

Controlling structuring risk for Business Angels



by Andrew Ireland and James Millea

Business angels investing in private companies is typically a high risk undertaking. Apart from needing to assess the opportunity of the underlying enterprise or product range, the opportunity for its growth, the calibre of the executive personnel involved, the integrity of the information management within the enterprise and the future anticipated financial and participation involvement required, the business angel also needs to assess the structuring issues. All these make for a complex matrix of risk assessment, whereby more opportunities are passed over than pursued.

Assuming the business opportunity being assessed passes most of the preliminary criteria set by the business angel for serious contemplation, then the angel must address structuring risk.

A private company is very different to a public listed company which usually attracts passive shareholder investors who typically rely on boardroom accountability, a strong executive, a rigorous related party protocol, takeover protection provisions, 15%+ threshold for equity raising protection, alignment of shareholders interest, significant information disclosure, a recognized dividend policy and market quoted securities (which reflect the market's assessment of the above criteria at the same time as valuing the underlying enterprise business).

Business angels must ensure that they build into an investment in a business opportunity arrangements which address their structuring risk. Although it will be different for each business opportunity having regard to various matters including the corporate structure already in place, the development stage of the enterprise, the time horizon for exit and the like, the most pragmatic form of managing structuring risk is by way of a shareholders agreement. The purpose of a shareholders agreement is to tailor and marry the business angel(s) requirements with those of the business owners. In reality a shareholders agreement addresses what would otherwise be potentially the application of prejudicial terms of the Corporations Act or the constitution of the corporate entity.

Typically, a shareholders agreement would contemplate various matters including board composition, shareholders rights to appoint directors, chairperson's role, matters requiring board approval, principle objects and business plans, policies management control and procedures, related party transaction protocols, information rights, matters requiring member approval or special approval, deadlock

provisions, pre-emption rights, tag and drag along rights, dispute resolution provisions and amendment rights.

By prudently addressing structuring risk both the business angel and the business owner can focus on the more challenging and more interesting objective of creating wealth and maximizing returns from the business enterprise. If they do not properly address structuring risk, they may be continuously looking over their shoulders and waste energy and focus on structural protection issues.

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