Legal Update: Growth Finance

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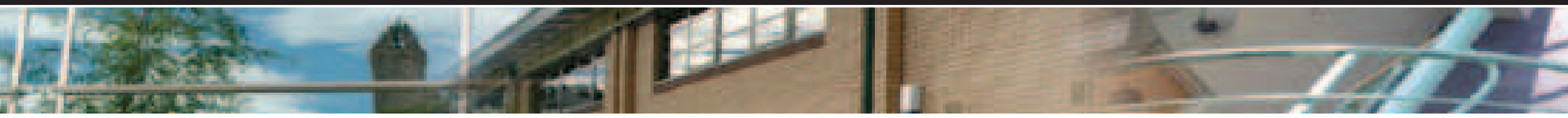

COMMON INVESTOR CONCERNS

Introduction

The investor is looking for a return on its investment. The basis of its investment decision will reflect the risks associated with the investment and the return it wishes to achieve. There are different considerations when investing in a start-up company and in an established business. While every investment is different there are issues common to almost all investments.

A Good Idea Is Not Enough!

A good idea or a perceived market for a new product or service is not sufficient. The investor's main concern is the quality and commitment of the management team. A large part of investor due diligence will turn on the management capabilities of the key directors and any weaknesses within the team from a financial, technical or other perspective.

Investors will seek protection in the form of appropriate service agreements ensuring the commitment of the executive to the company. Such agreements will contain appropriate restrictive covenants preventing competition if the executive leaves the company and protect the company's interests in relation to confidential information, and ensure exclusive attention to the company's business. The future of the investor is tied into the future of the executive in the company.

The Importance of IP Protection

The investor will conduct financial due diligence on trading performance and growth prospects and the likelihood of these being realised. From a legal perspective due diligence will be necessary on the company's ownership of assets. It is increasingly important for investors to assess the existence and protection of intellectual property rights (IPR) within a business, particularly in e-commerce or related applications. It is vital that all IPR is vested in the company the subject of the investment, and not retained by individual directors or shareholders who may have been the creators of the IPR in question, or by another associated company. Much "intellectual capital" or know-how is also inevitably held by the executives themselves hence the importance of service agreements to ensure that these individuals are tied to the company. If any IPR is owned by third parties, whether or not under common ownership, appropriate licence agreements must be entered into and the significance of exclusive/non-exclusive arrangements analysed. In addition, are the rights granted in the UK only or world-wide?

Investor Protections

The main concern for an investor is to ensure an appropriate exit together with an income stream during the investment. Investment funds are only generated from successful exits and the investment agreement and articles of association prepared on behalf of the investor will include adequate controls on the conduct of the business and mechanisms to permit and facilitate the sale of the company. These may include "drag-along" rights to ensure that minority shareholders are required to accept the decision of the investor as to the timing of an eventual sale.

Investors will almost always require to be involved with the running of the company on some level and will wish protections contained in the investment agreement to ensure that key decisions cannot be taken without the investor's consent - for example, any change in the nature of the business, or departure from the business plan or annual budget. The investors will ordinarily appoint a non-executive director who will provide a greater depth of experience as well as protect the interests of the investor in the company. Care should be taken to ensure a good "fit" between the proposed non-executive director and the existing management in order to secure the growth in value which both investors and management seek.

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