Establishment and Operation of Business Angel Syndicates

1. Background

1.1. Investing as part of a Syndicate:

A syndicate normally comprises of at least three investors who are investing together. In addition to spreading your monetary risk you will also be increasing the level of knowledge and experience. By investing alongside others in a syndicate you will be bringing together different individual business experiences and varying levels of knowledge that are valuable for an early stage business to succeed. As a result, syndication is a valuable and proven model of Angel Investing and should be encouraged.

There are different approaches to syndication:

1.2. Syndication on a deal-by-deal basis

On an ad hoc basis, you could form a syndicate around an opportunity. This often happens when you are part of an angel network.. Generally networks enable groups of angels to come together on a deal by deal basis according to their interest in a particular opportunity. Normally, you would identify a Lead angel who acts as the interface with the entrepreneur/management team in co-ordinating the due diligence and agreeing the final negotiations and would then generally act for the syndicate in following the deal. However you will sign the term sheet and other legal documents and subscribe to the shares as an individual investor, responsible for your own investment decision.

1.3. Creating a Formal Syndicate:

If you are investing regularly with fellow investors and are looking at investing together in different deals you should consider setting up a more formal syndicate structure, ie a constituted group of investors usually represented by a gatekeeper. Syndicates typically invest on a structured basis using standard investment documentation There are rules under the Financial Promotions Order relating to structuring and making investments as syndicates and it is advisable to gain legal advice if you want to put a formal syndicate together.

2. The Syndicate Model

For regulatory purposes the syndicate should be established as an "association of high net worth individuals or sophisticated investors". Typically, this would be a company limited by guarantee with a "gatekeeper", who will be a director or employee responsible for reviewing business plans. Typically there would be a small core of investors who may be non-executive directors who would review every opportunity. If they decide to invest (generally on the basis of a unanimous decision) the opportunity may then be offered to the other members. Importantly, it is the investors who decide whether they wish to invest and, if so, on what terms.

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3. Due Diligence

Due Diligence is not a regulated activity and the association can therefore carry out due diligence. The importance of appropriate due diligence is increasingly coming to be recognised as an essential part of the process.

4. Investment Process

Once Business Plans have been through an initial screening process, certain companies may be invited to "pitch" to the Board of the association. The non-executive directors of the association comprise the core group of investors. They will normally have an understanding that if an investment is to be made they will all unanimously agree to invest, failing which none of them will invest. The essential point is that each individual director makes his or her own investment decision at all times and the association does not exercise any investment discretion at any point in the process. Investments can only be completed by investors individually deciding to write their own cheques.

5. Completing Investments

If a decision is made to invest, the investment opportunity may then be offered to the wider group of investors who are members of the association, all of whom will have signed high net worth/sophisticated investor certificates and who are therefore all entitled to receive Business Plans which should contain a "health warning" in the prescribed form.

6. The Legal Process

As it would not be practical for individual investors to instruct their own lawyer, they all agree to one set of investment documents and they all grant a Power of Attorney to an employee of the association to conclude the investment on their behalf. This is used only to finalise investment documents and the attorney does not exercise any investment discretion.

6.1. On conclusion of the investment, each individual investor receives his or her own Share Certificate.

6.2 The investors may agree to appoint a non-executive director, they will arrange for the association to monitor their investments and provide them with regular updates. However, the association will not have any discretion to "manage" the investments.

7. Rights Issues, Placings and Exits

Whenever the investee company has a subsequent corporate event, whether that be a rights issue, placing or an exit, individual investors will on each occasion make their own investment decision. Routine matters which require an investor consent will normally be dealt with through an "investor majority" and this may be effected by an employee of the association acting under a Power of Attorney. However, individual investors always retain control of the decision to make any further investment in the company and to sell their shares. It should however be noted that if a company goes to an exit there is likely to be a drag along provision in the Articles which will require all shareholders to sell if that is the wish of a qualified majority.

8. Financing the Association

An association of Business Angels must cover its costs. This is typically done by way of making a charge against investee companies for carrying out due diligence, a charge which may be levied on investee companies or investors on completion of transactions, monitoring fees, non-executive director fees and share warrants which may be exercised on an exit.

9. Managing Cash

The association is not entitled to hold cash unless it meets certain regulatory requirements. The investors money is therefore usually always handled by the solicitors undertaking the investment transaction. They are responsible for co-ordinating and completing investments and also for completing exits and distributing the proceeds of sale to investors.

10. Compliance

In order to ensure compliance with all relevant regulations, the association will undertake (KYC) checks on investors every five years and obtain high net worth/sophisticated investor certificates which have to be renewed annually. It will not handle any investor cash with all cash transactions being processed through the solicitors. The investors all grant Powers of Attorney to the employees or directors of the association so that investments may be processed but individual investors retain discretion over all of their investment decisions at all times.

11. Conclusion

The syndicate model offers a co-ordinated approach to investment which enables substantial investments to be completed in an organised way. A successful syndicate will have a large pool of investors to draw on, a wide skills base for due diligence and a wide base of contacts for identifying high calibre non-executive directors and assisting portfolio companies to develop their businesses. It also provides an appropriate form of legal structure to undertake co-investment transactions with the Angel CoFund.

An established syndicate will also have access to dealflow which would not be available to individual members, it enables members to spread their investment risk by investing across a number of different companies and as investors all invest as individuals with no “pooling” of investments they are generally able to take full advantage of all the available tax reliefs.

UK Business Angels Association

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