CORPORATE STRUCTURE

A business can be run in a number of ways. From having the initial idea, one person alone, or two or more persons together in a partnership, can commence running the business without needing to register as a legal entity. This has the advantage of keeping both costs and administrative burdens low, which is essential at the outset of starting a business. The founders can choose a trading name and can enter into commercial contracts but the contracts would have to be in the name of the sole trader or one of the partners. That person then personally takes any risk of outstanding debts or claims under that contract (although such risks can be shared among the founders by way of a partnership agreement).

Once your business starts to grow, there are certain reasons why it becomes desirable, or necessary, to set up a legal entity under which the business shall be run. There are a number of options for this, but the limited liability company is the most common.

Once a limited liability company is incorporated, it is the company itself, rather than one of the individuals, that enters into contracts. The liability of the company itself is limited. The company is responsible for any outstanding debts or claims arising out of any contracts and the individual founders are therefore (other than in certain circumstances such as fraud) protected from any personal risk.

A law firm can incorporate a new company for you, assist with the filing requirements and can also be your registered office, all to ease the burden of holding a limited company.

Funding

To enable your idea to grow into a successful business, some initial funding is most likely required. Your small business, like many others may initially secure investment from individuals, such as friends and family or other more experienced investors (the so-called "angel investors"). Whilst at the outset investors may be happy to invest a sum of money as a loan, as your business grows a more sophisticated investment structure is required and, if it hasn't been done already, this is usually the time it becomes necessary to incorporate a limited company.

What is Equity?

The owners of a limited company hold shares in that company (also called "equity") and it is usual for investors to want to hold a certain percentage of those shares. There are a number of things a founder should consider carefully before agreeing to an equity investment. These include:

- day to day control and directorship – does the investor have the right to get involved in the running of the business, and if so should they be appointed as a director of the company, or are they just a "silent investor"?
- shareholder voting rights – should the investor have a proportionate number of votes to the number of shares they hold (and therefore potentially be able to force or prevent the company from doing something)?
- does the investor obtain a proportionate percentage of any dividends and any profits on a sale or winding up, or should there be some other arrangement?
- is it likely there will be further investment in the future? If so then consideration should be given now as to the ultimate proportion of shares the founders wish to retain going forward.

  Clear legal advice can assist you in discussing the various options available in respect of investment and putting the right documents and structure in place to ensure you have the best protection to continue growing and reaping the rewards from your business.

Collaboration in Action

We advise a reputable body care supplier based in the north-west of England. The company had initially been funded by the individual founders and had seen significant growth. At first, we advised the company on a reorganisation of the share capital, so that one founder bought the shares from the other founder. This enabled the realisation of profits for one founder while enabling the other founder to go ahead and continue to grow the business. Following this, we advised the company on the investment by the Business Growth Fund, an investment fund which makes investments of around £2m to £10m for a minority stake. The investment provided further realisation of profits for the founder while providing necessary funds to the company for further expansion. Being a minority stake, the current founder and management team are able to retain day to day control while BGF provides expertise and experience to assist the company on the next stage of its journey.