Private Placing Memorandum and Prospectus

Raising share capital privately

Expert knowledge means success

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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

Businesses need money to prosper and grow. There are basically two types of money - borrowed money or debt (that will have to be paid back at some agreed later date) and share capital money (which gives an investor a part ownership of the business).

This publication deals with the second category of money. But if you'd like to find out how to get your hands on the first category of finance, namely borrowed money, call us and we'll help you to achieve what you have in mind.

Before December 2001, dealing with prospective shareholders was a relatively straightforward matter – many companies were able to start the process of raising capital simply by issuing a business plan or an information memorandum to prospective investors.

In December 2001, a new financial regime came into force - *The Financial Services & Markets Act 2000* (the FSMA)[1] which placed restrictions on what can now be issued when trying to raise capital from investors. For example:

- The new regime prevents the issue of any document which constitutes a "financial promotion";
- Section 21 FSMA prohibits non-FSA authorised persons, in the course of business, from issuing communications (or causing communications to be made) which amount to 'invitations' or 'inducements' to engage in investment activity, unless the content of the promotion is approved by an FSA-authorised person or an exemption applies.

Exemptions

The Financial Promotion Order made under the FSMA provides a large number of important exemptions – for example, communications which are sent to:

- Persons who are "authorised persons" under the FSMA;
- Existing shareholders, creditors or employees of the company;
- Persons who certify themselves as a "sophisticated investor" (someone who signs a certificate declaring that he/she is a "sophisticated investor" and that he/she is able to receive certain communications which have not been approved by an authorised person);
- Persons who certify themselves as a "high net worth individual" (this is someone who signs a statement declaring that he/she is a "high net worth individual" and that he/she is able to receive certain communications which have not been approved by an authorised person). Broadly, to be a "high net worth individual", the individual must, inter alia, have an annual income of not less than £100,000 or net assets of not less than £250,000 (in excess of their primary residence and any loan secured on it) – these matters used to require certification by an authorised intermediary, but self certification is now acceptable.

Share Capital and how to get it

If you want investors in your business, then what you're looking for is share capital - although it sometimes comes in a basket containing a mixture of debt finance and permanent capital. Share capital comes in two main guises:

- Ordinary shares (which represent the backbone permanent finance of the business); and
- Preference shares (which may be redeemable or repayable by the company out of profits or out of another tranche of ordinary shares issued later on).

Small, medium-sized and large companies share one thing in common - they all need money to expand.

So, how do you go about raising share capital finance?

If you're fortunate enough to be speaking to a single investor, then you'll have to supply all the information that's specified by that person or company. This will usually comprise your business plan and projections as well as details of your strategy, customers, order book, prospects and so on.

But not everyone has the luxury of dealing with and speaking personally to a single supportive investor. In that case, you'll have to publish a document to set out information that an investor can read and on the basis of which, make a decision on whether to invest in your company or not.

It should be noted that:

- A private company may normally only issue shares to its members, to staff and their families, to debenture holders, or to others by private arrangement;
- A PLC may offer shares to the general public in a prospectus or by listing particulars.

There are two main ways to raise share capital finance via a "published document":

- By issuing a prospectus;
- By issuing a private placing memorandum.

These methods are discussed in the following sections of this publication.

Issuing a Prospectus

Company law in the UK defines a Prospectus as *"an invitation to the public to subscribe for shares or debentures in a company"*.

The key word is "public". In this context it means people or organisations that you don't already know directly or aren't currently speaking to directly about investing in your company. You probably already know that UK law has strict rules about persuading people to part with their money as an investment. The following legislation must be adhered to:

- The Companies Act 2006) which sets out very detailed requirements about the content and circulation of a Prospectus;
- The Financial Services & Markets Act 2000 which places restrictions on what can be issued when trying to raise capital from investors;
- The Prospectus Directive (which replaces The Public Offer of Securities Regulations) which aims to create common and enhanced standards for the issue of securities within the EU by setting out the initial disclosure obligations for issuers of securities that are offered to the public or admitted to trading on a regulated EU market;
- The Transparency Directive which regulates:
  - dissemination and central storage of regulated information;
  - major shareholding disclosure; and
  - periodic financial reporting that conforms to IAS or equivalent.

Private companies are prohibited from inviting the public to subscribe to their shares and therefore cannot issue a Prospectus. Only PLCs can issue a Prospectus.

A Prospectus should have the following characteristics:

- There must be an invitation offering to the public.
- The invitation must be made on behalf of the company or intended company.
- The invitation must to be subscribed or purchase.
- The invitation must relate to shares or debentures.

Easier for small companies to raise capital

The Prospectus Regulations 2011[2] came into force on 31 July 2011. The Regulations amend two provisions of the FSMA to implement in part Directive 2010/73/EU (OJ No L 327, 11.12.2010, p.1) of the European Parliament and of the Council. That Directive amends Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (the Prospectus Directive) and Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (the Transparency Directive).

- Regulation 1(2) increases the number of persons to whom an offer may be directed before it ceases to be an exempt offer from 100 to 150 persons.
- Regulation 1(3) increases from 2.5 to 5 million euros the limit for the total consideration of the offer in the European Union below which it is not unlawful to offer transferable securities to the public without an approved prospectus first having been made available to the public.

Issuing a Prospectus is usually a costly affair - it often involves the auditor of the company, a reporting accountant, at least two firms of lawyers, an authorised sponsor under FSMA and other professional advisors. It will have to be printed and advertised to bring it to the attention of your prospective investors.

As mentioned above, only a public limited company can issue a Prospectus. You don't have to be a quoted company on the Stock Exchange (you can easily form a "plc" without going public) but your constitution has to be as a public limited company.

Definition of a Prospectus

"A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other documents invent deposits from public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate."

So, as you can see, a Prospectus isn't for everyone. Apart from private companies, it doesn't usually apply to start-ups with no trading record (although there are examples for start up companies with a fully researched business format), nor does it apply to companies that are raising only comparatively small amounts. When we say "small" here, we mean amounts usually of £500,000 or less.

Prospectus Rules (PR)

The United Kingdom Listing Authority prospectus rules are published on the FSA website at:
http://fsahandbook.info/FSA/html/handbook/PR

For information about the Prospectus Directive see our publication:
587 - Prospectus Directive

Issuing a Private Placing Memorandum

If your company is looking to raise under £500,000, a Private Placing Memorandum (PPM) may be the answer to your dreams. But only if it's "Private" - more of that below.

First of all, a PPM is less formal than a Prospectus and there are fewer regulations governing the issue of a PPM.

The costs of putting together a PPM are less than for a Prospectus - costs as low as £5,000 to £10,000 need be paid (whereas for a Prospectus, the cost can easily start at ten times that figure and run into several hundred thousand £s.

A PPM can take as little as two weeks to compile whereas a Prospectus can take up to three months or even more because of the strictness of necessary compliance with Company law.

The broad content of a PPM is similar to that of a Prospectus but very much less detailed. Nevertheless, its content must give the prospective investors all the information that they need to make an informed investment decision.

Facts contained in a PPM should be true and accurate. Although the strict "verification" process of a Prospectus isn't always followed with a PPM, it's something that is recommended.

By using a private placement via a PPM, it may be possible to raise a significant amount of finance, and often quite quickly. Unlike a public offering of either bonds or shares, there is no need for a detailed Prospectus.

Advantages[3]

There are several advantages to using a PPM to raise finance for your company:

- allowing you to choose your own investors - this increases the chances of having investors with similar objectives to you and means they may be able to provide business advice and assistance, as well as funding;
- allowing you to remain a private company, rather than having to go public to raise finance;
- providing flexibility in the amount and type of funding - allowing a combination of bonds and equity capital, with amounts ranging from less than £100,000 to several million pounds;
- allowing you to make a return on the investment over a longer time period - as private placement investors will be prepared to be more patient than other investors, such as venture capitalists;
- requiring less investment of both money and time than public share flotations; and
- providing a faster turnaround on raising finance than the venture capital markets or public placements.

Disadvantages[4]

There are also some disadvantages of using private placements to raise business finance. For example, there will be:

- a reduced market for the shares in your business, which may have a long-term effect on the value of the business as a whole;
- a limited number of potential investors, who may not want to invest substantial amounts individually;
- the need to place the shares at a substantial discount to compensate investors for their greater risk and longer-term returns.

Additionally, although it isn't a mandatory requirement, having a credit rating can be an advantage. However, this is time consuming and will be an added cost to the process.

Business Angels

Business Angels are private investors. Usually, they have a business background and are experienced entrepreneurs. Many are, or have been, business owners, company directors, senior managers or business-related professionals. They all have some knowledge about business. Their main objective is to improve the business' chances of success and to help get good ideas off the ground.

The other thing about Business Angels is that they have capital to invest and are willing to take a degree of risk and work with another entrepreneur as well as being willing to take a medium to long-term view of the future success of the business. They usually play an active role in companies in which they invest by joining the Boards of these companies and often provide informal consultancy. In some cases, they work in the investee companies on a part-time basis or even, in rare cases, full-time.

Business Angels are a major source of knowledge for the companies in which they invest and they improve the flow of investment capital and management expertise into start-up and growing companies in the UK - thus overcoming one of the major barriers to economic growth for young and growing businesses.

The private capital that Business Angels provide to companies is particularly effective when packaged with their business acumen. Experience shows that investment by an experienced private investor in the early stages of a business can provide the key to further funding by venture capital organisations later on. Business Angels offer skills, knowledge and expertise to fill any gaps, an objective point of view, and someone with whom to share an interest in the business and they can help to put the company on a growth path. Further venture capital investment later on is not only based on a product or service but on a team who have some kind of track record.

Business angels typically invest in a company with:

- an investment need of between £10,000 and £250,000 - most initial investments are less than £75,000;
- the potential for high return - business angels are not averse to high risk;
- good early stage development or expansion;
- a presence in a particular sector.

The advantage of using a business angel is that they often make an investment decision quickly, without complex assessments. However, you will still need to draw up a professional and tailored business plan.

Business Angel financing is often best for:

- *Early-stage companies* - Business Angels typically provide seed money for companies just starting up or emerging from the prototype stage to establish their first operations;
- *Companies that need more than credit card financing but less than venture capital* - Most Business Angels keep their investments under £100,000, so they can spread their risk across several companies.

Advantages of Business Angel financing[5]

The advantages of Business Angel funding for your business can include:

- Business Angels are free to make investment decisions quickly;
- There's no need for collateral as security such as your personal assets;
- Access to your investor's sector knowledge and contacts;
- Better discipline due to outside scrutiny;
- Access to Business Angel mentoring and/or management skills; and
- No repayment of capital or interest payable.

Disadvantages of business angel financing[6]

The disadvantages of Business Angel funding for your business can include:

- It's not suitable for investments below £10,000 or more than £250,000;
- It may take longer to find a suitable Business Angel investor than other methods of raising capital;
- As with all share issues, you dilute your shareholding by giving up a share of your business;
- There's less structural support available from a Business Angel than from an investing company or venture capitalist.

Further Information

In the UK, there are several networks that provide access to Business Angels – check with us for contact details or ask for our publication:
292-Business Angels

We also publish information on Venture Capital – see our publication:
22-Venture Capital

This publication [7] is focused on raising share capital – however, there are other forms of finance that may be suitable for your business.

This guide is for the general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

Important Notice

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Acknowledgement and References

[1] See: http://www.legislation.gov.uk/uksi/2001/1335/contents/made The latest version is The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2010 which is published at: http://www.legislation.gov.uk/uksi/2010/905/contents/made

[2] See: http://www.legislation.gov.uk/uksi/2011/1668/contents/made

[3] Source: http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1087239222&type=RESOURCES

[4] Ibid

[5] Source: http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1087198064&type=RESOURCES

[6] Ibid

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