

INTRODUCING SHAREHOLDERS INTO A BUSINESS

Issuing Shares

Shares are rights of ownership in a company. Shareholders have a stake in the business and take the corresponding risks and rewards. Issuing shares can be a mechanism for raising finance. Shares in a private company may be issued to investors such as venture capitalists. Ultimately if a company is launched on the Stock Market, the shares may be publically traded. Shares can be issued to employees by way of incentive.

A return of information must be made to Companies House when shares are issued. There is no duty or tax applicable on the issue of shares.

Types of Shares

UK Company law allows a great deal of flexibility in the types of rights which may attach to shares. Particular types of rights may be appropriate to particular types of investors. Ordinary shares are shares with no special rights or restrictions. These would typically be entitled to dividends declared by the directors from the income of the business (if any), after payment of all other classes of shareholders, loan holders and other lenders have been paid.

The holders of ordinary shares are usually entitled to attend and vote at general meetings, to receive accounts and other information. They are also usually entitled to the assets of the company in a winding up after all debtors and other shareholders have been paid their entitlement.

Preference shares can be very useful in providing for medium term investment in business. Preference shares generally carry a preferential right for payment of income and/or capital to a specific extent, usually a percentage of the nominal value of the shares. Preference shares will not usually have a legal right to payment of their dividend. For example, there may be insufficient profits. Preference shares will typically have

cumulative rights to income, so that no income may be paid to the ordinary shareholders until the arrears of preference dividend have been paid. Preference shareholders carry less risk than the ordinary shareholder, but correspondingly have a limited and fixed return.

Redeemable shares allow the shares to be purchased back by the company, subject to certain conditions. Redeemable shares may be an attractive option as they allow the investor to exit the investment without requiring other shareholders to finance the repurchase. The repurchase must generally be financed from accumulated profits.

Investments in small companies are commonly engineered by creating classes of preference shares, redeemable shares and ordinary shares or a combination. Company Law provides great flexibility to provide an appropriate investment structure. It allows ownership rights in the company to be structured in any way desired.

The transfer of shares carries stamp duty at 0.5%. There may also be Capital Gains Tax implications. See our notes on shareholders agreements and joint ventures in relation to the issues that arise in relation to the transfer of shares.

Dividends may be declared by the Board of Directors out of profits available. There is no general right to a dividend unless this is specifically provided in a shareholders agreement. The payment of dividends attracts income tax for the recipient. Dividends are paid without retention of tax. Individuals in receipt are entitled to a tax credit against their income tax to compensate for the fact that the company has paid tax on the profits concerned.

Flotation

A minority of companies may be suitable candidates for flotation on a stock exchange. A stock market flotation involves shares in the business being launched onto one of the established Stock Markets. Companies must establish secure earnings and strong growth prospects before they can be suitable candidates for flotation.

A corporate adviser will be necessary to bring a company through the process of flotation. Companies require a nominated adviser who is on the London Stock Exchange Register of Advisers. A stockbroker will also be necessary to generate interest in the business. A corporate lawyer will be responsible for due diligence and verifying statements in the prospectus. An accountant will be needed to review and audit the company's finances.

The work involved in preparation for a flotation is significant. Certain key information must be available in relation to the company and published in the prospectus. There are detailed rules in relation to the contents of prospectuses. Directors and other parties can be personally liable for incorrect statements in a prospectus.

There are a number of advantages to stock market quotation. Access to the capital is more readily available. It is easier for existing shareholders and venture capitalists to realise their investments. Employees can be offered better incentives. Being a publically quoted company, can provide customers and suppliers with a reassurance and gives the business a higher profile. It also permits the possibility of acquiring other businesses using shares.

On the other hand, a stock exchange quotation makes the business vulnerable to loss of control. The cost of flotation and ongoing compliance and professional fees can be high. The interest of shareholders must be considered to a greater extent and an element of control is lost. Public companies have to comply with a wide range of additional regulatory requirements and high standards of corporate governance. A range of information relevant to price must be made public.

Stock Markets

There are three stock markets in the UK, the London Stock Exchange, the Alternative Investment Market (AIM) and PLUS. A stock market flotation means that shares can be bought and sold freely in a public market.

The main Stock Exchange is only suitable for large companies. They must have traded for at least 3 years. At least 25% of the share capital must be floated. Professional fees and costs are higher than for AIM or PLUS.

A number of Irish companies have launched on AIM market. No prior trading record is required. It heightens profile and increases interest from the investment community including institutional investors. A nominated adviser is required at all times.

The PLUS market is aimed at smaller companies wanting to raise up to £10,000,000. It is regulated but the requirements are not as stringent as on AIM or the main market.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.