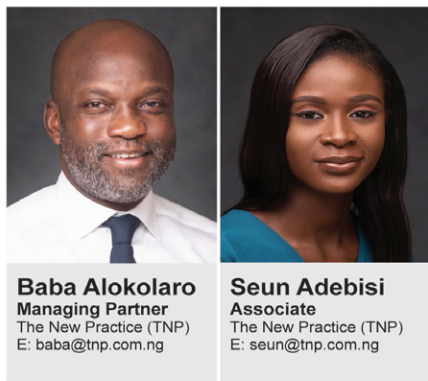


The New Practice (TNP) - An Andersen Collaborating Firm



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Keeping Your Shirt On

Having a great idea and building it out into a viable business could be quite daunting and difficult in a harsh business climate like Nigeria. Any founder who can build a company from the ideation stage to a certain level, surely deserves some accolades. In discussing the challenges faced while building their businesses, founders would often narrate their experience on how they bootstrapped, faced regulatory hurdles, had difficulties accessing funding to build their products, paying themselves little or no salary to keep the business afloat, and working hard to keep their team constantly motivated, even in the face of dissipating revenues. Somehow, these founders are able to surmount the hurdles and achieve a degree of success, while still maintaining complete control and ownership of their companies.

Although founders can be credited with laying the foundational stones of a business, this may however not be sufficient to enable the company take advantage of opportunities and scale. To sustain a business and eventually scale or expand, founders have to seek funding, which normally entails bringing in lenders and or investors.

This is the stage where founders may be faced with the harsh reality that they may need to give up an element of control or ownership of their businesses. Founders are visionary. They can dream dreams and execute that dream – its their passion. However, investors are largely focused on the bottom line and profitability. So, whilst the founder is able to create that business and its products along the lines of his/her dream, the investor coming in will largely be looking at how to make the business more profitable in multiple dimensions. With these almost conflicting values, some founders may come to face the reality of losing certain levels of control of their company, from board positions, appointment of C-Suite executives to significant amounts of equity. With this, is the additional reality that, where the founder is no longer in control of the board, his/her or her role as the Chief Executive Officer (“CEO”) of the company becomes uncertain.

One acknowledges how incredibly tough this situation could be, considering that a founder would have nurtured and built the company to a certain degree, only to have to relinquish

ownership and or control to keep the business going. The truth is, the founder needs to realize the company is no longer his or her own, it now has a life of its own and the umbilical cord has been severed. Some founders realising this, attempt to resist giving up ownership or control - but largely, this rarely augurs well for the business. The founder’s emotional attachment with his/her or her business indeed fuels the belief that the business will stand a higher chance of succeeding as long as he or she is in charge (failing to realise this may be more along the lines of their vision). Whilst such attachment, overconfidence, and naïveté may be crucial at the early stages of setting up the business, and getting it up and running, it is these kinds of feelings that later create problems for the growth of the business. But then again, the founder’s vision may not be growth, it may be fame, validation, pride or any other emotional feeling completely unconnected with business.

Now, there are two choices here; take the road less travelled – by taking less of a stake in your business and let the experts who know how to catalyse business growth take the business to the next level, or maintain your pride and control of the company, with the possibility of watching it plateau or fail. In our view, it is better to hold on to a 25% of something as against a 100% of nothing. It is important for founders to accept that when the need to raise growth capital arises, the harsh reality of business sets in – he who pays the piper, must certainly dictate the tune. So, the choice then becomes whether the founder is willing to keep his shirt on.

Smart founders have to understand the need to be less emotional at the point when their business requires growth capital. When you discover a unique product, process or service, and have decided to exploit it by starting a business, then it’s absolutely imperative that you don’t get yourself kicked out from the company you created and helped grow. To do this, founders need to ensure certain investment terms are properly negotiated, from the Term Sheet stage through to the Investment Agreement and Shareholders Agreement. With a proposed equity investment, founders must make sure the terms below are in place, at a minimum. They must also make sure they seek independent legal and financial advice.

Pre-Emptive Rights

This allows the founder along with the other shareholders of the company to purchase any shares newly issued by the company. In other words, in the event of any proposed issue of new shares, the company will first offer the shares to the existing shareholders at a price and upon terms determined by its board, in proportion to their existing shareholding in the company. This a a right that should ensure the founder doesn’t get diluted and can maintain

his/her percentage ownership in the company. Let’s not forget though, that the founder still has to pay for these shares.

Right of First Refusal

Having this in place, should help ensure the founder is the first person offered any shares for sale by an exiting shareholder in the company. With this right, the founder has the opportunity to buy out his/her investor when exiting. From a realistic point of view, it’s important to mention that the founder must have the capital to buy the offered shares.

It is instructive to mention that whilst a pre-emptive right is focused on the issue of new shares by the company (here the company sells), a right of first refusal involves the sale of shares by one shareholder to another.

“**Founders need to have a mindset shift on ownership and control. If the founder’s motive is indeed the company’s growth and expansion, then he/she needs to realise quickly that he/she may have to give up control of the company he/she helped build, no matter how painful it feels. The sooner this mindset shift occurs, the better.**”

Tag-Along Rights

These give shareholders an opportunity to sell their shares in the company in the event another shareholder (usually the majority shareholder) is selling his/her stake in the

company. Essentially, where a shareholder proposes to sell his/her shares in the company to a third party, the selling shareholder(s) would be compelled to secure a binding agreement with the third-party buyer, to purchase their shares on the same terms and conditions as the selling shareholder(s). The Tag along rights ensure you are not left behind in the event of a sale by another shareholder.

Reserved Matters

This is an area where the founder could get creative, by insisting he/she must be part of certain decision-making processes. And at the point of investment, the investor truly shouldn’t have a problem with the founder’s participation and or approval. Accordingly, the founder may demand that certain decisions concerning the company cannot be made without his/her approval. Some of these matters may include the following:

- the transfer of the whole or any material or substantial part of the undertaking of the company.
- capital expenditure.
- any amalgamation, merger or other reorganization of the company.
- the creation or subsistence of any encumbrance over any of the company’s assets.
- the creation of a subsidiary or acquisition of any material interest in any business or company.
- entering into any monetary contracts, transactions, or arrangements that exceed a certain sum with any shareholder or an employee officer, director, affiliate, shareholder of the company.
- the appointment, dismissal, powers and remuneration of the CEO or other executive officers of the company.
- granting options over the company’s shares, debentures or other securities or restructuring of its share capital etc.

The list is inexhaustive. Depending on how good a negotiator the founder and his/her advisers are, they may be able to convince the investors to agree to some of these matters.

In all, founders need to have a mindset shift on ownership and control. If the founder’s motive is indeed the company’s growth and expansion, then he/she needs to realise quickly that he/she may have to give up control of the company he/she helped build, no matter how painful it feels. The sooner this mindset shift occurs, the better. The founder can then begin to consider realistic ways to protect himself/herself and ensure that he/she is not ultimately pushed out from the next big thing.

Disclaimer: This article is provided for general information and educational purposes only. It should not be construed as legal advice from TNP or the authors. We advise that you seek legal and or other professional advice on issues raised in the article.

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