SHOOSMITHS

Management controls

(board structure, investor consents and information rights)

FOR WHAT MATTERS

Institutional investors will want to ensure they can properly manage their investment and, as such, will look for certain controls within the deal documentation in order to help safeguard their investments.

Some of the key items you will see in pretty much all term sheets include:

Board representation and structure: investors will want the ability to monitor their investment and have a say in the running of the business, though founders will want to ensure they maintain a level of control and that there is a good balance between founder and investor interests.

- Investor director appointment rights – these can be absolute appointment rights or dependent on the investor's percentage shareholding;
- Board observer appointment rights – as above, and/or where no investor director is appointed;
- Board composition – an investor may require more than one investor director, a maximum number of directors comprising the board, quorum required before a board meeting can go ahead and consent rights over board appointments; and
- Founder director(s) – investors may require a founder to appoint him/herself as the founder director if s/he holds shares and is an employee, rather than the ability for a founder to appoint anyone at their discretion and for this right to fall away upon being a leaver. An investor will be "investing" in the founders too, and so they will want to ensure that the dynamics of the board sit right with them.

Consent items: these prevent founders from taking actions which may dilute investors, invalidate their SEIS or EIS or VCT tax reliefs or negatively impact on the value of investors' investments, however, too broad or onerous consent items can lead to problems down the line and impact on founder productivity and decision-making if they're constantly needing to ask permission to make a decision. We'd typically expect to see consent items broken up into two categories.

- Investor consent items –
  - these tend to be more strategic, bigger picture items, for example, changing the company's articles of association, adjusting the company's share capital, commencing administration or insolvency proceedings and negotiating or permitting a sale of the company or an IPO.
  - investor consent can come in various forms, for instance, requiring the prior written consent of the holders of the majority of the preference shares, or requiring the prior written consent of the lead investor (or a number of named investors).
- Investor director consent items – these tend to be more business-focused, for example, incurring capital expenditure above a certain amount (i.e. in the budget), making material changes to the nature of the company's business and entering into material or onerous contracts.

Information rights: these impose contractual obligations on founders (and the company) to provide certain financial and business information, within certain timeframes, to investors. Founders may push back on timings for compliance and the extent of reporting required, however, the inclusion of information rights is likely to be a non-negotiable for investors.

- Information often requested includes detailed budget and cash flow forecast, management accounts and a schedule of the company's issued share capital and any warrants or options.