Getting Over The Hurdle

Companies often use equity incentives to reward key members of their workforce and attract and retain the best talent. In the UK, companies have typically granted EMI options (a government-backed, tax-advantageous share option) or unapproved options. However, where a company is unable to grant EMI options (for example, because the company is not sufficiently 'independent', the company's gross assets exceed the relevant threshold when the option is to be granted or the individual is not an employee of the company) and it does not want to grant an unapproved option, then growth share schemes can be used as an alternative.

The principle behind growth shares is that they only participate in the growth of the company from the date they are issued and the right to receive a return on exit in respect of the shares is only triggered if the value of the business increases above a 'hurdle' threshold. Growth share schemes can be tax efficient and attractive for companies and individuals, if they are structured in the right way.

With regards to implementation, the company's articles of association will be amended to create a new class of growth shares, which are then issued to the individual. Key considerations for the company include what rights should attach to the shares (for example, whether the shares will have the right to vote and/or the right to receive dividends) and where the hurdle should be set (ideally, backed by a third party valuation). In many cases, an individual will sign a growth share subscription agreement with the company, containing details of the hurdle and bespoke vesting or leaver provisions.

Whilst such schemes do not need to be approved by the UK tax authority (HMRC), tax is still a key area to consider, for both the company and any holder of growth shares, including how they are taxed on issue and any tax that is payable at exit, such as an IPO where the growth shares would convert into ordinary shares. Tax and legal advice should therefore be sought before implementing any growth share scheme.

Pressing the Accelerator on Growth

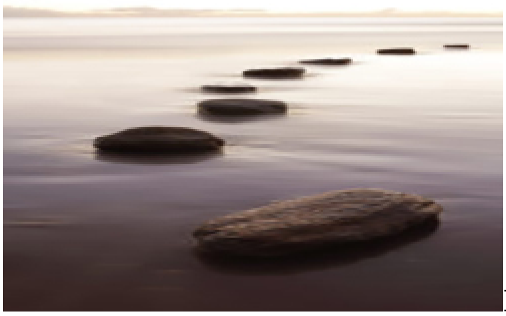
**What is an accelerator**? An accelerator is an entity that provides a fixed-term, cohort-based program designed to accelerate growth and support disruptive and innovative early-stage businesses. They can be generalist or specialist and are located all around the world.

Who are they? Probably the most well-known accelerator is Y Combinator (US), which is active in most sectors, including life sciences. Other particularly active biotech and life science accelerators include JLabs (US), Startup Health (US), BioCity (UK) and Illumina (US). Closer to home of the authors are Accelerate@Babraham (Cambridge, UK) and Start Codon (Cambridge, UK), which debuted its first cohort in 2020. Not all accelerators are the same though, so it is important to do the research to ensure they are the best 'fit' for the business (stage, location, specialism, oversight and financing level).

What do they do? There are many reasons why founders are attracted to an accelerator program. They provide an intense and immersive education in the life of a start-up, covering strategy, sales, marketing, communication, risk management, finance and legal matters. Perhaps the most popular reason is mentorship from experienced practitioners, investors and entrepreneurs, whose advice and relationships can be vital as the company grows. Although the level of financing is not normally substantial, it is nevertheless welcome and participation in a program can sometimes make future fundraising easier, as supported by the statistics. Therefore, it is crucial to maintain and leverage new connections with angel and institutional investors during and after the program.

Why are they important? Starting any business is difficult and can be isolating. As a result of lockdown and social distancing measures, isolation is a key concern for many and so building a business and developing relationships is even more challenging. Accelerators do not guarantee success and are not the only route, but they can provide valuable access to a community of entrepreneurs and mentorship and drive a business forward in a protected environment.

Tranched Investments in Troubled Times

Investments in early stage life sciences companies often

provide that payments are tranched over time, subject to satisfying agreed milestones. This is normal, but in this abnormal market, stakeholders are approaching tranched investments with more caution.

As a starting point, where milestones and other completion conditions are met, the investor should be contractually obliged to invest the next tranche. To facilitate this, operational milestones should be objective tests and completion conditions should involve clear deliverables for the company. However, unforeseen events may challenge the tranched structure that was originally agreed when the initial investment was made.

In the current climate, R&D-focused business models of life sciences companies are under pressure. Specifically, as the effects of COVID-19 crystallise, there has been an impact the ability to carry out R&D, particularly where it involves third party contractors, laboratory testing and evaluating patients during clinical trials. Where R&D is able to continue, the pace at which it is moving is generally slower. This is particularly difficult for companies that rely on tranched funding from investors linked to satisfying specific milestones.

Consequently, where companies are mid-way through a tranched investment round, parties may consider adjusting them to allow for smaller and more frequent tranches or adjust the associated triggers. In circumstances where a milestone has not been met, an investor may be persuaded to waive the milestone to invest the next tranche earlier than planned. Where a milestone has been met, if the investor does not invest the agreed amount for whatever reason, the company may consider what the ramifications on the investor’s preferential rights should be.

Tranched investments are not an option to invest. However, in these times, flexibility may be needed and regular communication between companies and investors as to what is appropriate at the time is essential.