Equity Fundamentals

The answers you need to start using your equity to grow your business.

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Introduction

This guide will give you the fundamental knowledge you need about the equity in your UK business. We'll walk you through the ins, outs, whys and wherefores of shares and shareholders in order to get you the answers you need.

The answers we provide are based on real questions we've been asked by businesses looking to get more out of their equity.

If there are still things you want to know at the end of the guide, then look out for our second edition coming out in April 2017. Can't wait until then? Just get in touch with us at hello@vestd.com

Cheers
Ifty Nasir, CEO at Vestd

Average reading time: 10 minutes

Contents

1

What are shares, what is a nominal value, how many shares should I have?

What are shares?

Every limited company in the UK is split into a certain number of shares, as decided by the directors on incorporation of the company – imagine a large pie cut into many equal pieces.

These shares and details of their holders are kept by the company in a share register, which is often referred to as the ‘cap table’.

A company can have any number of shares (literally), but most companies are incorporated with either 1, 10, 100 or 1,000 shares.

The holders of these shares then have certain rights, as laid out by the Articles of Association of the company. The Articles also determine how the company is run and how its income and assets are split.

What does nominal value mean?

At the time of incorporation, the directors determine the nominal value of each share, which the shareholder must pay to the company.

Again, this nominal value can be literally anything, but typically ranges from £0.01p per share to £1 per share.

There's no minimum capital amount that must be put into a company incorporating in the UK – the initial capital in the company is simply the number of shares multiplied by the nominal value of each share.

As time progresses and more of these shares are issued, they'll have the same nominal value but may well be issued at a premium to that, reflecting an increase in the overall value of the company.

How many shares should I have?

It doesn't really matter how many shares a company is incorporated with, as they can be relatively easily subdivided (dividing those original pie slices into multiple smaller pieces) at a later date. You do this by submitting a form (SH02) to Companies House and passing a shareholder resolution.

Having said that, it's much easier just to set up your company with enough shares so that it's flexible moving forward.

An example:

You want to be able to issue 1% of your equity to someone in future – so how many shares do you need now and what nominal value should they have?

- If you have only 10 shares then you can't give someone just 1% – that doesn't equal a whole share
- When you issue a new share (making the total 11 shares) that share will equal almost 10% of your whole business.

But, if you start with a higher number such as 1,000…

- 1% of 1,000 is only 10 shares, so you're not giving away too much of the total shareholding.

Then, if you've started with a low nominal value, say £0.01 then you don't need to put much capital into the business at the outset (total number of shares multiplied by nominal value = 1000 x £0.01 = £10 in this example).

The main reasons you're likely to issue more shares is if investors are putting money into your company in return for shares, or to give shares to team members who are part of developing the business.

2

What types of shares are there? Why would I issue one rather than another?

There are a number of different share types people talk about, but the great majority are variations of two:

- Ordinary shares
- Preferred shares

It's also worth mentioning Growth shares, which aren't quite as common but have some very interesting characteristics.

Within these share types, you may see a number of varying 'classes' with minor differences (like Ordinary A, Ordinary B, etc), which we deal with in the last section.

Ordinary shares

Ordinary shares are what most people have. At their simplest, they give the holder of each share the same rights to dividends, capital and voting in the company.

Most companies are founded with and issue only Ordinary shares.

Preferred shares

Preferred shares (often known as ‘prefs’) typically give their holders rights to specific dividends ahead of all Ordinary shareholders, and also give them rights to a specific amount of the capital at a winding up of the company ahead of any Ordinary shareholders.

As stated above, companies normally just have Ordinary shares, so all shareholders have the same rights to any value created by the business, whether it succeeds or fails.

When seeking additional investment in the business, however, it may well be that new (or existing) investors may only be willing to put in money if they have a preferential right to the cash flows from the business. These would be Preferred shares.

Although this may seem unfair to the existing shareholders, if that’s the only way the company can get additional funds to allow its expansion or survival, the ordinary shareholders may well vote to accept such a change. This then gives them a better chance of seeing a return on their existing shareholding than if there were no new investment at all.

Growth shares

Growth shares are issued at a ‘hurdle price’ that represents the value of the company at that time, and only share in the capital appreciation (its growth in value) in the business from that point on.

These are attractive for a company to issue as they don’t dilute value for the existing shareholders, and can be issued out at nominal value (such as £0.01) to new shareholders without incurring any income tax for the recipient, and will only be liable to capital gains tax on any sale.

They're typically used as rewards for people joining a company to incentivise them to grow value.

A note on Options...

Option shares (or Share Options) is another term that gets mentioned a lot. These are simply a contractual right to buy shares at a certain price at a certain time in the future under certain conditions. We'll deal in more detail with such 'conditional shares' in the next edition of this guide.

3

What rights can shares/shareholders typically have (or not have)?

We've dealt with preferential rights to dividends and capital in the previous section.

Aside from that, there a number of common rights that are varied from class to class of Ordinary, Preferred or Growth shares.

Voting or nonvoting shares

Although the standard approach is that all shares have equal voting rights, it's very common that certain classes of the shares don't. This may be to ensure that voting control sits with a certain section of the shareholders or maybe to limit the administrative burden of dealing with numerous shareholders in a particular class.

Dividend rights

Again, usually all shares have equal rights to dividends, but it's not unusual that certain classes will be excluded from them for a particular reason.

Although the rights of the shares are usually set out in the Articles of Association, they can be changed by a Shareholder Resolution (including a majority of the holders of that particular class of share), and the subsequent submission of a form (SH08) to Companies House.

We can help you do more with your equity

Distribute equity to your team and give them a real stake in the business.

Reward shares to your customers and build a loyal tribe of advocates.

Vestd helps you do it simply, safely and quickly, and save you time, money and headaches.

Learn more about your equity opportunities by emailing hello@vestd.com