GUIDE

# Venture capital: Series A preference share financings – why you should use the BVI

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## Introduction

While new business founders (**Founders**) are often highly entrepreneurial and capable of coming up with brilliant business ideas, they are sometimes unfamiliar with even the most basic corporate concepts. In some cases, they may not have formed a company, held shares or acted as directors before.

So when confronted with the prospect of forming a company, it is natural that Founders may look to their peers and predecessors and try to replicate previously used corporate arrangements. 'If it worked for them, it can work for us, right?'

In some jurisdictions, it is possible to incorporate a company over the internet very quickly, even without the involvement of lawyers. While this may save costs at the outset – which is, of course, crucial to Founders – it is important that the type of company and jurisdiction that is used will offer excellent flexibility for: (i) decision making; (ii) future funding options; and (iii) expansion.

During the early years of a start-up, most of the Founders' time will be spent on product development and getting things off the ground – and not worrying about the corporate structure. However, things get more complicated (and stressful) when external investment is required.

It is therefore vitally important that the choice of company and jurisdiction will facilitate the needs of all parties – Founders, investors and employees.

## Series A Financings

The first round of external financing for a start-up may well consist of an investor (the **Investor**) (eg a venture capital firm) acquiring ownership in the company in the form of preference shares.

Ownership of the preference shares may bestow certain important rights in favour of the Investor, for example:

- entitlement to dividends;
- anti-dilution;
- voting;
- put and call options;
- conversion rights;
- preferential redemption terms; and/or
- preference on liquidation.

Typical documentation for a Series A Financing may include some or all of the following:

- a purchase agreement;
- a subscription agreement for the preference shares;
- a shareholders' agreement;

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- an investor rights agreement;
- rights of first refusal, drag and tag-along and /or put and call option agreements;
- a voting agreement;
- director service contracts; and/or
- a share option plan.

## Why the BVI?

The BVI is internationally recognised as a well regulated jurisdiction with a robust legal system that actively engages and cooperates with foreign governments and supra national bodies to ensure that its regulation meets international standards.

The BVI Business Companies Act 2004 (the **Act**) is widely regarded as one of the most progressive corporate statutes in the world.

BVI 'business companies' are the most commonly used offshore vehicles in the world and are familiar to international investors.

## Advantages for Series A Financings

A BVI company has many advantages in the flexibility it offers for: (i) decision making; (ii) future funding options; and (iii) expansion. Here are a few:

- **Decision making**: compared to other jurisdictions, the Act offers a huge degree of freedom in choosing whether decisions are to be made by the directors or shareholders. It is possible to disapply numerous provisions of the Act and there are therefore few statutory shackles. It is also possible (but not required) to specify different thresholds for different shareholder votes (eg 50 per cent, 75 per cent, 90 per cent. Unlike other jurisdictions, there is no statutory requirement for certain actions to be approved by a 'special resolution' of the shareholders.
- **Corporate governance**: another key point for Series A Financings is that, unlike other jurisdictions, the Act permits a director to act in the interests of its appointing shareholder when carrying out a joint venture, even though it may not be in the best interests of the company.
- **Directors**: there are no requirements for directors to be resident in the BVI.
- **No share capital and can have no par value shares**: unlike other jurisdictions, share capital is an outdated concept in the BVI. A BVI company will simply have a maximum number of shares it can issue. It is also possible for a BVI company's shares to have no par value. These aspects help make the determination of the number of shares for the Investor and the issue price very straightforward.
- **Simple to make distributions and dividends**: the Act provides a simple regime for making dividends. Subject to the company's memorandum and articles of association, the directors may authorise a distribution if they resolve that they are satisfied, on reasonable grounds, that, immediately after the distribution, the value of the company's assets will exceed its liabilities and the company will be able to pay its debts as they fall due. So the focus is on solvency, rather than – as is the case in other jurisdictions - on making dividends out of 'distributable profits, reserves, premium or surplus'.
- **Easy to restructure**: the Act makes restructuring a BVI company very straightforward. Shares can easily be divided or combined. It is possible to migrate companies in and out of the BVI.
- **Tax neutral**: the BVI company is a tax neutral vehicle. Neither it, any payment made by it, nor any instrument relating to its business transactions, is subject to any form of BVI tax. However, the BVI is not a tax haven. It is listed on the OECD's 'white list' and continues to negotiate and sign tax information exchange agreements with foreign governments.
- **Speed and cost efficiency**: BVI companies can be incorporated quickly and easily, and set-up and annual fees are comparatively inexpensive.
- **Experience and skill**: the BVI hosts a highly skilled workforce of lawyers, accountants, corporate administrators and insolvency experts, many of whom have trained or worked in onshore financial centres and have considerable experience in establishing complex joint venture and funding arrangements.

## Early action = total satisfaction!

It is key that Founders seek advice in the early stages so their structure is flexible and can accommodate future investment and expansion. BVI business companies are very versatile and perfectly suited to Series A preference share financings.

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