ST. JAMES'S PLACE
WEALTH MANAGEMENT

ENTERPRISE

HELPING BUSINESS OWNERS SUCCEED

ISSUE 12

ENTREPRENEUR TO ANGEL

You've built and sold a successful business – so what's next? Many prudent entrepreneurs turn to 'angel investing' to help other businesses grow.

Angel investing is fast becoming the go-to source of funding for start-up owners looking to take their businesses to the next level. In 2015, a record £1.8bn was invested in 3,265 ventures through the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS)[1]. Unlike venture capitalists, angel investors generally take a longer-term approach, providing 'patient capital' and investing on the basis that they may not see a return for up to a decade, or indeed any return. Furthermore, they bring the benefit of their experience to the businesses in which they invest.

"One of the most important things about angel investing is it's not just about the money you're bringing to the business," says Jenny Tooth, CEO of the UK Business Angels Association. "It's a very personal thing, identifying the businesses you want to invest in and knowing that you'll be able to help them post-investment, bringing advice, support, contacts and customers – all the things that will really make a difference."

From the point of view of the entrepreneur, this is all good news. But what's in it for the angels themselves? For many, a wish to help and support others while keeping their 'hand in', so to speak, underlies the decision to provide funding. But there can be sound financial benefits, too. Although angel investing is regarded as high-risk, with some 58% of deals[2] not returning the original investment, many businesses supported by angels do go on to enjoy significant success. And valuable tax breaks are available for investors under the EIS and SEIS.

Spreading your wings

So how do you go about becoming an angel investor? It's not as simple as just finding a promising business and getting out your chequebook: regulations are in place to protect both investors and business owners. First, you will need to self-certify as a high net worth or sophisticated investor, which entitles you to receive business plans and make investments through your own decision.

Typically, angel investors will provide between £5,000 and £150,000 in

Continued on page 2

Welcome to Issue 12 of Enterprise, the publication produced three times a year on a variety of subjects that we hope will be of interest to business owners and those who run businesses.

The aim is to make the articles topical and, in order to maintain breadth and variety, contributions will come from St. James's Place and individuals in organisations with whom we work.

We will be delighted to receive any feedback, in particular ideas for topics that you would be interested to hear about.

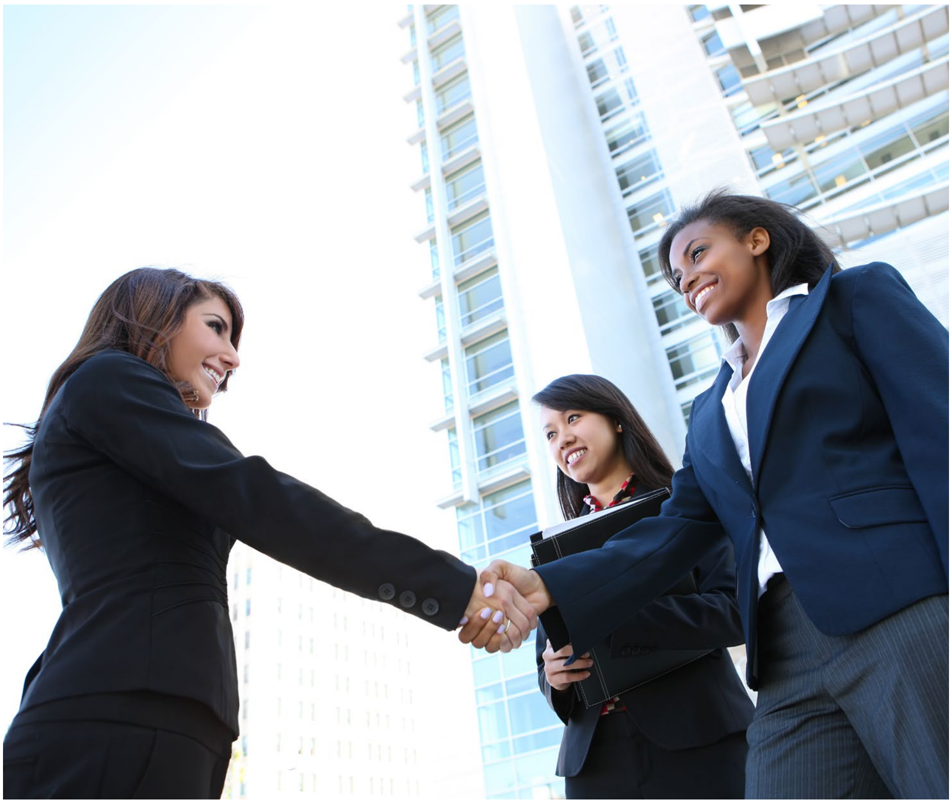
In this issue:

Entrepreneur to angel – *continued*

funding to single ventures, in return for a shareholding of no more than 25%, in order to ensure that business owners can hand over additional stakes in future rounds of fundraising. In order to mitigate risk, you will need to diversify your portfolio and invest in multiple start-ups. To make this possible, as well as sharing risk and reducing the burden of due diligence, many investors join together in syndicates, either formally or on an ad-hoc basis.

"I think it's very important to invest alongside others, especially in the early stages of becoming an investor," says Tooth. "To work with and learn from people who have already been through the due diligence process will help you with your own decision-making. You might also have the skills and experience to become a lead angel – someone who has more involvement in the company and really brings hands-on help on behalf of your fellow angels.

"The beauty of the syndicate model is you're spreading the time you spend. You're sharing risk, sharing decision-making. Companies will also need further rounds of finance, and as a syndicate you're more likely to be able to pull that together and have the firepower to follow those deals through. You've also got more muscle in terms of negotiations when you're investing alongside others such as Venture Capitalists."



Where to invest

With a host of promising start-ups out there competing for funding, from property developers to app developers, pharmaceutical companies to caviar farms, there is no shortage of investment opportunities. Most would-be angels invest in an industry in which they have experience, so they can bring expertise as well as cash to the table. Look for a management team that has the right blend of skills, experience and attitude to build not only the business but a long-term working relationship with you, the investor.

Beyond that, investors should ask themselves whether the business has the potential to address a real gap in the market, to be disruptive, and to change their industry or society more widely. Assess the market in which the business operates: what competition is out there, does the entrepreneur hold a defensible position in the market, and how scaleable is their business model?

Finally, look at the nuts and bolts of the deal: the valuation of the business, the proposed shareholding, the potential for growth and exit, and the extent of your role within the business.

By working alongside other investors, you can greatly enhance the benefit you bring not only to the business you're supporting, but to yourself as an angel, says Tooth. "The best investing happens when investors know each other and each other's skills and can build trust and a relationship through the due diligence process and post-investment, drawing on one another's skills and knowledge."

Please note that this is unlikely to be the first option for businesses raising finance, as there will be conditions attached by the fund managers to any agreement reached which, by their nature, will be more onerous than those imposed by a mainstream lender.

An investment in an EIS or VCT will only be suitable for sophisticated investors willing to take a high risk with their capital as there is a risk an investor may lose some or all of their capital if the company invested in fails. Also, they are fairly illiquid and as such investors must be aware they may have difficulty, or be unable to realise their shares at levels close to that which reflect the value of the underlying assets.

The levels and bases of taxation, and reliefs from taxation, can change at any time and are dependent on individual circumstances.

[1]www.gov.uk statistics on companies raising funds Oct 2016. [2]UKbusinessangelsassociation.org.uk, 2017.

THE ART OF THE DEAL

You may have a great product, but if you want to expand you'll need great negotiating skills too.

Entrepreneurs who find negotiating deals painful can find comfort from swimwear accessory group Halto. The company, which sells a device for use on halterneck bikinis to prevent bruises and blistering, has landed contracts with manufacturers and lingerie retailers such as Bravissimo, since launching in 2012.

Co-founder Lucy Cox says developing negotiating skills has been crucial. "We have learned a lot!" she explains. "You need to know your worth before starting any negotiations. This could be your own numbers, what customers say about you, how you differ from the competition and what value you can add to the client."

Deal making

It's often tricky for entrepreneurs, who may be experts in their own fields of, say, design or technology, to master the art of the deal.

"Negotiations cut across everything an entrepreneur does," says Clive Rich, a lawyer and owner of negotiation consultancy Rich Futures. "Whether it is dealing with investors, manufacturers, shareholders or suppliers you need these skills every day. But often entrepreneurs don't plan and try to mimic someone they have seen on TV, like Alan Sugar. They get lost in negotiations."

Tim Cullen, programme director, Oxford Programme on Negotiation at the Said Business School, adds: "Entrepreneurs are naturally competitive. But that is not necessarily an advantage in negotiation. It is not a competitive sport. It is about stepping into the other person's shoes and understanding their point of view."

Be prepared

Before any negotiation begins he advocates clearly determining what you want to achieve. "What do you want to get out of it? What is it that you desperately need or what could you possibly give away?" he asks.

This preparation includes gathering information on whoever you are negotiating with. "Talk to people who have previously negotiated with them and research them online. What are their motivations? What are their preferences, foibles and strengths? Maybe meet for a coffee beforehand to get to know them better," he says. "Not enough people focus on the person across the table."

Rich says more understanding can be garnered during the negotiations. "Spend a third of your time talking and the rest listening," he says. "Most people go in fixed on what they want and don't allow feedback from the other side. Listen out for clues about what is motivating your counterpart and what sort of person they are. It will help you find common ground."

Best behaviour

Entrepreneurs must also be aware of their behaviour – their words, voice and body language. "There are 'I' behaviours such as 'I want this, I want that'," explains Rich. "'You' behaviours are softer such as 'What do you think about this price?' and 'We' behaviours are where you share problems and solutions. Ask yourself if you are using the right behaviour for the right negotiation stage and with the right person. The 'I' behaviour can be useful in the cut and thrust of bargaining but is not good at the early stage when you are building rapport."

Behavioural biases must also be managed. One of these is called 'non-rational escalation of commitment' in academic circles. Cullen explains: "An example would be when you keep lowering the price to get what you want until it gets to a point where it is not profitable. You become irrational and give too much up."

Cox of Halto is aware of this problem. "In high pressure conversations, it is easy to just agree to the terms if it means you win the contract. By having a firm understanding of your lowest negotiating point you can confidently negotiate and make an agreement," she explains.

Another problem is confirmatory bias. "You are too gung-ho and only note information that confirms what you already believe," Cullen says. "Again, you don't fully listen to other points of view."

Finally, common sense also plays a part.

Cox states "Just being a trustworthy, easy person to get on with goes a long way. Also, don't be afraid to walk away if your gut tells you that they would not be good people to work with. Stay true to your values."

THE VICTORIANS STILL REIGN OVER US

Linder Myers Solicitors consider how a 127-year-old legal 'default' can impact the future of a business.

Home start-ups and small businesses are on the increase and, in some cases, are growing and expanding into very successful enterprises. What is often overlooked, especially when the business is started by close friends or family members, are the legal issues. The idea of seeking legal advice can be seen as too formal or an unnecessary expense.

What is not understood is that when two or more people come together for a common purpose in business, then in the absence of a written partnership agreement or deed, in legal terms, this is known as a Partnership at Will. If relations sour or things go awry, a Partnership at Will means that any dispute is governed by legislation dating back to Queen Victoria's reign – the Partnership Act 1890.

Whilst there are many things we may wish to thank the Victorians for, most of us do not want our business arrangements in the 21st century, dictated to by a law that is 127 years old.

Under the Partnership Act 1890:

- There is no general right for a partner to ever retire from the business. However, any partner can serve notice to dissolve the partnership and no reason needs to be given. Serving a dissolution notice could have disastrous consequences such as the sale of the partnership's assets and property
- If a partner dies or is made bankrupt the business is dissolved
- Regardless of the level of individual involvement in the day-to-day management, profits and losses are assumed to be shared equally.

Partnerships at Will are inherently unstable structures and so having a partnership deed is nearly always the preferable option. In brief, a partnership deed is a written agreement between the partners of the business and sets out the rights and responsibilities of all those involved. It will cover such matters as:

- Ownership – if the partners have an equal share
- Control – whether one partner can make decisions alone or if some decisions such as incurring a certain level of expenditure, must be joint
- Roles and responsibilities – what contribution either in terms of time and/or money each partner is expected to make
- Profits – how these should be shared
- Liabilities – if the partners are responsible for these in the same ratio as the profits which may not be the case for example, if one partner is an investor
- Termination – in what circumstances the partnership can be dissolved and wound up
- Exit terms – when partners can exit the business and what happens when they do
- New partners – in what circumstances a new partner can join and on what terms.

There are many reasons why a business should have a partnership deed:

- avoidance of conflict in the event of a dispute arising
- clarification of an individual's duties and responsibilities
- stability which may also be important if investment is required
- protection for those involved in the business
- evidence of good working practice.

However, it's not just start-ups and small businesses that default to a Partnership at Will arrangement - many professionals run their businesses without a partnership deed and hence, as a Partnership at Will.

Even a partnership which is governed by a deed should review the deed at least annually to ensure it correctly reflects what the business is doing and that the business and the deed comply with current legislation. There are specific circumstances where a review is essential including:

- Change in profit shares
- A partner retiring
- A new partner joining
- Sale of partnership assets such as the premises.

Partnership deeds can, in many cases, avoid a conflict arising, but if there is a dispute, the cost to resolve it can be several times greater when there is no partnership deed in place. Most importantly, it gives the partners choice on how they wish their business to be conducted, and means they will not be dictated to by a Victorian statute.

Please note that advice given in relation to this topic involves the referral to a service that is separate and distinct to those offered by St. James's Place.