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Types of venture capital investment

The main types of investment made by a venture capitalist firm or business angel are:

Ordinary shares

Ordinary shares give the investor ownership of an agreed proportion of the company, and each of the investor's ordinary shares will carry the same rights as each of your ordinary shares. The return is made up of a combination of dividends (if any) paid out, and the increase in the capital value of the shares.

Ordinary shares are cheap for your company to finance in the short term, and the company only has to pay out dividends if the company has profits available to fund them.

Negotiations over the proportion of ordinary shares that the VC firm or angel receives for an investment can be long and difficult. You will tend to value your company, and thus your shares, more highly than outsiders will.

Preference shares

Preference shares usually entitle the investor to a fixed dividend each year, such as 10p per £1 preference share (provided there are profits available to pay it from), before any dividend can be paid on the ordinary shares.

If there are no profits to pay the preferential dividend in a particular year, they dividend is usually cumulative, ie arrears are carried forward and paid to the investor in subsequent years when there are profits.

The terms of issue of redeemable shares usually provide that the shares are to be repaid ('redeemed') on specified dates, or if the company fails to meet its performance targets. On redemption, the investor usually receives at least the amount he originally paid for his preference shares plus any arrears of the preferential dividend.

Debt

Debt consists of overdrafts, loans, hire purchase, leasing and other borrowings. It is usually secured against specific assets (eg your premises or debtors), which will be sold and used to pay off the debt if you fail to keep up with payments of interest or repayment of capital.

Usually you borrow from a bank, rather than from a venture capital firm. But some firms can provide loans, leasing and hire purchase as well as equity finance.

This document was created on 05 May 2010