as understanding the market can be crippled even before starting the race.

17

HOW TO FIND THE RIGHT INVESTORS

Peter Cowley, *EBAN President, Chair of the Cambridge Angels*

Alan Cowley, *CEO/Co-Founder of The Invested Investor*

You've decided to become an entrepreneur. Even if this isn't your first time starting a company, you will still need to ask yourself: how will I grow my business? Where will the capital come from? If your research ultimately points towards external investment, you're going to need to know who the right investors are for your business and how to find them.

Your ideal investor may be the absolute opposite from another entrepreneur's ideal investor in so many ways. They may come from different industries or different continents or have opposing political views. However, they will have many similarities too.

The right investors believe in the problem a startup is trying to solve. They are willing to help the startup when needed. They join the startup's journey for more than just the money. The underlying trait they possess is a willingness to invest themselves in the startup.

Investors come in many forms and at many stages along an entrepreneur's business journey. It is beneficial for a startup to know its investment options, particularly before embarking on the sometimes back-breaking, and always stressful, task of fundraising.

FAMILY, FRIENDS AND FOOLS (FFFs)

The starting point for most entrepreneurs can be the easiest, yet a cautious, source of early investment. Family and friends are those who trust the entrepreneurs the most; they have unrivalled faith in the startup due to their belief in the people running it. Sometimes this pot of cash is a no-questions-asked affair, for example, a parent who is willing to help their child out of pure pride that their offspring is taking the plunge and is amazingly passionate about the venture.

The difficulty with FFF money is how much smartness comes with the cash. A family or friend who is happy to write off their cash as soon as they transfer it is what a startup needs – unless the investment also comes with some industry or business expertise. The issue with FFF investment often arises due to a lack of knowledge or experience, but a desire to still get 'stuck in'. Being one of the first investors of a company can give people the feeling that they are the most important investors and should always be listened to, regardless of expertise. This becomes a problem later in the journey, as the fools come out the woodwork and hinder future fundraising rounds because they are inexperienced with the notion of dilution.

If all goes to plan though, investment from patient family and friends is an invaluable source of early income, which can lead to a lot of closely tied people feeling very proud and possibly becoming very rich.

GOVERNMENT GRANTS

In the UK, the largest business-led stimulator and supporter for UK economic growth is Innovate UK. Having helped over 8,500 companies and invested £2.3 billion since 2007, Innovate UK supports businesses in developing ideas and commercialising new technologies. All research-driven startups should utilise resources to investigate grant offerings. Although sometimes they may seem expensive, consultants can help identify which grants the startup may be eligible to receive. Startups should remember that after profits from sales, grants are arguably the next best route for raising capital.

ANGEL INVESTMENTS

From an investor's point of view, an angel investment is often the riskiest type of investment, purely because of its externality and timing. FFFs are often those closest to the entrepreneur; they may have been present when the entrepreneur was born! This closeness and understanding of who the entrepreneur is as a person is so valuable when it comes to understanding their ability to run a business. Predominantly, an angel investor will not have that closeness; they will have to decide what types of people the entrepreneurs are within a matter of weeks. Can they walk through walls? Or find the hidden door that no one else can see? Do they listen? Are they coachable?

Angel investors will often want to meet the entrepreneur they are investing in or will be very close to a lead investor who is able to relay the information they need to know. The risk at this stage is so great that angels, like FFFs, need to write off their investment as soon as they make it. Therefore, if the angel is realistically going to make a return on investment, they need to know that the entrepreneurs are capable of running a business, even if the initial idea does not work.

Angels tend to invest at a very early stage, post-FFFs and pre–venture capital. This increases the risk of investment. Frequently in deep technological or bioscience startups, the angels are investing in an idea or a minimal viable product. Generally, the product or service will have no consumer traction, so angels really are backing the *people*. It can take angels years to understand that they are investing in the team and not the idea. This can be a tough lesson to learn at the start, and most angels will happily admit that their early investments were a failure because of this reason. Getting overly excited by an amazing idea run by the wrong people will fail faster than a poor idea run by the right people. The right people will listen, adjust and do what's best for the business; the wrong people will only stifle growth.

CROWDFUNDING

A relatively new form of investment for startups, crowdfunding is a digital method for raising capital. Crowdfunding began so people could invest small amounts (as little as £10) in startups. This could include hundreds of shareholders who would appear individually or under the umbrella of a nominee structure on the cap table. The benefit of crowdfunding is that startups can raise investment relatively quickly and easily, while marketing themselves online.

Generally, the product or service will have no consumer traction, so angels really are backing the *people*. It can take angels years to understand that they are investing in the team and not the idea.

The downsides, however, are that the potential shareholders on crowdfunding websites are often inexperienced, take up a lot of time asking

questions during fundraising and can potentially accept inflated valuations.

There are high-net-worth crowdfunding platforms that bring in a level of smartness. However, the key for startups is to raise a majority of the round prior to the crowdfund. This common practice allows other investors to know that the company is already sought after.

VENTURE CAPITAL

Later in a startup's journey, it may need to receive large sums of investment to continue rapid growth. FFFs will most likely have faded out after their initial investment; the startup will be beyond the research grant threshold; angels will not have the personal wealth to write such large cheques; and crowdfunding platforms will not raise enough to satisfy growth. This leaves venture capital investment.

Venture capital investment brings in both larger capital and new expertise. It is often the natural progression of a startup to scale up via venture capital. Startups should be prepared for new motivations from venture capital investment. The right venture capital firm (VC) will support the startup's growth, but it will also have a deadline to return investment to their own shareholders.

FOUNDER MEETS FUNDER

You must be searching for the right type of investment. Life as an early stage entrepreneur is relentlessly fast-paced, and resources are scarce. Everybody wants to become a success, and particularly in the current climate, many startups see success coming from angel and venture capital investment. The news is scattered with stories of investors making huge returns on relatively small investments in tech companies. Startups need to remember that those tech companies started somewhere, whether it was FFF investment, an overdraft or simply bootstrapping (i.e. starting a business with limited financial resources) while still in full-time employment. It is incredibly rare to find a company that was an almost instantaneous success.

Having invested their own money or received FFF or grant capital, the startup is looking for larger investment to grow substantially. Incubators and accelerators are great places to start growing the business and useful ways to access finance. If the next step for the business is angel investment, the entrepreneurs should utilise the connections and warm introductions made within an incubator or accelerator.

Going through an incubator or accelerator is a strong first step towards finding your ideal investor. Events are always an excellent place to meet people – but be prepared with a quick-fire pitch, and remember to sell yourself along with your business. Angel groups and VCs have investment associates and managers who entrepreneurs should contact before blanket emailing investors. An entrepreneur should do their research on anyone they approach; it is a waste of both parties' time if the answers can be found online. An investor will always prefer a warm introduction over a cold one.

Another downfall for some entrepreneurs is that they underestimate the time, resource allocation and distraction of raising capital. Although an entrepreneur should focus on finding the right investment, they should also be cautious that they don't step too far away from their company and their mission. All too often chief executive officers (CEOs) spend too long fundraising and neglect the day-to-day operations of their business. Some may argue that if you have hired the right team this shouldn't matter, but it is necessary for entrepreneurs to understand the need to aim for an equilibrium.

INVESTED INVESTORS

Let's delve deeper into angel investment. The term *angel investor* originates from investment in theatre productions in the mid-1800s, with the term *business angel* appearing about a century later.

Events are always an excellent place to meet people – but be prepared with a quick-fire pitch, and remember to sell yourself along with your business.

Although angel investors are regularly illustrated flying in with angelic wings, they do have to choose their investments wisely. Don't be offended to be told no by an angel investor. Very active, full-time angels are sent thousands of business plans every year, and it is impossible and unwise to invest in all of them. Again, not every investor is right for a startup, so 'no' may be a good thing.

In order to find your right investor, you need to do your due diligence. It is a two-way process, however, as an angel investor will not invest without investigating you. Smartness goes both ways. Understanding your ideal investors is paramount, so here are a few quick tips for identifying those investors:

- *Follow-on funding capability*. As noted previously, fundraising is hard work. Investors should be willing and able to follow on their investment. This is beneficial to all parties, particularly the startup because it should take less time to find funds for its next round. It is important to note that in order to receive follow-on investment, the startup must be transparent with its investors and regularly update them with the company's progress.
- *Diversification*. It is a huge bonus if your investors have varied industry backgrounds and diverse portfolios. This will allow you to ask questions and hopefully get an experienced answer from at least one of your shareholders.
- *Industry influence*. The connections investors bring with them are another significant benefit of bringing in investment. Having industry-relevant investors will speed up business development immensely. Make sure an investor's proclaimed influence is correct. As with prospective employees, it is essential to get references from your lead investors.

Although angel investors are regularly illustrated flying in with angelic wings, they do have to choose their investments wisely. Don't be offended to be told no by an angel investor.

- *Culture fit*. A startup is building a culture and a brand, so it is essential that your investors recognise and agree with what the entrepreneurs are creating.
- *Relationship test*. Can you comfortably spend time with your investors in an informal manner? You are stepping into a relationship with your investors, particularly your lead investor, so you should trust them and like them. Openness and honesty are the staple ingredients of a successful startup. You will always be found out if you bend the truth.

There are horror stories of investors bringing toxic behaviour to a board room, such as kicking out a founder because they think they know what's best for the company. An investor should provide advice, guidance and connections, but should also know that this is the entrepreneur's company. Investors should help without being overbearing.

Bad advice is often difficult for an entrepreneur to identify. Bad advice could be simply too much advice, causing an unnecessary burden of information flow for the entrepreneur. Worse advice can come in many forms, such as investors manipulating an entrepreneur for their own gain. The right investor will not only support and guide the founders but also allow them to grow with their business.

Earlier in the chapter, we mentioned that an entrepreneur should not be offended if they are turned down by an angel. Additionally, they should not be offended if they are told it is time to step away from leading their company. Some entrepreneurs do not possess the necessary skills to run a medium or large organisation. This is fine – don't be depressed by this news. Obviously, an entrepreneur should understand that this is for the overall wellbeing of the company. Technical founders often get bored of or fatigued from the day-to-day grind and stresses of growing a business. It's okay to want to pursue a more technical role, whether internally or in another venture. Remember: if you truly believe in the success of your company, you are a shareholder first and CEO second.

EXITS – THE GOOD AND THE BAD

The main reason early stage companies fail is that capital dries up. Lack of customers is the main cause (i.e. product–market fit), but often it is also due to investors deciding not to follow on their investment. The main causes of this are entrepreneurs who consistently do not deliver their plans, do not keep investors up to date and who are reluctant to listen to their investors' advice. The right investor will follow on their initial investment if they are able.

> It is widely regarded that the most useful board member is one who built and successfully exited a business themselves, so why not look for an investor that ticks that box?

Failure does not mean that an entrepreneur must hide away in a cave for the rest of their life. The right investor may well invest in an entrepreneur's next venture because they are investing in the people, not the idea. An entrepreneur should make sure they close their failing startup properly in order to remain a contender for future investment. An entrepreneur can do this by:

- recognising why the startup failed and explaining in detail to all shareholders (this can be as simple as an email, though a phone call is greatly appreciated); and
- learning from the mistakes that were made – understanding faults and not making them again is a shining light for investors.

Closing a company and upsetting your investors will only lead to negatives. Alternatively, a successful exit should benefit all those involved. An entrepreneur who exits and then becomes an investor is the cycle that most want to see. The ups and downs, successes and failures that an entrepreneur learns from during their journey build invaluable characteristics in an investor. This does not mean that only entrepreneurs-turned-investors are the right investors. Although, it is widely regarded that the most useful board member is one who built and successfully exited a business themselves, so why not look for an investor that ticks that box? This is particularly useful for younger, less experienced entrepreneurs.

YOUR IDEAL INVESTOR

Entrepreneurial journeys are filled with mistakes, and reducing those mistakes will improve the chance of success. There are many ways of doing this, including mentors, advisers or published content. Finding the right investors, particularly the right lead investor, will give entrepreneurs that experience and expertise.

It is extremely difficult to know who the right investors are, particularly if this is your first venture, but just remember how important it is to find them. A shareholder agreement is a stronger tie than marriage. The success of a startup that has raised investment will then rely on the trust that comes from openness, honesty and transparency. But keep in mind that finding the right investors will rely on the startup having the right entrepreneurs.

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DEMYSTIFYING PRIVATE EQUITY

LDC, the private equity arm of Lloyds Banking Group

Andy Grove, *Head of New Business*

Virtually all business success stories begin with a compelling vision and the ambition of a talented and motivated team. But what happens next, however, really determines the company's growth, profitability and ultimate success. This is where private equity support can be pivotal; at LDC, we call it 'Backing Ambition'.

Private equity partners provide a financial injection and strategic guidance to management teams so that they can grow their own businesses the way they want to. It's not about an external investor taking control, it's about supporting entrepreneurs and management teams to realise an opportunity.

Additional capital helps companies looking to make the next step on their growth journey, whether they are entering into a new market or investing in a new product or service line. This injection of funding enables businesses to capitalise on new growth opportunities that realise their long-term objectives and allows them to build market-leading businesses.

While it's true that businesses backed by private equity can grow faster than companies with different funding structures, it's not just a way of driving growth. A private equity partnership can also be the first step of a succession plan; it can enable business owners to realise some of the value they have created while still protecting their company, and it can be an alternative to a conventional sale to a corporate buyer or initial public offering (IPO).

It's a proven approach: in 2018, the businesses LDC sold increased their enterprise value by an average of 138 per cent during our partnership, thanks to an average increase in turnover of 79 per cent and an increase in profit of 45 per cent. It can be used to support a diverse range of businesses, regardless of their size or sector.

Investment from a private equity house can be structured in many ways. While the traditional management buyout is a staple, it's not uncommon for private equity investors to provide development capital when backing high-growth companies, or financing to support complementary acquisitions. Private equity financing can also be used as an alternative longer-term strategy to debt funding and can be a more effective way to build long-lasting value.

Releasing shares in a business for equity investors means that, in addition to securing a capital injection, the incoming party has a vested interest and is committed to supporting the company's growth. The combination of financial firepower and strategic support is key.

So, what do private equity terms actually mean?

- *A buyout* – Private equity–backed buyouts are when investors and management teams pool their money, often with debt finance, to buy shares in a company from its owners. The private equity finance is often used to replace existing third-party investors such as a parent company, retiring shareholders, other private equity funds, venture capital trusts, angel investors or friends and family members.
- *Development capital* – Private equity partners routinely provide investment that enables a company to launch new products, invest in infrastructure and talent, break into new sectors or expand overseas. This tends to be a minority investment backing the existing management team or business owners who are looking to use the capital to expand.
- *Buy-and-build* – This is an acquisition-focused strategy whereby a business will make complementary acquisitions in relevant sectors or countries to add value. It has proved to be one of the most effective ways for private equity to fund the growth of a business while simultaneously bringing economies of scale.

Private equity can bring added benefits such as helping to professionalise a business and financial de-risking.

- *Professionalising* – The strategic guidance from a private equity investor can help best position the firm for future growth. Support with the creation of formal legal and financial structures, governance and reporting, the recruitment of additional talent (particularly at board and executive level), the implementation of a clear succession plan and the identification of competitive obstacles are just some examples of the added value a private equity partner can bring.
- *De-risking* – Private equity is also an option for entrepreneurs to reduce the money they have tied up in their business to create financial flexibility while still retaining control of their company. In this option, a private equity firm will invest in the business and help to facilitate entrepreneurs' ambitions – or exit strategies – in return for an equity stake.

PREPARING A BUSINESS FOR EXTERNAL INVESTMENT

Taking on a private equity investment is one of the most exciting and daunting decisions a management team will make. While the journey to this point will differ from one business to another, there are five fundamental areas that every management team should consider in their preparations.

> "Don't focus solely on the senior leadership team. You should have a strong will and belief to support the next generation through talent mapping and succession planning."

SUSTAINED GROWTH

Potential investors will look for a consistent track record of growth to instil confidence in the business and its management team. "Don't worry if the actual numbers are small as long as they are rising," explained Stuart Miller, founder of supply chain technology firm ByBox. "What matters is that the trend is upwards. Sales growth is the evidence they are looking for."

TALENTED MANAGEMENT

Investors will want evidence that your company has talented leadership in place with the skill set, motivation and ambition to realise your vision and strategy, from board members to senior leadership and next-tier management. For Paul Thandi, chief executive officer of the NEC Group, it's important to evaluate talent at all levels: "Don't focus solely on the senior leadership team. You should have a strong will and belief to support the next generation through talent mapping and succession planning," he said.

A CLEAR VISION AND STRATEGY

It's imperative that your company's ambition and strategy for growth are clearly defined. This might include how you are going to differentiate in your market to outmanoeuvre the competition,

solve an emerging problem in your sector or completely revolutionise a marketplace. Establishing how you intend to achieve your objectives will demonstrate to private equity backers your determination to succeed. "You must also be able to demonstrate some flexibility and alternate thinking – contingent thinking – in case the market moves," said Jon Wood, commercial director of iconic crisp brand Seabrook, which increased profit by 28 per cent.

GROWTH TRAJECTORY

Ambitious but realistic forecasts demonstrating where your growth will come from are essential. Are you increasing export operations, investing in machinery to increase output yield or entering a new domestic or overseas market? Investors will want to see precisely how your revenues and profits will evolve over the next three to five years within the context of market trends and changing customer demands. Stuart Miller of ByBox added, "Don't claim to be the next Dyson, Branson or Zuckerberg. It leaves you wide open to be shot down. Aim for a purposeful and defensible set of forecasts that people will believe can actually be delivered, by you!"

> Private equity is about much more than just money. The expertise that comes from partnering with a private equity house is just as valuable as the initial funding.

MAP THE RISKS

Finally, complete a risk audit. No business is immune to risk and the best entrepreneurs are always looking for barriers to growth. The sooner you spot them, the sooner a solution can be found. Think about how long you need investment for and what risks may crop up during that timeframe; that will help you determine the level of flexibility and partnership you will likely need from any investment.

CHOOSING THE RIGHT PARTNER

The right private equity partner has the potential to help turbocharge your company's growth, but it's imperative that investors and management teams are the right cultural fit. Having a shared vision for the business is paramount to a successful partnership, which is why clearly defined long-term objectives – on both sides – are so important.

Expect the investment team to spend a considerable amount of time with you and your management team before any transaction. This will help both sides agree whether they can jointly facilitate your growth journey while also helping your partner shape what its final offer will look like.

To ensure that a private equity partner is the right fit for you and your company, you should:

CONSIDER THE CHEMISTRY

Private equity is about much more than just money. The expertise that comes from partnering with a private equity house is just as valuable as the initial funding. Investors are likely to want members of their team to sit on your board of directors, so it's important to know precisely who you will be working with and spend time with them face-to-face. The importance of the right chemistry can't be underestimated.

CONSIDER HOW MUCH FLEXIBILITY YOU NEED

Think about your growth strategy and the risks you have identified as part of your preparations for investment. This will help you gauge the level of flexibility and partnership you're likely to need. Experienced private equity firms will work with you from the outset to structure a deal that will support you throughout your growth journey, as well as providing a level of flexibility (should that journey change course and you need additional funding).

CONSIDER THEIR TRACK RECORD

Does the private equity firm you're considering already have expertise in your sector? From technology, media and telecommunications to manufacturing, health care and travel, it's imperative that you find an investor with practical experience working with companies like yours. Ask to see evidence of their portfolio

companies – those businesses that they've previously invested in – and ask to speak to other management teams who've been on a similar journey with them.

CONSIDER THE BROADER RESOURCES AVAILABLE

Even before an investment is made, partners can help you identify areas of your business where value can be added. For example, at LDC, the management teams we back work closely with our investment team and our Value Creation Partners, a dedicated team of industry professionals who help map both short- and long-term growth strategies. These partners support management teams with projects ranging from sales effectiveness to digital marketing as well as procurement and operations. Based on this, longer-term opportunities can be identified and mapped out to take your business to the next level.

CASE STUDY: Fever-Tree

When premium tonic water and mixer brand Fever-Tree wanted to grow in key markets, improve operational efficiency, launch new products and expand overseas, it used private equity. LDC backed the £48 million capital replacement of Fever-Tree in 2013 and subsequently supported its growth strategy. The following year, the company listed on London's Alternative Investment Market at £154.4 million, raising gross proceeds of approximately £93.3 million. Today it is one of the world's fastest-growing drink mixer brands.

HOW PRIVATE EQUITY INVESTMENTS ARE STRUCTURED

The structure of a private equity investment can differ by company and transaction. It all depends on a number of factors such as the company's stage of development, the management team's objectives, etc. As a general rule, private equity houses will 'buy into' your business using one or more newly incorporated companies.

The following sections detail what entrepreneurs should consider in terms of investment structure, legal implications and incentives.

HOW THE INVESTMENT IS STRUCTURED

There are several ways in which a deal can be structured and financed – including equity investment, bank debt or a combination thereof (mezzanine finance) – but ultimately, any decisions regarding the level of involvement a private equity firm has must be taken by you. It is up to you to decide how much equity each party has. Private equity houses will invest for a minority or majority share; each deal is different. It's also important to remember that while entrepreneurs need to be prepared to give up a portion of the equity, the business will likely grow faster, as will the value of their equity.

THE TAX AND LEGAL IMPLICATIONS

Take professional advice from corporate finance advisers to help you shape your thinking. The way private equity investments are structured can seem complicated, and these deals are legally binding. Accountants and lawyers with experience will be able to guide you through the full implications of any new organisational structure while simultaneously making recommendations that are in your best interest.

MANAGEMENT INCENTIVES

Management incentive plans (MIPs) are frequently incorporated into private equity investments to provide additional financial motivation for members of the management team, enabling them to participate in the value they create by growing the company. They are intended to ensure that those individuals are rewarded when the private equity sponsor achieves the realisation of all or part of its stake. 'Sweet equity' is the term often used to describe

the share options offered to senior management teams through MIPs.

COMPLETING THE DEAL

On the surface, securing private equity investment can seem like a daunting and drawn-out process, especially if you have not involved an investment partner before. There are consultants, accountants, banks and legal experts to engage along the journey, in addition to several options for the management team to consider ahead of finalising that all-important investment. Both internal and external communications are also essential as the deal progresses, and it's important that colleagues as well as clients know where they stand.

When it comes to completing the deal, there will be several landmark events along the journey:

- *Choosing the right partner* – You will likely have a number of options to choose from when deciding on a private equity partner. As explained previously in this chapter, be sure to choose a partner that is the right fit for you and your business.
- *The offer letter* – If both sides are keen to agree on a deal, advanced discussions will take place to formalise this. Subsequently, you can expect to receive an offer letter that details a deal that will deliver the best results for you and your private equity partner. The letter will typically include a time period of exclusivity between the two parties to complete the deal.
- *Due diligence* – After the offer letter has been accepted, expect to work with external advisers to complete a formal due diligence process on both your company and the market in which you are operating. This process has two purposes: first, it's intended to support all data and perceptions about your business; and second, it will identify future opportunities to create value.
- *Legal documentation* – While the due diligence is being completed, both sets of legal teams will work together to draft the formal legal agreements for the investment, including the Sale and Purchase Agreement.
- *Signing the deal* – Once both parties have reached the final agreement on the deal structure and financials, the legal documentation is signed and the deal is completed.

THE PRIVATE EQUITY PARTNERSHIP

The initial investment is just the start of a partnership, and the following years will be focused on growing your business your way, with the support of an investment partner and new non-executive directors. Each company's opportunities are different, and investors shape their approach accordingly. Whether it's about helping you to make acquisitions, launch new products, build new manufacturing facilities, break into new sectors or expand overseas, the right investors will take a long-term and supportive view. Ensuring flexibility is key to ensure your partnership can adapt to changing market conditions – especially in uncertain times.

PREPARING A BUSINESS FOR EXIT

The last step of any private equity investment process is the realisation, or 'exit'; decisions made at this step can greatly affect your returns and that of your investors. The exit plan is always considered as part of the original business plan and decided jointly between the management team and its investment partner.

Many entrepreneurs choose to view the exit as the beginning of their company's next phase of growth. Depending on the objectives for this next growth stage, there are a number of options available to management teams: an IPO, sale to another private equity investor or sale to another corporate. And the success of businesses that implement the right exit strategy speaks for itself.

IPO

An IPO is when a private company raises investment capital by offering its shares to the public for the first time. A good example of

this is our work with Wakefield-headquartered video games developer Team17. During our partnership, Team17 invested in product development and new launches, and continued to expand overseas, which helped increase revenues by 119 per cent to £29.6 million and increase earnings before interest, taxes, depreciation and amortisation by 11 per cent to £12.9 million between 2016 and 2017. In May 2018, Team17 announced its £217 million listing on London's AIM. The firm's strategic growth plan placed the management team in a strong position to continue its expansion and capitalise on its position as a leading independent video games label for indie developers.

PRIVATE EQUITY EXITS

Also known as secondary buyouts, this is when a company changes its investor from one private equity house to another. This tends to occur when a business has achieved the first stage of its growth plan and needs a different type of support for the next step of its journey. For example, in August 2016, LDC provided £37.5 million of development capital to accelerate the international growth of ByBox, which is the UK's leading technology-led logistics and locker provider. The deal valued the business at £105 million. The company subsequently invested in new products and increased its global presence with the opening of three offices in America in 2018 to help meet customer demand. LDC exited our investment in ByBox in September 2018 in a £221 million sale. To continue LDC's partnership with the firm, we retained a minority share in ByBox to continue supporting the management team's growth journey.

TRADE EXITS

As its name suggests, a trade exit is the sale of a business – or a part of it – to another company. Trade sales provide the purchaser with an opportunity to buy the market share or underlying intellectual property owned by your company. In July 2015, LDC invested in Seabrook, the iconic Yorkshire crisp brand, and subsequently supported a growth strategy that included investing in its manufacturing facilities, developing and launching a number of new products and expanding internationally. In October 2018, LDC exited its investment in a trade sale to leading snack brand Calbee (UK) Ltd.

WHY PRIVATE EQUITY?

The right private equity partner can help accelerate an ambitious management team's growth plan, adding significant value to a firm in almost any sector or location. Research in 2019 from accountancy and business advisory firm BDO revealed that the revenues of 2,000 private equity–backed businesses collectively rose by more than 50 per cent in the last five years, with employment at these firms increasing 43 per cent over the same period.

These figures speak for themselves, and with private equity backing, yours could too!

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LEGAL ISSUES ENCOUNTERED IN EARLY STAGE FUNDRAISINGS

MARRIOTT HARRISON

Daniel Jacob, *Partner*

David Strong, *Partner*

Sive Ozer, *Associate*

Early stage fundraising, such as angel investing and venture capital, can bring a variety of legal challenges. In this chapter, we will discuss key legal issues entrepreneurs should understand in order to mitigate risk and support their decision-making processes.

It is important to bear in mind that the type of investor involved and the amount of money being raised will have an impact on the legal process. Angel investors typically invest smaller sums, often as part of a syndicate, and have fewer resources to devote to the legal process. By comparison, a funding round led by a venture capital firm (VC) likely involves a more bespoke set of investment documents and a more in-depth due diligence process, where investigations are made into legal, financial and operational matters.

There is a trend in England towards standardisation of legal documents for the fundraising process. The British Private Equity & Venture Capital Association (BVCA), the industry body in the UK for private equity and venture capital, has produced standard documents (available on their website) that they encourage parties to use as a starting point to save both time and money. The documents assume a significant investment is being made by fund investors and have been drafted for use in a Series A funding round. They can also be used for earlier stage investments but often with scaled back rights and restrictions. Even though VCs have their own house-style documents, they often lean on the BVCA standard forms.

This chapter focuses on equity fundraisings, where investors take a minority interest in a company and receive shares immediately upon releasing funds to the company. There are other ways for companies to fundraise that are not covered here, such as convertible loan notes and debt instruments.

KEY DOCUMENTS

There are two principal legal documents, often referred to as the 'investment documents', that govern the terms of a fundraising in the UK: (1) a subscription and shareholders' agreement (SSA), and (2) articles of association (articles). However, parties sometimes choose to enter a subscription agreement and a separate shareholders' agreement as well as adopting new articles.

THE SSA

The SSA is a contract between the company and its shareholders for the purpose of regulating the management of the company's affairs. It establishes the terms of the investment and contains other provisions detailing operational matters relating to the company (e.g. board composition) and shareholder protections (e.g. information and consent rights).

Investors will want to protect their position as shareholders in the company by ensuring that they have appropriate rights to access management information, including the right to receive monthly financial reports and approve annual budgets. Because investors do not control the board or daily operations of the company, consent rights are incorporated to ensure that limits are placed on the directors' ability to take certain actions without the investors' consent.

Investors typically expect the SSA to contain a set of warranties associated with their investment. Warranties are statements of fact about the company and the state of the business at the date of investment. The investor will rely on these warranties when making the investment. It is common in early stage fundraisings (which tend to carry more risk) for the investor to ask the founders and the company (together the 'warrantors') to give the warranties (i.e. if the warranties are not true subject to the provisions of the SSA, the investor can bring a claim against the founders and/or the company). We tend to see a founder's liability under the warranties limited to one or two times their salary and the company's liability limited to the amount being invested.

The warrantors will be given the opportunity to disclose against the warranties before the SSA is signed. These disclosures will qualify the warranties and act as a defence to claims made by the investor. In order to qualify the warranties, the disclosures should typically include sufficient explanation and detail so that the investor can identify the full implication of the matter disclosed. This is often a point for negotiation between the parties. The disclosures are collated in a disclosure letter, which is a separate document prepared alongside the SSA. First-time entrepreneurs can fall into the trap of providing an abundance of information to potential investors by way of pre-investment due diligence, but not disclosing the details and implications as part of the investment suite of documents. Care should always be taken to ensure that the information is disclosed under the SSA.

Companies may be set up with a standard set of model articles, but most companies will create a bespoke set of articles when taking on investment, incorporating some of the provisions of the model articles but with tailored provisions to reflect negotiated terms.

In practice, it is unusual to hear about investors bringing claims for breach of warranty after an early stage fundraising. Most investors will simply want to ensure that the founders are in a position where they take the warranties seriously and have an incentive to provide thorough information (or disclosure) to the investors about the company in advance of the investment, with the knowledge a claim could be brought.

ARTICLES

Every company incorporated in England is required to have a set of articles. They represent the constitution of the company and the rules as to how the company is governed. Unlike the SSA, the articles are public documents filed with Companies House, the UK registrar of companies. Companies may be set up with a standard set of model articles, but most companies will create a bespoke set of articles when taking on investment, incorporating some of the provisions of the model articles but with tailored provisions to reflect negotiated terms.

The articles govern the procedural requirements of the company, including details about how board and shareholder meetings are governed, and contain the rights of each share class, such

as voting and dividend rights, special rights or restrictions on the issue and transfer of shares, preferential rights on exit and any compulsory transfer provisions relating to employee shareholders who leave the business.

DUE DILIGENCE

Whether and to what extent an investor carries out legal (or other) due diligence depends on the type of investor and the amount being invested. Angel investors tend not to carry out extensive legal due diligence and focus instead on financial and operational matters and the business plan. At the other end of the spectrum, VCs investing at the Series A stage and beyond typically conduct an element of legal, operational and financial due diligence and will involve relevant experts in the due diligence process. The founders will need to complete a legal due diligence questionnaire covering key legal matters, including the company ownership history, terms of customer and supplier contracts, ownership of intellectual property, data protection and details relating to employees. If the due diligence uncovers any issues that the investors are uncomfortable with, this may impact the valuation and viability of the business plan in the investors' opinion, and can result in the investors deciding not to take matters forward.

ISSUING NEW SHARES

If the company wants to issue new shares, does it have to offer those shares to all shareholders first (so-called pre-emption rights)? Can investors block the future issue of shares? Do the same rules apply to a transfer of shares?

Subject to certain exceptions, the default position under the Companies Act 2006 is that shareholders of a company have pre-emption rights on a new issue of shares and a special resolution (the consent of 75 per cent or more of shareholder votes) is required to waive shareholder pre-emption rights. Some investors will seek a 'right of first offer', which will require an initial offer of new shares to be made first to those investors. A subsequent offer would then be made to the remaining shareholders if there are any outstanding new shares not subscribed for by the investors. Investors will sometimes seek a veto on any issue of shares as well as any waiver of their pre-emption rights so that they always have control over the next fundraise.

It is typical to see similar provisions in relation to the transfer of shares, and for investors to seek to limit or block the transfer of shares held by founders to ensure that they stay invested in the company. Founders sometimes counter this with a right to limited sales over a period of time.

LEGAL ISSUES

There are several legal issues that arise on an early stage fundraising that need to be considered, both by founders and by investors. A selection of the issues that typically emerge is discussed in the following sections.

WHAT SPECIAL PREFERRED ECONOMIC RIGHTS CAN A SHAREHOLDER ENJOY IN RESPECT OF THEIR SHARES?

There are no predetermined rights associated with special classes of shares in England. Labelling classes of shares as 'Seed', 'Series A' or 'Preferred' will not create any special rights on its own. The rights attached to shares will be those that the company and investors agree to and that are set out in the articles and SSA.

> There are no predetermined rights associated with special classes of shares in England.

It is typical for all classes of shares to have the same voting rights (one vote per share), but there are often different economic rights, special dividends or preferential rights on an exit, for example.

LIQUIDATION PREFERENCE

A liquidation preference provision determines how the proceeds are distributed on a sale or related exit event, or if the company is liquidated. Investors ultimately want to see a return on their investment. However, a liquidation preference right is usually there

to protect investors in the event that they are unlikely to get their money back on an exit when the proceeds are distributed.

While not always included, if investors require a liquidation preference, this would usually take the form of a *non-participating* liquidation preference, which would enable the beneficiary to receive, on an exit event, the *higher* of (1) its total investment in the company (including any accrued dividends) and (2) its *pro rata* entitlement to the proceeds according to its percentage shareholding in the company (where all shares are treated as the same class).

On occasion, investors instead seek a *participating* liquidation preference where the preferred shares entitle its holder to receive both (1) its total investment in the company (including any accrued dividend) *and* (2) its *pro rata* entitlement to the proceeds according to its percentage shareholding in the company (where all shares are treated as the same class). It is unusual to see investors request a *participating* liquidation preference in early stage fundraising in the English market.

ANTI-DILUTION PROTECTION

On an equity fundraising, the number of shares issued to investors is determined by the valuation applied to the company, the amount being invested and the number of shares that are already in issue. Generally, as businesses grow and succeed, higher valuations are applied to subsequent fundraisings. The greater the valuation, the lower the proportionate dilution of an equity fundraising to existing shareholders.

There will however be instances where a company fails to grow in line with expectations, or where unexpected circumstances result in the valuation being revised downwards from the last round of funding. Investors sometimes insist on including anti-dilution rights in the articles, which are triggered when there is a 'down-round' (i.e. when the valuation of the company in the current round is lower than the previous round). In simple terms, the anti-dilution rights will allow for an adjustment to take place, and depending on the formula used, an investor holding these rights will have their equity adjusted upwards to account for the fact that a new investor has invested at the lower valuation.

FOUNDER EXITS

What happens when a founder leaves the business due to resignation or where the company decides to take action to terminate their employment contract?

Investors want to ensure that their investment is protected and that their money is invested into a venture where a founder is incentivised to stay by being tied to the long-term success of the company. This is often achieved by including vesting and/or leaver provisions in the articles, which require founders and employees to transfer some or all of their shares if they leave (or are required to leave) the company. The amount paid for their shares on such transfers will vary from a low nominal amount to market value, depending on the circumstances of departure.

The idea that a founder is at risk of losing some of their shares under any circumstances can be difficult to accept for a number of entrepreneurs. That said, co-founders quickly learn the benefits of well-drafted leaver provisions when faced with another co-founder who walks away from the business at an early stage still holding all their shares and leaving others to continue the hard work of growing the company without their input.

It is not possible to summarise all of the possible outcomes that may apply in these circumstances; however, the leaver provisions usually allow for a period of vesting so that the risk to founders reduces over time.

Co-founders quickly learn the benefits of well-drafted leaver provisions when faced with another co-founder who walks away from the business at an early stage still holding all their shares and leaving others to continue the hard work of growing the company.

HOW IS THE BOARD STRUCTURED?

The directors of a company are responsible for the day-to-day running of the business. Under the SSA, investor shareholders often negotiate additional consent rights over key matters such as:

- material changes to the nature of the business;
- decisions that impact the share capital of the company;
- borrowing money; and
- material business decisions, especially in cases where the founders retain operational control of the business by virtue of being a majority of the directors.

Unless the SSA or articles say otherwise, each director will have one vote on the board and decisions will be made by the majority. It is common to see protective provisions detailing those directors required for a quorum to be present and sometimes designating a director as the chairperson and empowering that director with an additional casting vote should there be a deadlock at a board meeting.

Institutional investors typically request the right to appoint a director to the board to participate in, and oversee management decisions, allowing them to monitor the outcome of their investment more effectively. This right can sometimes be qualified by a requirement for the investor to hold a minimum percentage of shares in the company. If the investor's percentage shareholding falls below the stated threshold, it will no longer have the right to appoint a director to the board. Having multiple investor directors after several rounds of fundraising, may have an impact on the balance of representation at the board level, something that all shareholders should keep in mind.

Some investors seek to avoid the responsibility of acting as directors, or for other reasons are unable to act, and instead opt to take an observer status on the board. There is no legal framework around an observer position, so the SSA will typically establish the observer rights, entitling the observer to attend board meetings to listen in without giving them the right to vote.

HOW DO I PROTECT THE COMPANY'S INTELLECTUAL PROPERTY?

Another area of risk in relation to the legal framework of early stage investments relates to the ownership of intellectual property rights (IPRs). (Chapter 6 discusses how you can protect your intellectual property.) Those investing in companies built on new or innovative technology will want to ensure that the company owns all of the relevant IPRs relating to the value on which the company is built. In the early stages of growth, companies often rely on third-party contractors rather than employees to help build their product and develop certain aspects of the IPR. Founders often start to develop the IPR before they incorporate their company and sometimes do so as employees or directors at a different company. All of these factors raise concerns at a later stage when investors are looking at whether the IPRs are in fact owned by the company they are investing in.

Those investing in companies built on new or innovative technology will want to ensure that the company owns all of the relevant IPRs relating to the value on which the company is built.

When an IPR is created outside of the traditional employment relationship, the default position under English law is that the IPR belongs to the individual creator rather than the company. The transfer of ownership of the IPR is not difficult to achieve; however, if companies do not put these agreements in place at an early stage, as the IPR is developed it can be difficult (and sometimes expensive) to fix it at a later stage. Increasingly, companies are looking to contract out development work to consultants in multiple jurisdictions. If agreements are not put in place on day one, this may pose a significant legal hurdle further down the line when investment is sought.

HOW DO SHARE OPTIONS WORK?

A share option gives the option holder the right to purchase shares in the company.

The main difference between an option holder and a shareholder is that an option holder is not a shareholder from day one, but they have the option (subject to any agreed restrictions) to purchase shares in the company at a fixed price at a future date. The shareholder base will not be diluted until the options are exercised, and option holders do not have voting rights, pre-emption rights or rights to share in dividends. Once exercised, options convert into shares and would typically enjoy the same rights as all other shares of the same class.

Options can be structured in different ways. For example, they can be subject to vesting (i.e. can only be exercised after a certain amount of time has lapsed or immediately prior to an exit), and/or performance targets can be specified. There are tax-efficient enterprise management incentive (EMI) options in the UK. In order to qualify for EMI status, the company granting the options and the option holder must meet certain criteria.

The exercise of options out of the option pool will dilute the percentage shareholding of all shareholders, which is why investors will be keen to agree on the size of the option pool prior to investing. This will clarify any potential dilution they may face if those options are exercised and additional shares are issued.

Options are a helpful way for early stage companies to attract new skilled hires who are incentivised to stay with the business. They help to align the interests of employees with those of shareholders for the long term, as the value of the option will grow as the company grows, subject to the dilution of the issue of new shares as a result of new investor rounds.

FINAL REMARKS

This chapter discusses some of the main issues that an early stage company embarking on their fundraising journey will need to consider. It is important for founders to develop an understanding of the key legal terms of an investment that have both operational and economic effects before embarking on their fundraising journey. This is of particular importance since founders of early stage companies often tend to lead negotiations on term sheets with seasoned angel investors or VCs in order to keep costs down, and this is the stage at which the main investment terms are agreed.

The information provided by this chapter on investment documents and key investment terms will help guide companies through their fundraising.

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THE TERM SHEET

BAKER BOTTS

David Ramm, *Partner*

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As an international law firm, Baker Botts understands the importance of protecting its clients' interests at all stages of growth, including the investment term sheet stage. This chapter outlines the most frequently negotiated aspects of term sheets associated with raising investment and can be used as an initial guide for founders upon receiving one.

A term sheet (also referred to as the heads of terms, letter of intent or memorandum of understanding) will be the likely product of successful meetings between the founder, or founders, of the company ('Founders') and an investor, or investors, ('Investors'). The term sheet summarises the major commercial terms agreed by the Investors and the Founders and will provide the framework for drafting the binding legal documents that will set out the investment into the company.

Although typically non-binding, the term sheet is an important step in the investment process that evidences the Investors' and the Founders' shared understanding of the transaction and, more importantly, the Investors' intent to invest. Once key terms are established in the term sheet, it is often difficult to change them in the binding legal investment documents that will follow. It makes sense to involve lawyers when negotiating the term sheet (as well as ensuring the term sheet is not legally binding if it is not intended to be).

The key legal investment documents that will result from the term sheet include:

a. new constitutional documents for the company, known as the articles of association ('Articles'), although depending on the existing capital structure of the company and the equity and rights being offered to Investors, it may be enough to amend the existing Articles;

b. a shareholders agreement, which sets out how the company and its shareholders, particularly the Investors, will deal with each other after the investment (the 'Shareholders Agreement'); and

c. a subscription agreement ('Subscription Agreement'), which primarily set outs:

   i. the price per share being paid by the investors;

   ii. the number of shares in the company to be issued to the Investors;

   iii. how the company may use the investment funds (Investors often put restrictions on the company using the investment funds to pay down existing debt); and

iv. the logistics of the investment (i.e. the date on which the investment funds are to be transferred to the company and the date on which the shares are to be issued).

Often, the Subscription Agreement and Shareholders Agreement are combined into a single agreement referred to as either a Subscription and Shareholders Agreement, or an Investment Agreement.

ECONOMIC TERMS

VALUATION

Often, the most contentious and negotiated term of any term sheet is the valuation of the company (discussions around the valuation usually begin prior to drafting the term sheet).

When considering and discussing valuation, the following three terms are important:

- *pre-money valuation* – the agreed value of the company prior to the Investors providing money;
- *the investment amount* – the amount of money being offered by the Investors; and
- *post-money valuation* – the valuation of the company after the investment has taken place; it is the sum of the pre-money valuation and the investment amount.

When engaging with Investors, Founders should ensure that both parties are referring to the same valuation metric (i.e. pre-money valuation or post-money valuation). Although an obvious point, this is often missed and can lead to subsequent issues because the Investors and Founders are working on the basis of different valuations.

The pre-money valuation of a company determines the price per share issued to the Investors and helps Investors decide how much money to invest in the company. The Investors will stress test the valuation and examine the company's financial statements closely. The Founders should be able to robustly support their suggested pre-money valuation with a good business plan that incorporates strong financial projections and defensible underlying assumptions.

ISSUE PRICE

The price per share issued to the Investors is calculated by dividing the pre-money valuation by the number of shares in the company prior to the investment being made. The Investors typically insist on the number of shares being calculated on a 'fully diluted' basis (meaning the pre-money valuation is divided by the number of shares, options, warrants and any other debt or equity right that can be converted into shares, otherwise known as convertible securities). It is preferable for the Founders and other existing shareholders for the calculation to only include issued shares. If the number of shares is calculated on a fully diluted basis, the Investors essentially shield themselves from dilution when the convertible securities eventually convert. Further, the more shares the pre-money valuation is divided by, the lower the issue price, the more shares to be issued to the Investor and the higher its percentage holding in the company post-investment.

LIQUIDATION PREFERENCES

On a sale, dissolution or distribution of assets of the company (a 'Liquidation Event'), liquidation preferences (occasionally referred to as the 'waterfall') entitle the Investors to recoup

EXAMPLE 1. Valuation

The pre-money valuation of the company is:	£4 million
The investment amount is:	£1 million
This would give a post-money valuation of:	£5 million

Post-investment, the Investors would own 20 per cent of the company (£1 million being 20 per cent of £5 million).

EXAMPLE 2. Issue Price

The pre-money valuation of the company is:	£4 million
Investment amount:	£1 million
The issued share total:	100,000 shares
The fully diluted share capital comprised of:	
■ 100,000 issued shares	
■ 50,000 warrants (convertible into shares)	
■ 50,000 options (convertible into shares)	
	200,000 shares
Price per share on a fully diluted basis:	£20 per share
Price per share on an issued share basis:	£40 per share

£1 million investment on a fully diluted basis would result in the Investor being issued 50,000 shares. £1 million investment on an issued share basis would result in the Investor being issued 25,000 shares.

their investment before money is returned to the Founders or other shareholders who did not pay for shares at the same time, or at the same valuation, as the Investors. This is not an unreasonable request on the part of the Investors, but most future Investors will expect to receive the same rights as existing Investors. Therefore, once an Investor is given a liquidation preference, it is very likely that the same right will need to be given to each round of Investors thereafter.

Without a liquidation preference, if the company were to be sold soon after the Investors had invested at or below the post-money valuation, the shareholders would share in the proceeds of sale, dissolution or distribution equally with the Investors and the Investors would lose a large proportion of their investment. For example, if the company in Example 1 were sold the day after the investment at the post-money valuation, the Investors would only receive £200,000 (i.e. 20 per cent) of the £1 million they had originally invested.

Typically, Investors will seek to receive a liquidation preference by being issued a separate class of preference shares, which grant the Investors higher priority as compared to the holders of ordinary shares in the company. Although additional rights can be attached to preference shares, it is certainly common to see a 1x preference in term sheets. Liquidation preferences in excess of 1x can be proposed by Investors and, in certain circumstances, may be reasonable – for example, if the Investors have agreed on a particularly high pre-money valuation, based on ambitious projections and business targets.

In addition to standard liquidation preference provisions, Founders should also be aware of 'participation' liquidation preference provisions, which entitle Investors to receive proceeds equivalent to the amount they invested (or a multiple thereof) before sale proceeds or assets are distributed based on their shareholding.

CONTROL TERMS

Upon investing, Investors will usually seek a degree of control over the company. This is normal and typically achieved by (1) the Investors' right to appoint a director or directors (or observers) and (2) consent matters.

These investor rights are usually referred to as 'negative controls'; they enable Investors to block or obstruct decisions that they do not agree with or that they believe will impact their investment. However, they do not enable the Investors to force the company to do things (i.e. they are not 'positive controls'), other than as a result of the leverage they have under the negative controls.

EXAMPLE 3. 1x Preference

The post-money valuation is £5 million. The Investors invested £1 million and hold 20 per cent of the shares in the company.

On a Liquidation Event, the Investors would have a choice to take from the proceeds either:

- the percentage of the shares that they own (i.e. 20 per cent) or
- the first £1 million (the liquidation preference).

On this basis, if the company liquidates for less than £5 million, the Investors are likely to take the first £1 million as a liquidation preference. If the company liquidates for £5 million or more, the Investors are likely to choose to receive proceeds based on their percentage shareholding (i.e. 20 per cent) rather than in accordance with the liquidation preference. If the Investors have a 2x preference, they would be entitled to receive the first £2 million of the proceeds.

THE RIGHT TO APPOINT DIRECTORS

Almost invariably, the term sheet will contain a right for the Investors to appoint a director to the board of the company. This allows the Investors to be involved with the day-to-day running of the company. It is important to note that the Articles and Investment Agreement usually state that a director appointed by an Investor may only be removed by that Investor. Contrast this with other directors who can often be removed by a decision of the majority of the board (and always by a majority of the ordinary shareholders).

The Founders should be mindful of the following:

- The term sheet should not entitle the Investors to appoint the majority of the directors – this would effectively give the Investors positive control of the company's board.
- The board should remain sufficiently small after the investment to be manageable – too many people in the boardroom often causes the board to be less functional.
- The board should remain reasonably balanced between the Founders, Investors and any independent directors that have been, or are to be, appointed.

To protect his or her position in the company, it is possible for a Founder to negotiate for the right to appoint a director (usually themselves). This would entrench his or her position in the company because the Founder could not be removed from the board without his or her own consent.

If the Founders are reluctant to grant a board seat to the Investors, they may be able to negotiate so that the Investors are only entitled to appoint a board observer ('Observer'). An Observer is entitled to attend and speak at all board meetings but cannot participate in any vote of the board. Occasionally, Investors may prefer to appoint an Observer in order to avoid the perceived legal liability and duties associated with being a director.

CONSENT MATTERS

Investors will typically seek consent rights (or veto rights) over certain company actions, which will usually be outlined in the term sheet. If the company wishes to carry out any actions that are subject to consent rights, it will have to seek approval from the Investor before doing so.

Veto rights are standard in equity investor transactions, and their purpose is to protect the Investors' investment rather than restrict the day-to-day running of the company.

Although Founders should expect to accept a number of veto rights, there will be room for negotiation if particular veto rights are not aligned with the investment or would materially inhibit the day-to-day running of the

business. Usually the negotiations are centred around:

- whether consent should be required for the general issue of additional shares or simply the issue of shares at a lower issue price;
- the amount of debt the company can incur before it needs Investor consent; and
- the amount of money the company can spend before Investor consent is required.

As the company progresses through funding rounds, it should attempt to ensure that Investors receive veto rights as a collective (so the majority can give consent) rather than as separate veto rights for each Investor; if every Investor has an individual veto or consent right, this can be used as leverage over the company and can be burdensome for company operations.

A non-exhaustive list of possible consent matters is shown in Example 4.

LEGAL TERMS

WARRANTIES

A warranty is an assurance that a particular statement of fact is true and can be relied upon by the Investors. The primary purpose of a warranty is to give the Investors a complete and accurate understanding of the recent history, the current conditions, the intellectual property and other crucial features of the company, allowing them to make an informed, risk-based investment decision. The Investors will expect to see appropriate warranties provided by the company, and Founders and shareholders who are actively managing the company; these parties will be the 'Warrantors'. The warranties are typically contained within the Investment Agreement.

Warranties will typically cover (at least) the following areas:

- legal existence of the company (including all share capital details);
- financial status of the company;
- business plan;
- assets (including intellectual property);
- liabilities;
- material contracts;
- employees; and
- litigation.

Warrantors' liability in respect of warranty breaches is usually limited according to the severity of the breach, the size of the investment and the financial resources of the Warrantor, and will be subject to negotiation. Commonly, the company's liability is limited to the amount actually invested by the Investors in the relevant investment round. The Founders' liability will be limited to an amount equal to (or a multiple of) each Founder's salary. If the Founders do not derive a salary from the company, an amount

EXAMPLE 4. Matters Requiring Consent

- Issuing any further shares;
- Granting any option, warrant, convertible loan or other rights to subscribe for, or convert into, additional shares (although it is typical to have a carve-out that allows the company to grant options as part of an employee incentive scheme);
- Altering the Articles;
- Selling or disposing of a material part of the business or its assets or intellectual property;
- Approving or adopting accounts or business plans;
- Passing any resolution to liquidate, wind up or strike off the company; and
- Employing people above a particular salary threshold or materially changing the remuneration of Founders or key directors.

aimed at providing a disincentive against inaccurate warranties will be negotiated.

FOUNDERS VESTING AND GOOD AND BAD LEAVERS

Founders vesting is a mechanism whereby a proportion of shares held by the Founders is subject to a right of repurchase (often at a specified price) if the Founders leave the company within a certain period after the investment has occurred. Usually, the Founders' shares fully vest at the end of the specified period or in the event of an exit (sale or initial public offering) before the end of the time period. Once vested, the shares can no longer be repurchased. The proportion of shares that is subject to repurchase generally decreases over time. For example, a Founder's shares may vest over a period of four years from the date of investment, with 25 per cent vesting at the end of each anniversary of investment.

Founders who leave the company prior to the end of the vesting period or an exit event are typically characterised as either good leavers or bad leavers. Good leavers are generally individuals who leave their employment through no fault or decision of their own; their employment ends due to retirement, redundancy, disability or death. Bad leavers are often those who are dismissed for poor performance or misconduct or leave voluntarily to join a competitor or change careers.

> Vesting and good leaver/bad leaver provisions are designed to protect Investors by providing contractual incentives for the Founders to remain working at the company.

Although heavily negotiated, good leaver/bad leaver provisions often operate as follows:

- Good leavers will be required to offer their shares to the company and/or the other shareholders at the *higher* of (1) fair market value and (2) the price originally paid for the shares.
- Bad leavers will be required to offer their shares to the company and/or the other shareholders at the *lower* of (1) fair market value and (2) the price originally paid for the shares.

As Founders are usually vital to the running of a new business, vesting and good leaver/bad leaver provisions are designed to protect Investors by providing contractual incentives for the Founders to remain working at the company.

DRAG-ALONG RIGHTS

Investors will usually seek to include drag-along rights ('Drag Rights') in the term sheet. A Drag Right is a contractual mechanism to force minority shareholders to sell their shares to a purchaser if a specified percentage, usually a significant majority, of the other shareholders agree. This mechanism is important to Investors because it ensures that a potential exit cannot be blocked by minority shareholders.

Founders will obviously want to retain some control over the potential sale of the company; therefore, it is important that the Drag Right percentage is set at the right level to ensure a degree of Founders' control or ability to veto.

TAG-ALONG RIGHTS

Conversely, the Founders may wish to include tag-along rights ('Tag Rights') in the term sheet, which protect existing minority Investors. Under a Tag Right, if the Investors or another significant shareholder sell their shares in the company, the remaining minority shareholders will have the right to join the deal on the same terms and conditions as the Investor.

PRE-EMPTION ON NEW ISSUES

Pre-emption rights on new issues of shares, often referred to as a right of first refusal (ROFR), are a provision that entitles Investors to be offered any further shares of the company before they are offered to third parties.

Although a ROFR clause is not controversial and often applies to all shareholders, not just Investors, the Investors may be the only shareholders that are able to undertake any follow-on investment. Accordingly, the Founders will need to determine the follow-on shareholding percentages following

EXAMPLE 5. Drag-Along Rights

Post-investment, shares are held as follows:

- Investors: 40 per cent
- Founders: 30 per cent
- Other minority shareholders: 30 per cent

The term sheet and investment documents include a Drag Right at 70 per cent shareholding.

In this scenario, if a third party made an offer to purchase the company, the Investors and the Founders, or the Investors and other minority shareholders, would be able to force either the other minority shareholders or Founders (as applicable) to sell their shares. The Founders and other minority shareholders would not be able to force the Investors to sell their shares to the third-party purchaser in this scenario.

any participation in an ROFR and the impact this might have on other shareholder provisions that are subject to shareholder percentages (e.g. investor consent, appointment and removal of directors, drag-along and tag-along).

PRE-EMPTION ON TRANSFERS

Term sheets often also contain pre-emption rights for the transfer of shares, which apply if an existing shareholder is seeking to sell their shares in the company ('Sale Shares'). In this scenario, the Sale Shares would first be offered to the other shareholders in proportion to their existing shareholding, with the option to acquire additional shares to the extent that any of the other existing shareholders do not take up their pro rata entitlement to the Sale Shares. Any Sale Shares remaining after this process can be issued to third parties. As with ROFR, a pre-emption right on transfer is not controversial; however, Founders should consider what impact this may have on the shareholding percentages if some shareholders do not have the funds to participate in the pre-emption right.

BINDING NATURE

As previously mentioned, term sheets reflect the key commercial and legal terms agreed between the Founders and the Investors. However, as a general rule, they should not be legally binding between the parties as they do not contain sufficient information or legal detail to act as definitive agreements.

Notwithstanding the above, the following clauses of a term sheet *should* be legally binding to ensure parties' rights are protected:

- confidentiality – this ensures that the potential deal (and its terms) are kept confidential until the parties are ready to announce;
- costs – each party will typically cover its own costs (e.g. financial, legal) in respect of any investment; and
- governing law and jurisdiction – a suitable governing law and jurisdiction should be decided to settle any disputes arising from the term sheet (e.g. if either party breaches the confidentiality provision).

EXCLUSIVITY PERIOD

Term sheets often include an exclusivity period during which the company and the Founders will not negotiate an investment with other third parties. This period typically ranges from four to eight weeks and demonstrates that the company is, in good faith, willing to forgo conversations with other potential Investors. This can also be tied-in with a costs clause, which results in the company paying the Investors if it breaches the exclusivity provisions.

CONCLUSION

Term sheets represent an important milestone in a company's development and are usually welcomed by Founders as they validate the

Founders' creation and hard work. Following initial discussions, Investors will often push for term sheets to be agreed without delay. However, although Founders may be keen to finalise an investment as quickly as possible, they should be mindful that the initial draft of a term sheet will usually be weighted in the Investors' favour and may include terms that the Founders do not fully understand.

Prior to signing any term sheet, Founders should seek legal advice to ensure their interests, and those of the company, are adequately protected and that the deal is on 'market' terms.

21

THE STARTUP AND GROWTH INVESTMENTS WITH THE BEST RETURN

JUDE'S ICE CREAM

Chow Mezger, *Managing Director*

Our dad was starting an ice cream company.

What began as a barely whispered idea had soon become a regular topic of conversation among the family, and in the space of a few months it was actually happening. Although it seemingly came out of the blue, it made sense. Our dad had often talked of making something with his own two hands, selling a real product to real people, and he has always loved great food. His mission was to make the best-tasting ice cream in the UK.

He started small and set to work in our old dairy barn at home in Hampshire. Our mum soon joined him in the work, and he decided to name the company after her. On 19 December 2002, he walked across the field to the village pub to sell his very first tubs of Jude's ice cream.

Our products are now sold nationally in the UK and are increasingly exported around the globe. We are the challenger brand to the large multinational companies in our category and aim to be the UK's most loved and most known dairy brand. Our product range is expanding beyond the confines of ice cream, and we have an ever-increasing number of plant-based products.

Since the initial capital investment of approximately £100,000 to fit out the barn with the correct equipment, we have used some external financing for major capital expenditures and to smooth out cash flow in what is a seasonal business. Nonetheless, Jude's growth has been mostly financed from profits generated.

Given that there has never been a large amount of spare cash available, we have had to make all investment decisions very carefully. Particularly at startup, every last penny counts. Prioritising how to spend your precious resources is a fundamental discipline. Knowing what we know now, we recommend the following investments for new entrepreneurs.

INVEST IN YOUR PURPOSE (YOUR 'WHY')

Spend time clearly articulating why your new company exists and what good it is going to achieve for you, your team, your customers and your local and global community and environment. Writing this down is the starting point from which you can set ambitious goals for your future, which will simply articulate how you plan to achieve your purpose.

As you progress towards your goals, every decision will have competing demands, and this simple document of your company's purpose (best served as a poster on the wall) will drive all decisions that you and your team make. It will become the compass by which you navigate the opportunities that appear before you and the compromises that you will inevitably have to make.

In reality, this document will evolve over time. With Jude's it started with a mission to make incredible products, then evolved into a mission to build a great company. It has more recently evolved into a document that speaks to the major stakeholders – our team, customers and community – and includes a statement relating to our environmental footprint. Consumers care about these four factors (i.e. the product, company, stakeholder community and environmental footproint), and with this information available at the world's fingertips it is difficult for a business to succeed without taking them all into account when making decisions.

As you progress towards your goals, every decision will have competing demands, and this simple document of your company's purpose (best served as a poster on the wall) will drive all decisions that you and your team make.

INVEST IN YOUR LEADERSHIP SKILLS

We believe leaders exist to serve those they lead, so investing in leadership is investing in your team, who will ultimately grow your company, achieve your goals and fulfil your purpose.

Developing your leadership ability is easy to neglect for a number of reasons: (1) the need can appear less urgent than the rest of the tasks on your long to-do list; (2) it is often time-consuming, as it requires you to assess your character and change your habits, which have taken a lifetime to form; and (3) you might also presume that high-quality leadership training is expensive.

However, we would challenge all these potential barriers as follows:

- There is nothing more important and urgent than improving your leadership. With every new skill you learn or old habit you break, the impact on your team will be instantaneous, and the results will flow through your business faster than you could imagine.
- Yes, it will take a lot of time; however, this is one of the areas of business where the playing field is even – every chief executive officer gets precisely 24 hours in the day to make their impact.
- We have found a huge number of excellent cheap or free resources that deliver world-class training through a number of media, such as podcasts, videos, books or short conferences.

The model of 'servant leadership' that we have embraced presents daily challenges to everyone in our company, as we all ask ourselves, "Am I really serving those I manage?" It is so easy not to; however, our experience is that we have all grown as individuals as we have strived to do this, and the culture of our company continues to improve despite the fact that we have the constant pressures of being a fast-growing business.

INVEST IN RELATIONSHIPS

Investing in relationships takes time – there is no way of avoiding it. However, as mentioned previously, time is a great equaliser. As a startup, time is the one resource with which you are on a level playing field with every other company. We have always spent much of our time investing in relationships, and this has become a cornerstone to our way of doing business.

Through relationships we try to help people understand what we are trying to achieve, hopefully inspire them and give them the opportunity to partner with us on this exciting journey. The following sections outline some of our most important relationships.

FAMILY AND FRIENDS

It is essential that your family and friends understand precisely what you are doing and why. If your reasons are good enough, they are the ones who will support you through the lows and celebrate with you during the highs. If your reasons aren't good enough, they will challenge you to change them. As a family business, we have had the privilege of working with our family, which means we have had to set strict boundaries to ensure that family time remains family time and work time remains work time. We would advise discussing these boundaries with loved ones (and keeping to them) so that expectations are agreed upon. The risk of relationships suffering as a result of your work is real.

CO-FOUNDERS

As co-founders, we check in with each other regularly and wish that we did so even more frequently. We have three joint managing directors and make decisions based on consensus. This is highly unusual, but we find this the best way to establish unity of vision and direction – one of the most powerful drivers of performance. We have also noticed that even if two of us are feeling down, there is always one who picks us up and brings the confidence and positivity we need to press on. Morale is one of the most valuable commodities and something we are mindful of nurturing and protecting.

TEAM

As previously mentioned, we believe that leadership is service to other people. Serving people involves listening to people, understanding them and ultimately trying to make their lives better. Wherever we have done this well, Jude's has benefitted immensely. As Jude's grows, we are continually implementing new systems and structures, and we estimate that people's roles – in everything from ice cream making to management of the finances – change significantly every 6 to 12 months. Managing this change requires clear communication to keep us all moving in the same direction and focused on the same things.

Serving people involves listening to people, understanding them and ultimately trying to make their lives better.

BUSINESS-TO-BUSINESS CUSTOMERS

One of our mentors taught us that there is no substitute for key customers meeting the founder of the company. Our sales team is highly skilled and has more industry experience than we do, but we try to ensure that as many of our key customers as possible have a relationship with one of our founders or directors. Although we believe our ice creams bring great value to the retail customers who sell them from their shelves or the restaurants who serve them on their desserts, we are also thankful to our customers for giving our products the opportunity to be sold through these channels. There is a limited amount of space on any shelf (especially in the frozen aisle) or menu, and we are grateful that Jude's products are chosen above the competition.

USERS OF YOUR PRODUCT/SERVICE

This is not something we actually did much of during the early days. We simply made products that we personally liked, and this approach got us a fair way. However, it has been important to learn where and when we need feedback, which is usually when we are launching into new categories (such as milkshakes or vegan products) where we have less experience or when the market is evolving faster than our natural intuition may be able to keep up with.

MENTORS

We have been fortunate to have had many informal and formal mentors over the years. If people believe in what you are doing, they will be willing to give you much of their time and wisdom. There are not many 'new' problems in business, and there is usually someone who can give you measured advice on how to overcome them.

PRESS AND INFLUENCERS

This group is always looking for the new thing, the David to champion over Goliath. Because we have never had much marketing budget, our strategy is to create ice cream products that are so exceptional that press and influencers, who have a reach far greater than us, want to share them. Bringing this group of people on board to do our marketing for us has been at the very heart of our strategy, and we regularly visit them with sneak previews of new launches.

FINANCIERS

Build a relationship based on trust and not just numbers. We are transparent with our financiers because we want to preserve a trusting, long-term relationship with them, which ultimately benefits both parties. We have seen tremendous value in bringing our bank managers into the business to understand our vision, share in our success and enjoy plenty of visits to our ice cream factory!

INVEST IN BRAND

You will end up telling your brand's story at nearly every meeting you go to, so make sure it is compelling. The startup stage offers a unique opportunity to shape your story and differentiate your company from the competition. Then invest in good design. We started with brand design from friends and family. Once we invested in a design agency – we asked them to create a brand based on the classic British milk jug with blue stripes – we had a brand ready to take us to the next level. Our professional branding gave us greater credibility, and soon some of the most famous brands in the UK, such as Wimbledon Tennis, Waitrose and Ocado, wanted to work with and be associated with Jude's.

INVEST IN INFRASTRUCTURE

Infrastructure, whether it is a new factory or a new team, is costly, but making these risky investment decisions is all part of the entrepreneur's journey. Once you have proven your concept, build as big as you dare.

However, acting responsibly and keeping your stress levels manageable are as important as being bold: (1) your due diligence should be proportionate with the size of the investment, and (2) your investment should be proportionate with your appetite for risk (which varies from person to person).

We have found that the level of risk that works for us is when we are all feeling a little uncomfortable, but we can justify our decisions based on empirical (rather than emotional) data.

The advice to 'build as big as we dare' was originally given to us by friends (who we also consider to be mentors) who run the wonderful pie company, Higgidy Pies, when we were building our second production site. Their experience was that it is far more expensive to retrofit for success, so we built a dairy that was much larger than we needed at the time. It felt like a huge risk at the time, but in retrospect it has served us extremely well.

INVEST IN TEAM

Hire the best people you can afford, and then invest in these people. They are the engine room of your business, your most valuable asset, and your most immediate opportunity for your business to have a positive impact in the world.

> We have found that delegation of work and responsibility nearly always produces a win-win throughout the team. It requires a short-term investment of internal training, but the output is that all team members develop their skills.

We are always aware that we are not able to afford the training budgets of larger companies or the HR resources that would allow us to formalise and provide for learning and development as much as we would hope.

However, we do see it as our responsibility to provide a rich, stimulating and safe environment where our team can grow personally and

professionally. We have found that delegation of work and responsibility nearly always produces a win-win throughout the team. It requires a short-term investment of internal training, but the output is that all team members develop their skills; those who are delegating free up their time in the long term and learn how to manage people better, while those being trained learn new skills and grow by assuming new responsibilities. Delegation feels risky when the business is your baby and training your team well is time-consuming. However, relinquishing certain tasks and letting others have a go has freed up our time so we can learn new skills and focus our attention on new opportunities.

CONCLUSION

In our experience, we would not be where we are if we had not been fully committed to our purpose and goals. Perhaps you have what it takes to go it alone – it is laudable if you do – but in our case, we have depended on each other for encouragement to press on with energy, passion and perseverance.

Our philosophy is that business is one of the great tools in service of developing and nurturing relationships (however unlikely that may appear from the outside). We recognise that we run an ice cream company in a small corner of England and that our day-to-day is designing, making and selling treats for people to enjoy. But we are aiming to leave the world a better place, and we would encourage you to aim for the same thing. This is what gets us out of bed every morning, and we'd wager it will do the same for you.

GO GLOBAL (AND BEYOND)

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THE INTERNATIONAL ENTREPRENEUR

LLOYDS BANK AND BANK OF SCOTLAND

Gwynne Master, *Managing Director, Head of Trade, Global Transaction Banking*

Trading overseas is a giant step forward for any business – a move that can bring multiple benefits. Businesses that trade internationally are typically more productive and innovative, fuelling skills and wage growth as well as product development.

New overseas markets open up potentially significant income streams and have the power to transform a successful domestic business into a serious international success story.

Not every business needs or wants to make the shift, but those that do are generally characterised by ambition, organisation and a competitive suite of products or services for foreign markets.

GETTING READY

Selling internationally takes a great deal of preparation, research, organisation and market awareness. Companies will continue to need sufficient working capital to see their business through the transition from domestic-only to international.

Research alone can take many months and disproportionate expenses if it is not highly targeted towards essential business information. Regulations surrounding product standards, labelling requirements and product inspections, for example, may vary country by country – and are certainly different outside the European Union.

Close oversight of cash flow is vital to ensure that payments from foreign customers are assured and reach your business accounts safely and in good time. Likewise, terms of purchase will need to be enforced as never before.

Trading overseas is therefore a long game. The upside is that you will no longer be dependent on a single market. If trading conditions were to worsen for a time at home, for example, you would be well placed to switch focus to more favourable markets elsewhere.

Bear in mind that, while thorough preparation is important, it is possible to overthink and over-research the potential for exporting and end up missing out. It can be worth visiting your target market and seeing the opportunities that are available first-hand.

BALANCING RISKS

As with any business decision, any entrepreneur thinking to trade internationally must weigh up the risks and rewards. It's largely about focus: establishing one's products or services in new markets often requires significant effort, and it is important not to lose focus on success in existing domestic market(s).

ACCIDENTAL EXPORTERS

Some entrepreneurs plan to move into overseas trade from the onset of their business. However, it is also not uncommon for businesses to end up as exporters almost by chance.

Accidental exporters have no pre-existing plan for exporting. Instead, they often stumble across an opportunity to sell a product or service abroad – almost as a one-off project. For a while, they make money, but because the plan is a bolt-on to their existing business strategy, they can struggle to sustain their exports and eventually be forced to withdraw.

Another casual form of exporting is when companies switch their market focus from domestic to foreign markets and vice versa. This shift is made based on which market offers more favourable trading conditions.

Some businesses arrive at an international strategy from a combination of scenarios. However they get there, everyone needs to know where they can access the right sort of advice and support.

SOURCES OF SUPPORT

Banks and government are both good places to look for information about sourcing, the climate for a company's goods in particular foreign markets, required documentation, etc.

Online support portals are becoming more popular with small businesses because they can access the portals from their decks and outside business hours. Portals can also point owners to sources of information or answers to specific concerns such as risk mitigation, foreign exchange, working capital and regulatory/legal requirements.

Every exporting business is different, and each exists within its own local ecosystem of customers, contacts and support networks that can be used to source useful information.

> Establishing one's products or services in new markets often requires significant effort, and it is important not to lose focus on success in existing domestic markets.

CASH FLOW AND RISK MANAGEMENT

Overseas trading brings with it certain implications for cash flow and risk management, all of which can be successfully addressed with some careful planning.

The cash flow cycle, for example, can be much longer if you are sourcing from an overseas supplier. Likewise, the average development period may be longer due to the additional period of time during which products are on the water or in the air.

Once a business has acquired goods, the company may still need to manufacture the product and sell it. There may also be payment terms attached to the sale, further delaying receipt of income from the sale. Companies need sound processes in place to manage these extra strains on working capital that international trade can entail. Overdrafts alone are unlikely to be enough to efficiently address working capital needs. While every business has different requirements, a bespoke package of working capital support, covering issues such as risk mitigation and funding, can add meaningful benefits.

The cost of finance tends to depend on where the enterprise is trading. Even within the same overseas markets, businesses trade in different ways.

There are the specific risks that come with overseas trading:

- *settlement risk*, or the risk of not getting paid by your buyer/customer;
- *counterparty risk*, or the creditworthiness of the companies/buyers you deal with; and
- *currency risk*, or the impact of changing exchange rates on income and net profits.

Your bank can often help facilitate a deal to mitigate these types of risks. In addition, you may be able to benefit from government export finance schemes.

Both cash flow and risk affect the types of funding you are likely to need, and there are various forms of trade finance that can be used for support, which are described in more detail in the following section.

A GLOBAL BANK OR A PARTNER BANK?

Going into new markets raises several issues for businesses (e.g. how can my business connect with companies in my target countries? How can I handle transactions or agree to contracts to the best effect while mitigating risks?). Such questions are compounded by the fact that you may lack international market knowledge and, as a newcomer, are yet to establish a track record or secure effective buyer–seller relationships. In short, you're not known, your brand may not be known and you don't have long-term trusted customers.

These issues affect the two main components of international trade – risk management and financing. For example, you may find that you have to extend payment terms as an incentive to win new customers. This will impact your cash flow and working capital. On top of this, you will face the challenge of breaking into new markets and dealing with scepticism about your business's ability to deliver and the reliability of your goods.

In these scenarios, businesses look to their banks for help. A global bank, with its worldwide presence, might seem like the obvious first port of call for a new UK exporter. But when it comes to trading internationally, one size does not fit all, and deeper or more bespoke expertise may be required.

National champion banks in international markets are able to reach out to all client segments in their home markets – SME, medium-sized business and large corporate customers, as well as financial institutions – and offer a full range of international trade solutions.

Global banks have a finite capacity, which is typically focused on supporting their largest multinational clients who are already established in many global markets. Global banks may not be able to offer a full product range for small and mid-sized corporates in all markets. Likewise, reach in international markets may be limited to a few branches.

On the other hand, national champion banks in international markets are able to reach out to all client segments in their home markets – SME, medium-sized business and large corporate customers, as well as financial institutions – and offer a full range of international trade solutions. When banks partner together, they can identify where in the trade cycle the client and their counterparty need assistance, and then deploy their product set to fill the gaps.

Lloyds Bank and Bank of Scotland include, for example, benefits from an established network of like-minded partner banks in over 100 countries, each a national champion in their home market and offering indispensable on-the-ground knowledge and regional expertise.

DO I NEED A FOREIGN BANK ACCOUNT?

If you regularly pay in or receive funds in foreign currency, a commercial foreign currency account can be an efficient way of managing your international trade activities.

A good commercial foreign currency account will provide you with the flexibility to help you maximise international trade opportunities, enabling you to hold balances in different currencies, and facilitate international payments in a range of currencies to meet your global trading requirements.

A commercial foreign currency account can help you simplify the payment and receipt of foreign currencies, manage your business's exposure to exchange rate movements and minimise foreign exchange costs. With these accounts, you can transfer money into and out of your primary Sterling business account at agreed foreign exchange rates, and even get chequebooks in key foreign currencies (although most payments could be made electronically).

To apply for a commercial foreign currency account, you will usually need to be an existing business account holder of the bank, aged 18 or older, and a sole trader, partner or director in a business.

If you have excess funds in a non-GBP currency that you intend to hold for a period of time, you might also consider a currency deposit account, which could help you maximise the interest on your surplus funds. These accounts typically operate on a fixed-term basis and are available for a range of major currencies.

SOLUTIONS TO SUPPORT YOUR INTERNATIONAL PUSH

There are many solutions that your bank can help you with as you look to grow your overseas trading:

- *International payments* allow you to move money across borders electronically. Most banks, Lloyds Bank included, can make international payments online to almost any country.
- *Foreign exchange risk management* reduces the risks that come with exchange rate movements for foreign currencies when doing business internationally. There is a wide range of foreign exchange solutions to help you manage your foreign currency exposures and get the most out of your international engagements.
- *Documentary collections* reduce the risk for all parties involved by providing protection and security for both the buyer (importer) and the seller (exporter). By using banks to handle the documents related to the goods and payment, both the buyer and the seller can be sure that a consistent set of rules will be followed, ensuring that the shipment and payment will be undertaken. The buyer has the opportunity to inspect documents prior to payment, reducing the risk of paying for unwanted goods, and the bank will not release the documents for the goods until payment is received. This removes the risk of losing control of goods without being paid.
- A *letter of credit* can be issued by the buyer's bank to help guarantee safe delivery of payment for your exports overseas. The letter of credit sets out a range of terms and conditions and ensures that if the goods shipped meet agreed specifications, which can be evidenced by documents presented, you will be paid. The documents are checked by both banks, and the buyer's bank commits to paying, or to pay at a future date, if the documents are compliant.
- A *guarantee or bond* is an instrument for reassuring your buyer that you will supply goods or services as agreed. It is issued by a bank on behalf of a client to support the contractual obligations (whether performance or financial) to the buyer or importer. The bank commits to paying upon a claim received from the buyer or importer under the terms of the guarantee, if there is a default under the contract. It's one of the most widely used instruments and is extremely versatile.

There are other trade finance products that may be available to support your needs, so it is worth seeking advice from a bank trade professional.

GOVERNMENT HELP

If your export planning has reached an advanced stage, local and national government initiatives may start becoming more attractive.

There are schemes designed specifically for businesses, such as trade missions, that can prove extremely helpful in unlocking doors to foreign markets.

The Mayor of London's International Business Programme is one example. This involves cohorts of SMEs receiving targeted, practical advice and coaching on how to approach exporting. The scheme also offers businesses the chance to join trade missions abroad – either led by the Mayor's Office or by central government.

FINANCIAL HELP FOR EXPORTERS

The type and level of financial support available for a business depends on what stage of the exporting journey it has reached: preparation, planning or trading.

At the very beginning, when the business is just starting to invest, some government grants are available – as is the chance to attend trade shows.

As the business's strategy firms up and a company starts to identify opportunities, a wider range of support becomes available, such as export credit finance from a bank.

A business can sometimes help fund its own export drive by releasing capital within the business itself. This could happen through efficiency savings made elsewhere, or increased productivity.

RISE IN EXPORTERS

Exporting is a growing trend among the UK's SMEs, with increasing numbers trading internationally for the first time – even among a general slowdown of goods exported from the UK.

Europe remains the key overseas market. This is partly a function of geographic proximity, but the relatively good risk profile and the stability of European countries compared to markets outside the bloc are other factors to consider.

Some research shows that UK businesses are also targeting English-speaking countries, such as the US, Canada, Australia and New Zealand. In addition to the ease of communication, many entrepreneurs see these markets as having lower barriers to entry due to their broadly similar legal and political environments.

DIGITAL UPSKILLING

Making sure your business has the right digital skill set is an essential component of preparation for overseas trading.

Digital skills are important for businesses anyway, but there is increasing evidence that the better a business performs digitally, the better it will perform as an exporter. Understanding how to stay secure when making payments online and the ability to effectively analyse customer data are two examples of the importance of digital upskilling. It is also becoming increasingly important to have a familiarity with technologies such as blockchain, which are being used to address global trade issues.

As with financial support, a range of digital upskilling assistance is available from both private sector and government providers.

Digital skills are important for businesses anyway, but there is increasing evidence that the better a business performs digitally, the better it will perform as an exporter.

BUSINESS JOURNEY

There are many routes to international trade. The exact path your business takes will depend on your aims, determination, the right systems and processes, target markets and your ability to find the right advice and financial support.

If you can manage all that, your company will be stronger, more resilient and far better placed to reach the next level of growth.

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FINDING CUSTOMERS OVERSEAS: THOUSANDS DO, AND YOU CAN TOO

DEPARTMENT FOR INTERNATIONAL TRADE

Mark Robson, *Head Exports Yorkshire Region*

Thousands of businesses of every size and type, and from every part of the UK, sell overseas every year. As a direct result, most become more innovative, profitable and resilient to challenges, such as a loss of a key customer or economic downturns – because they spread risk across more customers and more countries.

Businesses selling overseas contribute immensely to both the UK and local economies. The government's export strategy has set a national goal to transform export performance, raising exports as a proportion of GDP from 30 per cent to 35 per cent.

However, for every business that successfully sells overseas, there is another that has real potential to break into new markets but does not take advantage of the opportunity to find new customers and new revenue. Many of these businesses are run by dynamic people who have thought about expanding internationally but haven't got around to it due to time, concern about the complexity of selling overseas or not really knowing where to start.

This is a short introduction to selling overseas, which aims to demystify the process. Before we begin, there are three key points to emphasise:

1. Thousands of businesses sell overseas every year: if they can, you can.
2. In most cases, selling overseas is not that difficult; it's just different from selling in the UK. If you need qualifications to practice or comply with specific regulations and standards (such as for food manufacture in the UK), expect the same requirements overseas. You should check whether you need to do anything different to comply in other countries. Equally, if you protect your intellectual property here, you will need to think about securing protections abroad.
3. There is a lot of support and advice available from the government, your bank and many others. You don't have to know everything, you just have to know where to seek help. Websites such as *www.great.gov.uk* are excellent resources.

STEP ONE: DECIDING TO GO FOR IT

Like any other new business direction, international trade requires an investment of time and money, and a bit of planning. You can waste a lot of your own and others' time and money if you start with no real intention of seeing something through.

But naturally, you may have some concerns or reservations.

WILL ANYONE WANT TO BUY MY PRODUCT OR SERVICE?

British businesses and products are highly regarded around the world, so if your products or services are in demand in the UK, there will probably be demand overseas. If you look on *www.great.gov.uk*, you can search a live database of thousands of *export opportunities* from around the world. You can also look for case studies about businesses like yours.

WILL I GET BURNED? INTERNATIONAL TRADE SOUNDS DANGEROUS

When someone has difficulties overseas, it is usually because they haven't really thought through the process. Common issues include not finalising payment before dispatching the goods, not checking what documents you might need to shift product across borders or forgetting to include all costs in the price.

Some countries are riskier and harder to do business in than others and, of course, more expensive to enter. That is why many entrepreneurs tend to start in local or English-speaking countries.

There are plenty of resources from organisations such as the Department for International Trade (DIT), your bank and chambers of commerce to help you ask the right questions and plan properly.

IS THERE A DECENT RETURN ON INVESTMENT?

It is no mistake that the majority of the most dynamic and profitable businesses in the UK trade overseas. Obviously, one explanation is that these businesses have access to many more customers and, in many cases, the potential to charge a higher price in another country. But there are other reasons for their success; for example, travelling overseas exposes entrepreneurs to new ideas or new challenges that they can learn from, which then drives innovation in the UK.

STEP TWO: DECIDING WHERE TO GO

There are three main strategies companies use to select their first markets: (1) responding to an opportunity, (2) following existing customers or (3) planning from scratch.

RESPONDING TO AN OPPORTUNITY

People contact you to make an enquiry or place an order. You may not even notice they are overseas. You may also come across an opportunity on *www.great.gov.uk.*

FOLLOWING EXISTING CUSTOMERS

If you have good customers who have offices or factories overseas, then offer to supply them with products or services or ask for introductions and recommendations to their decision makers overseas. It's a great way to get a safe introduction to a new market and helps pave the way for targeting new customers once you're there.

There is another benefit: by proactively offering to supply your customers internationally, you expand that relationship, which avoids having a competing supplier in a different country do the same to you. You do not want your customers' overseas suppliers to win the business you supply them in the UK.

PLANNING FROM SCRATCH

Conducting market research to identify the best opportunities for you is something that requires a bit of skill. We generally advise people to look at the size and the attractiveness of several countries. Size is broadly defined as how many potential customers there are in each country, and attractiveness considers barriers to accessing a market (such as quotas or tariffs), the presence of competitors, the distance to travel and the complexity of doing business there.

British businesses and products are highly regarded around the world, so if your products or services are in demand in the UK, there will probably be demand overseas.

In the past, this was an onerous task, but now a lot of work can be done using digital tools and databases. Once you have completed this initial desk research, you will probably need to carry out more detailed and specific analysis to identify the best way to tackle the country and who to target.

For most businesses, this will be the route they have to take. In the long term, this is the most profitable approach.

STEP THREE: GETTING OUT THERE

You've made the decision and identified where there is probably demand for your products or services, and the time has come to enter your new market and win new business. You may be tempted to race out there and start knocking on doors, but there are a few key considerations to keep in mind first.

IDENTIFYING CONTACTS

Make sure you have created a series of appointments before you set off. You wouldn't drive to a new city in the UK and then wander about aimlessly hoping to find a potential customer, and the same rules apply overseas – yes, people really do this! Speak to your existing online and offline networks for potential introductions, talk to DIT or your local chamber of commerce and do your own research to find new contacts. You can also use DIT or attend a relevant event such as a trade fair. DIT has over 100 teams around the world to support companies from all over the UK.

HOW MUCH SHOULD YOU CHARGE?

Clearly, you should start with the component costs. Depending on the deal you make with your customer or client, these will vary. For example, you may have no additional costs if the customer agrees to pick up product from your office; alternatively, you may incur quite a few additional expenses if you offer delivery and have to deal with all cross-border costs, such as duties, documentation or freight. Incoterms – a set of global standard agreements of the commercial terms for delivery of physical goods – simplify the process. These include standard approaches such as 'ex works' and 'delivered duty paid'. Make sure you know what they mean, and what you have to do and pay for before agreeing.

> Creating a loyal customer is about building a relationship with a person, and culture is just one part of them.

If you agree to deliver to the customer, costs would normally include expenses such as shipping, import duties, exchange rates, insurance and maybe packaging. If you provide a service, you need to think about the logistics involved in delivering those services, such as travel to the country or rental space.

It is also important to research what people will pay in a specific country. You will be kicking yourself later if you add a small margin and then see a competitor charging double the price.

UNDERSTAND THE BUSINESS CULTURE

We have certain expectations of how someone should present themselves when selling to us. They should arrive on time and have a short general conversation before moving to the business discussion. This isn't the same everywhere. Some countries are much more formal, while others are more concerned about building a relationship before talking about business; this takes time.

There is plenty of advice on cultural business practices online, but remember: creating a loyal customer is about building a relationship with a person, and culture is just one part of them. So take the lead from the customer, but keep your eye on securing a business relationship.

Culture also extends to personal interpretations, such as what people expect to see on packaging or the meaning of different colours. For example, if you expect the picture on food packaging to show the ingredients, then you might think twice about putting a happy baby picture on a container of baby food.

WILL LANGUAGE BE A BARRIER?

In many cases, you will be able to use English in normal conversations, but that does not mean

you shouldn't learn a few basics to communicate with taxi drivers or reception at your customer's office.

If you need a translator or interpreter in a meeting, be sure to plan ahead and practise with the translator before the meeting. There are two ways of translating: (1) simultaneously, when the translator effectively talks over you, which takes some getting used to; and (2) consecutively, when you talk in turns, leaving the translator time to translate. If you talk nonstop for 10 minutes, a consecutive translator will probably not remember much of what you said, and your pitch will suffer as a result. I have seen this happen with an important delegation where, after a lengthy and impassioned speech without breaks, the translator said something like, "It is an exciting product with lots of innovative features."

You will also have to translate packaging and instructions in most cases. It is always worth getting someone to do this who knows what they are doing, just in case software translation ends up with a meaning you didn't quite expect.

There are many businesses that offer a wide range of translation services, from telephone-based translation to specialists in a particular field who can help with technical translation.

WILL I NEED A LOCAL PARTNER?

Many businesses seek a partner, agent or distributor on the ground who will help win new business or provide local support. The right person or organisation can grow your business, be a key part of your team and make things pain-free. The wrong one can make life difficult and be costly to get rid of if you have signed an agreement without fully thinking it through. There are three key issues to be aware of:

- Be clear about your objectives before looking for a partner and get advice on the best approach for that country. For instance, you are unlikely to find anyone who can really cover the whole of the US or India for you.
- You need to be aware that agents have legal protection in most countries because they invest time and money building a market for you, and unscrupulous principals could easily just say 'thank you very much' and sell directly without paying the agent. But that also means getting rid of someone who isn't very effective is not going to be easy unless you have clear performance targets they have failed to meet.
- DIT and others can help you find suitable candidates, but it is always worth doing proper due diligence and seeking advice before making an agreement.

WHAT ABOUT MY WEBSITE OR SELLING THROUGH ONLINE RETAILERS?

The term 'localising' is used to describe the range of ways to improve the usability of your website in a new market. This is more than just translating the words, because people in different countries expect to see different types of information on a company website. You may also want to look at some of the images you use to ensure they are appropriate for the country you are targeting. This requires specialised advice, and DIT offers techniques to make a website work for you.

Selling through an online retailer can be a good route for starting in a market for some products. Online retailers already have massive flows of traffic and can greatly enhance the chance of your product or service being discovered in the new market. There are many online retailers across the world, and the dominant ones in the UK do not necessarily have global coverage.

STEP FOUR: COMPLETING THE DEAL

You've made it to a new market, found some good contacts and secured your first sale. However, a deal is never done until you have delivered the product or service and received payment.

Online retailers already have massive flows of traffic and can greatly enhance the chance of your product or service being discovered in the new market.

DELIVERING ON YOUR PROMISE

Depending on what you do, delivery may be as easy as sticking your item in the post or putting a member of your team on a plane.

Delivery of larger volumes of physical products will require shipping, and you need to consider the options and relative costs for doing this.

Think about time. If you agree to get several tons of kit to China in two weeks' time, you will probably be sending it by plane. Needless to say, this is generally more expensive than by ship.

GETTING THE DOCUMENTATION RIGHT

Cross-border documentation and procedures are standard across the world for delivering physical goods. You can find the correct documentation from chambers of commerce, which also provide training. In most cases, however, businesses leave most of this to their freight forwarder, who is a specialist in this field.

For products such as food and drink, agricultural products or medical equipment (where there are regulations you need to comply with to operate in the UK), additional documents are required, and you will need to check compliance in the country to which you are shipping. Again, this information is easy to find on *www.great.gov.uk*.

If you are selling a service that is regulated in the UK and you need a certificate or qualifications to practise, then you need to ensure that your UK qualifications allow you to operate in the new country. You will also need to check work visa requirements.

Making sure you have the correct documentation is not difficult, but getting it wrong can cause delays and unnecessary work and expenses.

GETTING PAID

There are several ways to get paid, from cash with order to open account (where the customer pays after a set amount of days – maybe 30 days after receipt of goods, but in some countries the expectation may be up to 90 days). Cash with order obviously is the least risky option, while open account is the riskiest and best suited for customers you've come to know and trust.

There are ways of guaranteeing payment by insuring the deal or drafting formal payment agreements, called 'letters of credit', through your bank and your customer's bank.

There are three key considerations:

1. Think about being paid at the beginning.
2. Think about cash flow. Your client may pay you more for the contract if you operate on open account, but if it takes 40 days to deliver the product and they pay 30 days later, you will end up waiting 70 days for payment.
3. Stick to what you agree to do. Letters of credit normally specify how you will deliver a product, and if you do something different, payment may be disputed.

The government also has a body called UK Export Finance that can play a key role in more complex countries and deals. Their mission is to ensure that no viable UK export fails for lack of finance or insurance, and they offer many products to UK exporters.

Making sure you have the correct documentation is not difficult, but getting it wrong can cause delays and unnecessary work and expenses.

STEP FIVE: GROWING YOUR BUSINESS FURTHER

Once you have had some success, the next step will be to find more customers and enter more countries.

If you started by responding to enquiries or following a key customer, then now is the time to think through and research a proper plan. Here are a few things you might also think about.

RAISING YOUR PROFILE

Many companies find that attending trade fairs regularly helps get their name out. You will meet many useful people because usually

everyone interested in your field will be there. However, trade fairs can be expensive to attend, so it is often worth being a visitor before exhibiting. Make sure you line up people to meet beforehand rather than hoping for a lucky break once you get there.

MAKE THE MOST OF YOUR TIME AND MEET MORE PEOPLE

If you are visiting a city overseas on business, think about finding new contacts either from research or talking to the local offices of DIT. There are local networks of British businesses in many countries with a local chamber. Your bank may also have local networks.

Additionally, think about using other routes for introductions as well, such as LinkedIn, web research and your personal network.

DRIVE TRAFFIC TO YOUR WEBSITE

If you have already localised your website, you might want to review it with local experts and then look at ways to drive traffic as you would in the UK.

CONCLUSION

Selling overseas is a way of growing your business and making it more resilient. It isn't just for big manufactures – all types of businesses already do it: if they can, you can.

It isn't necessarily that difficult, just a bit different. So you should be thoughtful and proactive before you act.

Unlike selling in the UK, there is a lot of support, much of which is free, from the government, your bank and others to help you get this right.

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MOVING ON AND REALISING VALUE FROM YOUR BUSINESS

LLOYDS BANK, BANK OF SCOTLAND AND LDC

Nick Laird, *Managing Director, SME & Mid Corporates, North*

Andy Grove, *Head of New Business at LDC*

There are many reasons for an entrepreneur to look at exiting their business. Much depends, of course, on the nature of the business, the founder's current role in it, and future investment needs.

DETERMINING YOUR STRATEGY

Defining your ongoing involvement in the business is the first step in creating an exit strategy. Ask yourself:

- Do you intend to exit completely, realising value as you do so?
- Are you keen to move on to your next project?
- Do you want to leave the business to the next generation or to an experienced management team?
- Does the business need to evolve in a way that you'd prefer to leave others to manage?
- Do you want to step down from the front line of the business or work part-time?
- Has the business reached a natural closing point, having achieved its goals?

Regardless of your level of involvement, the next stage will be largely informed by your answers to these questions, both from a financial and a managerial perspective. The next stage will also likely be influenced by your current investors and by external advisers, such as your banking partner.

To prepare your business to realise value for its owners, you'll need to make sure your financials are in excellent shape. There are several routes outlined in this chapter, all of which will require adequate preparation to be successful.

CONSIDERING YOUR EXIT OPTIONS

There are numerous ways to realise value and move on from your business, whether partially or as a clean break. For example, you may be planning to hand the business on to the next generation, with family members either taking over the day-to-day operations while you remain nominally in charge and draw profits, or buying out your stake to take control of the company entirely.

An outright sale to another party is the most straightforward option for exiting. This may include the sale of just your share of the business's assets or stocks,

or it could encompass the entirety of company property. To make an outright sale successful, the business's financials and prospects need to be in the best shape possible to attract buyers or investors.

Depending on your exit plan, you may wish to stage a gradual sale (when the business owner sells equity or other assets in phases over an agreed time frame until a full transfer of ownership has been effected). This strategy may be suitable when a confirmed buyer wishes to purchase preferred stock in stages before taking over the business entirely. A gradual sale can also be a good option for you if you're seeking to release funds but plan to exit in stages.

For many entrepreneurs, seeking the support of a private equity partner is not only a way of accelerating growth, it can be an opportunity to start thinking about future leadership and ownership of the business.

You could also sell your stake to the management team, or to partners, investors or a private equity house. If you've developed a strong management team that has the confidence to take the company forward or if one of the partners or investors would like to continue handling the business, selling to the existing operational team can be an ideal way to unlock some of the value of the business as you move on. However, the sale may be less lucrative than selling to an outside buyer, such as interested investors or a private equity house. We look at the private equity option in more detail in another section.

You might even look to float the company through an initial public offering (IPO). Your company's reputation and brand value will be crucial here, as the public will value your business in relation to others in the industry. This can be a lengthy process, so it may be a longer-term strategy.

Another option is simply to liquidate your business. If the business has run its natural course, it may be time to close down and sell off company assets. Any shareholders or debts will need to be repaid if this option is chosen. This doesn't have to be a negative experience or direction: liquidation can be a stepping stone to new opportunities, freeing you up to start on a new venture or move into a new industry.

There's also the option for a merger or acquisition. By merging your company with, or selling it to, another similar business, you can take a more flexible role or exit the business entirely. This option could take some time to process and will require significant financial preparation. Mergers or acquisitions are likely the best option for a company that needs to evolve further in order to retain market relevance.

PRIVATE EQUITY PARTNERSHIP AS A ROUTE TO EXIT

Put simply, private equity funding is the injection of capital into a business in return for an equity stake. For many entrepreneurs, seeking the support of a private equity partner is not only a way of accelerating growth, it can be an opportunity to start thinking about future leadership and ownership of the business. Successful private equity partnership requires a clear succession plan and a team capable of taking the business forward.

As a result, it is not uncommon for private equity firms to work closely with business owners who have reached a stage in their career where they are looking to take a step back, de-risk their finances and realise some of the value they have created.

Similarly, seeking the support of a private equity partner can provide an alternative to a conventional sale to a corporate buyer or IPO, allowing the business to live on independently. It can enable existing shareholders to maintain control of their business and share in the upside from a successful sale process in the future.

The degree to which the founder of a business remains involved is also entirely at their

discretion and can vary greatly. Some maintain their current roles as chief executive officer (CEO) while others decide to step back from the frontline and move to a non-executive position.

For those business owners looking for a non-executive role, while still retaining a stake in their business, a private equity partnership can be both an ideal funding solution and the first step of their succession plan. It can also help empower a management team to step into the driving seat.

Private equity partners work with management teams to make their growth strategy happen – whether through making acquisitions, launching new products, embarking on a buy-and-build strategy to break into new sectors or expanding overseas.

Those investors focused on partnership do not take control, which means management teams are still at the forefront of the decision-making process. Private equity investment can be the first step on their growth journey, particularly if the management team has ambitions to take the business to IPO or an eventual trade sale.

GOING PUBLIC VIA AN IPO

An IPO is a complex move that provides another avenue to additional funding in which the company will make a portion of its shares tradable on a public stock market. While some fast-growth companies prefer to sell to bigger competitors or partner with private equity houses, going public is still a viable option for the right kind of business. But it's important to remember that there are benefits as well as challenges that come with IPOs.

> To be suitable for going public, a business needs to demonstrate consistency in performance both now and into the future – steady profitability and a predictable rate of growth.

Traditionally a business would be expected to demonstrate revenues of £100 million or more to be considered a suitable candidate for floatation. But today, businesses that are smaller in size (in the tens of millions of revenue) can still go public. This may be particularly relevant for fast-growth tech companies that choose to float on the Alternative Investment Market (AIM) to raise cash.

An IPO is a powerful way to raise funds, and additional cash can be generated by issuing new shares post-floatation. Publicly quoted businesses are often able to borrow money at better rates, and acquiring other businesses becomes easier too. Going public rewards your current (often original) investors with the opportunity to realise some or all of the value of their investment by selling their shares. And in terms of brand reputation, a public listing sends a powerful message about the perceived durability and potential of your business.

However, it's not easy to prepare your business to be listed on the stock market. To be suitable for going public, a business needs to demonstrate consistency in performance both now and into the future – steady profitability and a predictable rate of growth. You must be confident that there is a clear path to scale the business and grow its revenues and that the sector in which you operate has strong growth potential. The quality and depth of your management team will also be closely scrutinised.

In addition, listed businesses are expected to abide by corporate best practices, with a formal board structure and clear governance processes in place. You will need to provide regular updates to investors and be prepared to account for your decisions at meetings with shareholders. It typically takes several months of consultation with experts, financial modelling and due diligence before an investment bank will commit to underwriting your shares. With deals between investment banks and issuing companies often running into the hundreds of millions of pounds, this is a very high-stakes process.

EXAMPLES OF PRIVATE EQUITY IN ACTION

To illustrate how private equity can support the growth of a business, let's look at a couple of examples.

JOULES: INTERNATIONAL EXPANSION AND IPO

In 2013, private equity partner LDC invested £22 million for a minority stake in leading lifestyle brand Joules. The firm backed founder Tom Joule, alongside his senior management team, and partnered with the team to drive growth across all channels of the business.

Over the next two years, and with the continued leadership of Tom Joule as CEO, the business grew its UK portfolio from 61 to 98 stores, while also investing in its supply chain, IT, international sales support offices and people.

Total sales from Joules' distinctive collection of clothing, accessories and homewares grew by 50 per cent to £116.4 million during this period, with international sales increasing by almost 200 per cent to £10.6 million.

In May 2016, Joules went on to complete a £140 million listing on London's AIM market, which raised proceeds of approximately £77.5 million. At this point Tom Joule moved from CEO to Chief Brand Officer.

BOFA: ORGANIC GROWTH AND TRADE SALE

In 2015, LDC invested in fume extraction and filtration specialist BOFA International to help the firm develop its infrastructure and support international growth in a deal that valued the firm at £23 million.

LDC backed the existing management team, led by Chief Executive Tony Lockwood, in a £23 million management buyout, which facilitated a transition of ownership for the Cornell family who founded the business in 1987. Chris Cornell, one of the three family shareholders, opted to retain a stake in the business, working with LDC and the management team to continue growing the business.

During the partnership with LDC, BOFA doubled revenues, establishing its first European on-the-ground presence with an office in Hamburg, investing in its US-based operation in Illinois and increasing its employee numbers by more than 50 per cent. The firm also increased international sales so that 90 per cent of revenues were from export markets in the US, Europe, Africa, the Middle East and Asia.

In September 2018, LDC completed the sale of BOFA in a deal worth £90 million to the NYSE-listed Donaldson Company, the leading worldwide manufacturer of filtration systems and parts.

PLANNING AN EXIT AND REALISING BUSINESS VALUE

While the timing of an exit can vary, planning ahead is advisable at any stage of the business to make sure you maximise its value.

You may have been clear from the start as to when you planned to exit, or you may have recently decided that it was time to move on. But whatever stage of exit planning you are in, there are certain steps that need to be taken.

Assessing your company's financial status with the assistance of financial advisers is key. Whether you plan to sell or float the company to exit or to raise cash while remaining involved, you will need to present the business as an attractive prospect for potential buyers and investors.

Once you know where your business stands, you can make executive decisions on the best strategy for exiting. As outlined in this chapter, you'll need to establish what level of involvement you'd like to have going forward and decide on the future of the business and its structure.

While the timing of an exit can vary, planning ahead is advisable at any stage of the business to make sure you maximise its value.

There will likely be a transitional period as the company changes hands or changes structure, and it's important that there are appropriate checks in place to ensure the business delivers

on the agreement made at sale or for the restructure.

HOW CAN BANKS SUPPORT THE PROCESS?

The process of exiting a business and releasing some or all its value doesn't have to be a solitary move. Given that a banking partner has likely been involved with the business throughout its journey, it's worth consulting financial experts to make the transition as painless as possible.

If you're seeking external capital through debt financing or attempting to change ownership or financial structure, talk with your banking partner to avoid overcomplicating a financial structure that might already be very complex.

No matter the chosen process or change to a business's financial structure, banking partners can continue helping a business deliver its requirements as follows:

- *Advisory services*. Banks and their wider networks can be instrumental in business restructuring, altering financial arrangements or developing a business further.

  In addition, bank networks can put businesses in touch with many different bodies, including members of the advisory community, solicitors, accountants, tax specialists, potential investors and investment bodies such as the Business Growth Fund. This can help entrepreneurs and businesses handle the complexity of extracting a management figure or rearranging corporate structure without damaging profitability.

- *Partner banks and syndication*. Banking partners can also provide end-to-end financing arrangements for large deals, such as debt financing. If the deal is of a scale that would require more than one banking partner, a partner bank or small group of banks can be brought in. Banks can also underwrite, distribute or syndicate much larger loans, bonds or other instruments.

  In addition, banking partners can help the business with associated requirements, such as risk management – whether through currency, commodity or interest rate risk management.

MAKING THE DECISION TO MOVE ON AND REALISE VALUE

Deciding to exit a business can be a difficult decision, or it could have been your plan all along. Regardless, there are flexible methods to suit your needs and goals and to ensure the business is prepared financially to meet those requirements.

Restructuring plans and advisory services can facilitate solid exit strategies so that all stakeholders have the best chance of maximising the value of their efforts and investments.

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WHAT WILL YOUR BUSINESS LOOK LIKE IN 100 YEARS?

INSTITUTE FOR FAMILY BUSINESS

Fiona Graham, *Director of External Affairs and Policy*

Every family business starts with an entrepreneur, but entrepreneurs rarely think of themselves as founders of dynastic businesses.

It's understandable. Setting up a business is hard work. You are focusing on making things work now to ensure your business can have a future – not worrying about what the business will look like in 60, 80 or 100 years.

But stop for a moment and think about your long-term ambitions for the business you have created: would you like the business to still be around in 100 years? What do you want it to look like? Would you like your family to have built on your legacy, while upholding the values and culture you developed? If you think of yourself as the founder of a family business, how could that affect the decisions you make today?

It's often said that family firms go from 'clogs to clogs in three generations'. Most cultures around the world have some form of idiom that reflects this. In the United States, it's 'shirtsleeves to shirtsleeves'. A Scottish proverb says, 'The father buys, the son builds, the grandchild sells and his son begs'. And according to a Chinese saying, 'Fu bu guo san dai' – wealth does not pass three generations.

There are, however, plenty of phenomenally successful multigenerational family firms in the UK and around the world. These families have built on the foundations laid by the original entrepreneur, and by continuing to adapt, innovate and learn, they have built a family legacy of success.

In this chapter, we will look at not only how you can give your business the best chance of succeeding across the generations, but also how choosing that path might impact decisions you make today.

PURPOSE

Having a clear, defined purpose is fundamental in family businesses. Those businesses with a family united behind that purpose are the most likely to succeed.

The family business system is complicated. Along with the daily challenges of running a business, you have all the complexities that come with being part of a family. It's essential for each individual to understand their role in the family, for the family to understand its role in relation to the business, and for the business to have and uphold its purpose. In understanding and articulating all three of these relationships, you will be able to build on the benefits of family ownership and reduce the risk of conflict or miscommunication.

Understanding why you want to be in business as a family and what your business will look like in practice is essential. If the family isn't aligned around a purpose, difficulties will occur. For example, if most of the family agrees they are in business together for the benefit of future generations, then they are less likely to pursue a strategy that focuses on fast growth and keeps an eye on future sales. If the family believes part of the business's purpose is to provide good-quality jobs for the local community, they won't be looking to relocate. However, if other family members consider the primary purpose of the business is simply to support themselves financially, they may have a different view. Misalignment of vision and goals can lead to family disputes and potentially send mixed messages to the executive team.

In addition to understanding your purpose, it is important for each family member to have their own individual purpose, as well as understand how they fit into the family's goals.

Not every family member will be involved in the day-to-day management of the business. In fact, there may come a day when no family members have an executive or management role. But there are many other ways that the family can be involved in the business that draw on their strengths and passions.

The purpose you set now will go a long way to determining what your business will look like in 100 years' time. For many successful family firms, the core purpose set by their founders still influences how they operate, but that doesn't mean the purpose hasn't been considered, debated and renewed with each generation. For a purpose to truly unite a family, each generation needs to discuss and then buy in to that vision.

Revisiting the company's purpose means that each generation can adapt to the new family and business environment facing them. They can also anticipate challenges and subsequently put structures and policies in place to address them. For example, as family businesses grow, they often include more structured philanthropy. Re-evaluating your purpose gives you an opportunity to decide if philanthropy is something you want to do as a family, or whether individual family members will pursue different routes.

OWNERSHIP

For many business families, their business is not only the key part in their overall financial wealth, but it also has enormous emotional value. For these reasons, the issue of who can be an owner of the business is important; and given the impact it can have in other areas, it's important to be clear why certain decisions were made.

> If you are competing against public companies for talent, it is important to consider how you will attract and retain valuable employees when owning shares isn't an option.

Often, there is a clear preference to keep the business entirely in family hands. For many, that means in-laws will not be owners. If you would like your business to remain solely within the family, then there are two key areas to consider: (1) how your business will attract and reward non-family talent and (2) how you will fund growth in the business.

As a business grows, entrepreneurs need to bring in outsiders who can introduce new skills to help move the business to the next level. This is true of family businesses too. Even those firms that have a family member at the helm will have non-family in senior positions. If you are competing against public companies for talent, it is important to consider how you will attract and retain valuable employees when owning shares isn't an option. That is not to say family firms don't offer their own advantages as employers – longevity, agility, culture and sense of purpose. Understand what makes your business different and how that can work to your advantage.

When looking to grow, many businesses bring in outside investors, giving up equity for investment. This works well for many entrepreneurs, particularly when the outside investors also bring knowledge and experience to support the business. However, if continued

family ownership is your intention, this might not be the best way to fund the business's growth. That doesn't mean all options are off the table, but you must be clear with any potential investors and partners about what your long-term intentions are so that you can work with people who understand your plans.

Deciding whether only family members can be owners isn't the only issue that needs to be resolved. As a family firm continues across generations, the family grows along with the number of shareholders – from a single founder/owner, to a group of siblings, then a larger group of cousins, and so on. Some families manage this complexity with governance structures, which I will explore shortly, but others choose to 'prune the tree'.

For some families, 'pruning the tree' can help the family stay focused on its common purpose and long-term ownership. This can be accomplished by buying out those family members who are not aligned with the idea of reinvesting in the business and prioritise short-term financial gain over sustainable growth and value creation.

Transition of ownership from one generation to the next is a crucial process for all family businesses. Treat this stage as a process, not an event. Business owners need to decide whether they want to pass all their shareholding at one time, or whether they will rely on dividends for their own income later in life. Do you still want to have a role in the business, even if you have stepped away from the day-to-day?

It's important to take professional advice when planning succession for your business, as there are many tax and legal issues to be considered. Some families decide that the best way for them to maintain stable ownership and protect vulnerable family members is to establish a trust. For owners who intend to hold shares for life, there may be inheritance tax implications – or your business may be eligible for reliefs, such as Business Property Relief. Succession planning is important to understand and consider as you make decisions about who will own your business, and how, in the decades ahead.

GOVERNANCE

As businesses grow and mature, good governance becomes even more important. In most businesses, this means robust corporate governance. But for multigenerational businesses, this also includes 'family governance'.

> As the family grows and fewer family members are directly employed by the business, the governance that worked for the founder will no longer be fit for purpose.

Family governance refers to the structures you put in place to manage the relationship between the family and the business. Having a well-constructed family governance arrangement can aid families in building trust, teamwork and a consensus around the role of the owners and their hopes for the business. However, family governance should not replace corporate governance – it is there to complement those structures and roles, giving the family a forum for discussions to speak with a united voice to the board and management of the business.

In family firms, individuals often have dual roles. In addition to being a family member and shareholder, they may also be the managing director. The goal of family governance is to separate family and business issues and decisions. It can also help ensure that family members who don't work in the business feel they have a space to share their views.

The family governance structures also need to adapt and evolve with the changing makeup of the family. As the family grows and fewer family members are directly employed by the business, the governance that worked for the founder will no longer be fit for purpose. Structures that support understanding and communication become increasingly important.

Family governance can take different forms, but the three most common types include:

- a family constitution or charter;
- a family council; and
- family assemblies or meetups.

Because no two families or businesses are alike, it is best if the specifics of these are tailored to your own situation.

A family constitution is a written document that outlines the family values, vision and key policies. The constitution might include policies relating to family member employment, succession, ownership, divorce or the transfer of shares. It can also include a code of conduct for how family members should treat each other and discuss the role of the family council.

A family council is a representative body of family members. In smaller families, all family members may be part of the council. But as the family grows, the council members are often chosen or elected to act as a conduit between the family and the business board. The council acts a decision-making forum – a place for the family to discuss their vision and values for the business to present a unified voice.

A family assembly is an opportunity to bring a broader group of family members together, including shareholders and other family members. It provides in-laws, next-generation family members and others with an opportunity to find out more about the business and any updates. This can be an important part of building trust and allowing family members to have their voices heard.

This kind of family governance is essential if you want to have a successful business and harmonious family in 100 years' time. Establishing structures early supports future success by building a culture of responsible ownership to be passed on to the next generation. Defining policies before issues occur can help address or prevent conflict further down the line.

FUTURE GENERATIONS

Throughout this chapter, I have referred to family members and the next generation. If your business is to remain in family ownership for the next 100 years and beyond, your posterity is a vital part of its success.

Knowing who the future owners will be gives family firms a unique advantage over other businesses. Namely, you are able to plan much further ahead influence the development of the future owners. Engaging and educating the next generation should be at the forefront of any family business leader's mind.

The challenge is, therefore, how you can balance inspiring and educating the next generation without pressuring them into directly following your footsteps. The aim is to raise the next generation to be confident and independent, with awareness and respect for the family legacy but not being overwhelmed by it.

Joining the family business should be a choice, not something that feels like an obligation. Family members who don't want to be working in the business aren't good for the business. At the same time, the next generation should never feel that joining the business is the easy option. They need to build skills, experience and credibility so that they can add something to the business and earn the respect of the both the family and non-family employees.

The challenge is, therefore, how you can balance inspiring and educating the next generation without pressuring them into directly following your footsteps.

The next generation also needs to understand what it means to be an engaged and responsible owner. They need to know what the business does and what it means to the community, as well as its values and their responsibilities as owners.

The children of entrepreneurs can often feel that the business is something that prevents their parents from spending time with them. If you want your business to remain and thrive under family ownership, the whole family needs to feel a connection to the business and understand their role in it.

Encourage the next generation to visit the business and give them the opportunity to get work experience. Structure learning so that it will equip them with the skills and knowledge they need as future owners. Communication is fundamental. Your next generation needs to feel the door is open to ask questions about the business. They need to hear the story of your business – what went right and what didn't. And they need to understand how you overcame obstacles and how you built the resilience to succeed.

As families and companies move further from their original founder, the entrepreneurial spirit can dissipate. The family may not have the same hunger for success now that their lives are more comfortable, or they may be afraid to take risks that could damage a business that had been built by previous generations.

For your business to thrive for 100 years, fostering a culture of entrepreneurship and innovation is essential. This culture should be renewed in every generation to make sure your business stays competitive in a rapidly changing world.

As the entrepreneur, there are steps you can take now to build that enterprising culture in your family. Encourage younger family members to learn about risk-taking and to experiment in developing new ventures. Some families develop a specific fund to invest in next-generation entrepreneurial ventures, ringfencing core assets while giving the space and opportunity to explore new business ideas.

A 100-YEAR VISION

This chapter has explored some of the challenges you will have to consider as a founder of a 100-year-old business. Considering these challenges early will give you an advantage that the longstanding businesses of the past didn't have.

But don't just think about the challenges, think about the benefits. By choosing to be the founder of a family business, you have the opportunity to begin an incredible story. Family businesses touch the lives of every community, and you have the chance to build a legacy that could benefit your family for generations to come.

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FROM ENTREPRENEUR MANAGER TO INVESTOR: FINDING THE NEXT CHALLENGE

LLOYDS BANK AND BANK OF SCOTLAND

Paul Morales, *Head of Private Capital and Family Offices, Commercial Banking*

In the early years of developing a business, the entrepreneur's focus is unsurprisingly operational in nature. Turning a concept into a viable business involves managing a wide variety of roles and responsibilities, from negotiating a lease to selecting a software provider and to implementing an HR policy. While value creation is undoubtedly an objective, the realisation of this value feels far off in the future, as the concept first needs to prove itself as a thriving and sustainable business.

Over time, as the business gains ground and becomes more complex, the successful entrepreneur will switch focus from operations to building the business and scaling its growth. He or she will begin to attract and assemble a management team who will need to possess sufficient capacity and expertise to lead the business in its current state and to steer it into a profitable future, while safeguarding its direction and values.

Subsequently, with the right management team and a robust governance structure in place, the entrepreneur will be in a position to delegate a growing number of day-to-day responsibilities and to transition into a role that is more strategic in character. At this point, the focus rapidly moves towards initiatives that can either accelerate value creation within the business or hasten a liquidity event (e.g. dividend payment or partial sale), thus unlocking some of the value in the business. Importantly, liquidity events act as a catalyst for entrepreneurs to start thinking about both personal wealth planning and future investment strategy.

There are likely to be several conflicting priorities as the prospect of growing the business through reinvestment or acquisitions competes with a new urge to diversify and the ensuing anticipation of potential new investment opportunities. The impulse to seek new ventures also needs to be balanced with the founder's ambitions to, for example, remain custodian of their business legacy, plan for the next generation and support the charitable causes that have grown close to their heart.

Although the answers may vary enormously, ultimately the question for every highly successful entrepreneur is the same: what comes next?

THE ENTREPRENEUR-INVESTOR

Most successful and dynamic businesses will eventually outgrow the vision of their respective founders. However, from the entrepreneur's perspective, this should be considered an opportunity.

At this point in their journey, the entrepreneur will carefully reconsider the value locked in the original business and start benchmarking reinvestment opportunities against the potential returns from less mature (and potentially riskier) ventures or alternative asset classes (e.g. bonds, shares or real estate).

Successful entrepreneurs can spot opportunities for investment as well as the right windows for divestment (whether full or partial) when the business prospects are better under different ownership and the price offered is right.

However, it should be noted that tapping into the value of the original business does not always mean selling up and parting ways. Mergers and acquisitions (M&As) are an option to utilise the original business as a platform to expand into related businesses and markets. Additional ways of unlocking value to invest elsewhere include:

- Dividend distributions (paying out dividends to the entrepreneur and other shareholders).
- Recapitalisation (using the company's debt capacity to raise funds and pay an extraordinary dividend).
- Partial disposal, where just a part of the business is sold off – typically a part with the potential to stand alone and that is a good fit for another business looking to expand into that area.
- Flotation, where the company goes through a regulated process of listing their shares in a regulated stock market. The entrepreneur will usually dispose of a material stake in the business that will trade publicly and retain the option to gradually sell more shares in the future.

Nevertheless, the entrepreneurial spirit rarely disappears, and the founder now has the experience, the means, the motive and the opportunity to take on new challenges.

When reviewing opportunities, the entrepreneur will now have a powerful network to draw upon. The success of their original business, coupled with the respect they have earned over the years, will facilitate their exposure to a whole ecosystem of sector and business contacts and strategic and financial ideas. Investing at this level involves leveraging relationships and affinities, which could be based on sector, geography or even culture and religion. A successful and resourceful entrepreneur will make sure they know of every deal taking place in their patch.

Successful entrepreneurs can spot opportunities for investment as well as the right windows for divestment (whether full or partial) when the business prospects are better under different ownership and the price offered is right.

Networks aren't just about identifying deals – they are also pools of talent and experience to draw from when building management teams to support new ventures or to assist in managing difficult situations (e.g. M&As, turnarounds, internationalisation) within the entrepreneur's portfolio of investments.

It is common to see successful and proven management teams get repeat backing from entrepreneurs across multiple ventures and concepts in sectors such as casual dining. It is also common to see entrepreneur-investors supporting strong and focused management teams in management buyouts. Ultimately, the ability to identify, attract, incentivise and retain high-performance management teams is a key differentiating factor for successful entrepreneurs.

Moreover, with the experience that they have accumulated over the years and their growing external profile, the entrepreneur will be well placed to identify fresh opportunities. For example, these could involve supporting younger entrepreneurs or identifying businesses in need of direction and investment, whether as acquisition targets or standalone new ventures.

Eventually, an entrepreneur-investor may decide that their investment office (i.e. the team of colleagues and professionals that support the

entrepreneur's investment portfolio) cannot commit enough time and attention to new investments on a controlling basis. Instead, they are open to coinvesting alongside trusted or like-minded partners (e.g. venture capital firms or other families) while becoming 'validators' of businesses in their sectors of specialism.

You can think of names such as Peter Jones, Sir Charles Dunstone, Sir Richard Branson, Sir Brian Souter, Chrissie Rucker, Sahar Hashemi, Alex Chesterman, Alan Yu and Philip Day as serial angels, dragons and sometimes white knights in their respective patches.

PERSONAL WEALTH PLANNING

You would think that realising millions of pounds of value from your business would be the easy conclusion to years of hard work. However, wealth planning both towards and following liquidity events is not without its own complexities.

"In many cases there is no one-off, clear 'exit' for an entrepreneur," says Nick Sanderson, Portfolio Director at Cazenove Capital. "The business may be sold in part, or floated, and the founders will obviously benefit financially from this event. But in many cases, they will continue as major stakeholders too – possibly still owning a large shareholding and continuing to play a management role.

"This is why it's vital to start financial planning well ahead of any exit event. It's important to ensure that business shareholdings are correctly structured and owned so as to benefit from entrepreneur's relief as an incentive for reinvestment, and other financial efficiencies."

Where possible, wealth managers typically aim to start working with entrepreneurs two to three years before an exit. However, entrepreneurs rarely step back from their day-to-day responsibilities prior to an exit, meaning they may not have had much time or space to consider wealth planning in any depth in advance.

For an entrepreneur, a major liquidity event such as an exit is a life-changing moment – especially if it's their first one – and it is usually a good idea for them to take some time before making any firm decisions. The entrepreneur will need to assess where they are in their life and career and come to a decision about the right balance of value creation and value protection that lies ahead of them.

"One of the big considerations is risk and where the entrepreneur's own business interests will sit in relation to other investments," says Andrew Towers, Wealth Planning Director at Cazenove Capital. "The right investment planning will take into account any wealth tied up in the family business, which is often a huge consideration. It's why many entrepreneurs need highly specialised advice. People who've built significant businesses and who want to access some of that wealth are likely to have a number of choices about raising capital and drawing income. There could be sales of shares – with the capital gains considerations this brings – and there could be various sources of income including dividend income, earned income from the business and investment income from other assets. Structuring these assets and taking capital or income in a financially efficient way takes foresight and planning."

The wealth management process involves the allocation of elements of the entrepreneur's capital across a series of different investment categories with a balanced spread of risk/reward profiles in a way that is consistent with the entrepreneur's stage of life and career. These categories range from relatively simple, low-risk investments (such as gilts, fixed-income bonds and funds) to more specialist asset classes (such as private equity, corporate investments, art and, of course, real estate). Buying property is a common first step for an entrepreneur starting to diversify wealth.

For an entrepreneur, a major liquidity event such as an exit is a life-changing moment – especially if it's their first one – and it is usually a good idea for them to take some time before making any firm decisions.

Wealth managers bring a useful level of rigour and consistency to the planning process, and they are most effective when their clients are open and transparent about their drivers and aspirations. The idea is to optimise the risk/reward balance through a diversification exercise that considers the entrepreneur and their family's existing investments, personal needs, risk tolerance, liquidity and life events. The strategy is actively monitored and calibrated on an ongoing basis to adjust for changes in the markets, risks and personal circumstances. The planning process also assesses the way assets and investments are owned to ensure that their value is protected for the entrepreneur, their family and succeeding generations.

From the foundation provided by the wealth-planning exercise, the exiting entrepreneur may naturally look to focus their attention on shaping and protecting a legacy, whether for family, philanthropic causes or other interests.

PASSING ON THE BATON: FAMILY AND PHILANTHROPY

Perhaps the greatest benefits of a successful entrepreneurial career are being able to decide when to step away from the business and giving your family a secure platform upon which to build their working future. Though the classic generational succession model has become less relevant in fast-paced tech businesses, where ownership can shift very rapidly, it is still visible in larger corporate groups. Since the plan may involve the transfer of wealth, assets and business control to the next generation (and sometimes to charity), the process can be complex.

Perhaps the greatest benefits of a successful entrepreneurial career are being able to decide when to step away from the business and giving your family a secure platform upon which to build their working future.

"Entrepreneurs tend to face a number of problems as they consider passing their assets on to children or other beneficiaries," says Nick Sanderson. "If there is still a family business in operation, then there will be questions around the future management of the business and whether children will be actively involved. They may not be ready, or they may not want to be involved. The right advice can help; it may be that external trustees or other advisers are needed to bridge the handover, for example. In all cases these advisers will need to have significant experience as well as be able to win the trust of all the family members involved."

Where business legacy or family interest in the business is strong, entrepreneurs tend to stay on longer to ensure that the role of family members is clear and that those involved are fully prepared. In comparison, where the children are not interested in pursuing the business, the founder is more likely to move on sooner.

A further issue is reaching agreement among family members about how the wealth that's been passed on is best utilised. "As the entrepreneur and original founder of the wealth steps back, one of the big issues we see is a need for family members to agree on how that money is to be used in future," says Nick Sanderson. "This is where an experienced adviser can be invaluable – helping family members agree a common aim. Families are made up of individuals, so of course they're different and have different views. But a planned approach, where you've reached some form of consensus, is generally the best way to safeguard the wealth for the long term and avoid potential disputes and divisions."

There are many tools to assist with the preservation and transfer of value and responsibilities over the generations. Family trusts can establish clear rules for the transfer of family wealth across generations. Similarly, the creation of a family office can assist in professionalising and aligning investment policy and management of various family interests.

Family constitutions or charters can be set up not only to articulate guiding principles on family values and strategic goals but also to specify family governance and

mechanisms for resolution of conflict across family members and generations. This could cover areas such as how to manage voting rights and employment of family members in family companies, as well as requirements for preservation of family control over certain companies or assets.

"There are significant tax issues as wealth passes on to the next generation," says Andrew Towers. "Business owners' circumstances often require specialist advice. Some entrepreneurs will want to make generous lifetime gifts to help children, and these will need thought and planning. Others will want to retain ownership until their deaths or devote more of their wealth to charitable causes. There are tax implications in all these scenarios. All families will have their own unique complexities, for example, with assets or family members overseas, and so there may well be a need for highly specialised expertise."

Beyond the planning around the family, philanthropy usually becomes a focus of business and dynasty founders in their later years so they can give back and cement a legacy. Here the entrepreneur's business and innovation skills can be put to good use, for example, by building a strategy, leveraging contacts and finding ways to maximise the impact of donations.

There are many cases of family wealth being transferred as endowments into foundations or trusts, providing them with financial independence to sustainably fulfil their purposes across a number of worthy causes. A good example of this is the Wellcome Trust, which arose from the single largest charitable donation in UK history and remains one of the largest charitable foundations in the world.

A foundation with a clear sense of purpose and mission could also function as an axis that gives structure to the family's legacy and coherence to their values over generations.

LOOKING BACK TO LOOK FORWARD

For a founding entrepreneur, the decision to look at succession planning and consider fresh challenges is not one to be taken lightly. However, as their circumstances evolve, so too will their perspectives on business and life and their strategy for the years ahead.

Whatever they decide to do next, the successful entrepreneur knows that, as they size up their next adventure, they can draw on decades of experience of turning challenges into advantages and translating ideas into realisable, valuable business outcomes.

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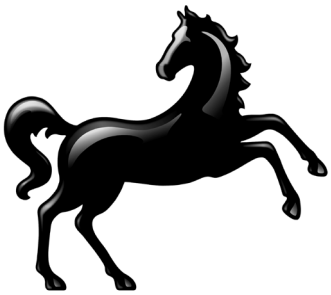

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António Horta-Osório joined the board of Lloyds Banking Group in January 2011 as an Executive Director and became Group Chief Executive on 1 March 2011. Previously, he was the Chief Executive of Santander UK plc and Executive Vice President of Grupo Santander. He was also Chairman of Santander Totta in Portugal until 2011, where he was Chief Executive Officer (CEO) between 2000–2006, and between 1996–1999 he was CEO of Banco Santander Brazil, having started its retail banking activities in the country. António started his career at Citibank Portugal where he was Head of Capital Markets. At the same time, he was an assistant professor at Universidade Católica Portuguesa. He then worked for Goldman Sachs in New York and London. In 1993, he joined Grupo Santander as Chief Executive of Banco Santander de Negócios Portugal. A graduate of management and business administration at Universidade Católica Portuguesa, António has a MBA from INSEAD where he was awarded the Henry Ford II prize – and an AMP from Harvard Business School. He has also been awarded Honorary Doctorates from the University of Edinburgh, the University of Bath, and the University of Warwick. In 2014 the Government of Portugal awarded him with the Order of Merit Grã-Cruz, which is the highest Order of Civil Merit. The Spanish Government in 2009 awarded him the Order of Isabel la Catolica, Commander by Number and in 1998 he was also awarded the National Order of Cruzeiro do Sul from the Government of Brazil. Previously a non-executive Director to the Court of the Bank of England, António is currently a non-executive

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LDC, the private equity arm of Lloyds Banking Group, backs ambitious management teams from UK-based medium-sized companies that are seeking up to £100 million of investment to fund management buyouts or development capital transactions. The firm invests in a broad range of sectors and has a portfolio of 90 businesses across the UK, which collectively generate £5 billion of revenue and employ in excess of 32,000 people. In his role as Head of New Business, Andy Grove has overall responsibility for new investments and plays an integral role in the delivery of LDC's pledge to invest £1.2 billion over the next three years (2019–2022). With more than 20 years' experience, Andy leads a national team focused on identifying ambitious management teams that would benefit from private equity investment, and ensuring they have a strategic partner that can help them to deliver their growth ambitions.

L39

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Ben Brabyn launched his first digital business, Bmycharity, in 2001. It combined payments, social networking and data analytics, enabling 800,000 donors to deliver more than £50 million to UK charities. Shortly afterwards, Ben survived a brain tumour while launching his next digital business, an ecommerce site, and advised various energy, health-care and social media businesses on strategy, finance and business development. Ben then worked for the UK government as Chief Operating Officer of UK Trade & Investment's Venture Capital Unit, leading a team of venture capital and sector specialists. Ben started his career in the British Armed Forces as a Royal Marines Commando. After leaving the Royal Marines as Captain, Ben

joined J.P. Morgan and worked in New York, London and the Middle East. Ben joined Level39 as Head in 2016, supporting 200 high-growth technology companies that are transforming the security, productivity and reach of global financial services and other sectors.

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Daniel Jacob is a Partner at Marriott Harrison and is the head of the Corporate Practice, where the team advises investors, entrepreneurs and companies on venture capital-backed fundraisings, ranging from early seed stage through to later stage investments and exits. Over the last five years Daniel has regularly provided training to entrepreneurs on early stage investment and fundraising issues and advises companies on their growth capital investments.

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David Strong heads up the Venture Capital team at Marriott Harrison and is recognised in the two main legal directories, the Legal 500 and Chambers & Partners for his work in this area. His particular focus is on the technology sector, and he works with some of the leading venture capital funds in the UK on their investments, as well as advising a range of early stage companies on their fundraisings and exits.

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Sive Ozer is a Corporate Associate at Marriott Harrison, with a strong focus on venture capital work (acting both for investors and companies seeking finance). Sive also works with accelerator programmes and regularly delivers talks to and mentors startups and early stage companies. She has a master's degree in Corporate Law.

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Brian Dow is Chief Executive Officer of Mental Health UK, a coalition of four charities across the UK. He is also Deputy Chief Executive of Rethink Mental Illness, one of the founding charities of Mental Health UK. He is a Trustee of Beyond Shame, Beyond Stigma, which was set up by Jonny Benjamin and Neil Laybourn, and is also Co-Chair of the National Suicide Prevention Alliance.

He began his career as a broadcast journalist in Scotland, moving to the BBC in London, and has spent 20 years in the voluntary sector with organisations including Shelter, the School Food Trust and the Royal College of Paediatrics and Child Health.

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Gillian Connor is Head of Policy & Partnerships at Mental Health UK. Gillian has a particular focus on influencing policy and practice related to workplace wellbeing and financial inclusion. She has over 15 years' experience in policy, public affairs and communications in the public, voluntary and housing association sectors.

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Irene Graham is the Chief Executive Officer (CEO) and a board director of the ScaleUp Institute. A former senior banker at Standard Chartered Bank where she held both European and global managing director roles, she set up, ran and scaled several of the bank's key client and product businesses across its corporate and institutional bank and led several global mergers and acquisitions activities. Before joining the ScaleUp Institute, she was Managing Director at the British Bankers Association. She led a host of strategic work across the industry from the regulatory and business perspectives, including leading the Business Finance Taskforce set up by the CEOs of the UK banks, which resulted in the creation of the BGF, the Enterprise Research Centre, the SME Finance Monitor and Mentorsme. She is a Visiting Professor of Entrepreneurship at Strathclyde University and holds a variety of non-executive director and advisory roles across the creative, business and finance communities.

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Josh Robson leads External Affairs at the ScaleUp Institute, engaging at a national and local level to help grow and enhance the UK scaleup ecosystem. He has worked extensively in the private sector, including heading up European public affairs for a large German manufacturer and across multiple industry bodies, representing UK businesses at an international level on key EU-level and global projects. He has advised both business and government on legislation for more than 10 years, including on the passage of three energy acts, the Localism Act and the Digital Economy Act. For the private sector, he has also led negotiations on strategic sectoral changes and investment cycles with Financial Times Stock Exchange 100 companies and with government. He is passionate about innovation and has worked at both UK and EU levels on the nature of disruptive business models in high-growth businesses, the importance of emerging technologies and the need for greater understanding of research and development in highly regulated sectors.

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Carlos Eduardo Espinal is a Managing Partner at Seedcamp, the leading European seed fund that launched in 2007 with a belief that European entrepreneurs have the power to compete on a global scale. With investments in more than 300 companies, including three European unicorns (TransferWise, UiPath and Revolut), Carlos is experienced in identifying and supporting founders from the earliest stage and helping them create the breakout businesses of tomorrow. Carlos is a published author and podcaster and in 2018 made it onto the Forbes Midas List as one of the most influential venture capitalists in Europe.

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Max Kelly is Senior Vice President of Strategy for Techstars. He covers the overall company strategy, product strategy and expansion plan. Before his current role, Max was Managing Director of Techstars London, where he ran the accelerator for three years, investing in 33 companies. Prior to Techstars, Max spent 12 years at Virgin where he ran strategy for the group during its growth from $4 billion to $20 billion revenue. He also co-founded Virgin Mobile USA, one of the Virgin unicorns. In addition, he co-founded Virgin Mobile Canada, Virgin Healthbank and Virgin Insight where he served as Chief Executive Officer. He obtained a First Class Degree in Chemistry at Oxford University.

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Peter Cowley, a Cambridge University technology graduate, founded and ran over a dozen businesses in technology and property over the last 38 years. He has built up a portfolio of 68 angel investments with six good exits and 10 failures. He is the President of the European Business Angel Network (EBAN), chair of the Cambridge Business Angels and was UK Angel of the Year 2014–2015. He has mentored hundreds of entrepreneurs and is on the board of seven startups. He is a Fellow in Entrepreneurship at the Cambridge Judge Business School and on the investment committee of the UK Angel Co-fund. With his son, Alan, Peter is sharing his and others' experience and anecdotes in order to educate angels and entrepreneurs via The Invested Investor, which publishes both a book and over 50 podcasts. Peter is a public speaker on entrepreneurship and angel investing throughout the world.

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Alan Cowley is the Chief Executive Officer and Co-Founder of The Invested Investor. A startup helping startups, The Invested Investor is sharing people's experiences to educate others. Alan has a passion and drive for the growth of the startup ecosystem, sharing the knowledge and enterprise of people from all over the world.

Eager to help early stage entrepreneurs and investors not make the same mistakes. He and his team believe that learning from mistakes and failures leads to greater success. He has an unrivalled passion for the company, not simply because it is a family-run venture, but because from his own experiences he knows all too well that learning from mistakes leads to greater success and that honesty is paramount in any relationship. His varied background consists of ski instructing to fast-moving consumer goods market research to exploratory gold mining.