Company Formation

Resources

Angel Investment Network

By Oliver Jones

angelinvestmentnetwork.com/resources

Part 1: The Founding Team

“Coming together is a beginning; keeping together is progress; working together is success.”

Henry Ford,
Founder Ford Motor Company

Tweet This

Introduction

Your choice of founding team will have an enormous effect on the **future success of your business**. For one, the need to have a team that shares common goals, has a relationship of trust, works well together and whose skills complement the requirements of the business is self-evident.

Of equal importance, and tied in with this to some extent, is the need to have a team that will **impress potential investors**. Your team will constitute an entire slide of your pitch deck, so it had better be impressive.

> Investors will invest in a team they believe will succeed.
>
> Tweet This

Choosing your founding team is, therefore, not to be taken lightly. Moreover, it should be one of the first hurdles you jump in founding your business. You do not want to be wasting time, energy and money 6 months down the line trying to sort out who is on the founding team and what stakes they have in the company.

To help you with this process, here are some important considerations to take into account:

How big should your founding team be?

Most evidence, both statistical and anecdotal, seems to indicate that **larger founding teams increase the chances of success**. That is to say, founding teams of 3-4 people are superior to a one man operation or anything larger. There are a number of reasons for this:

- **Functional diversity** – 4 founders can bring different skillsets to the table. This allows essential elements of the business to be dealt with at the same time rather than one man trying to do everything even when he is not fully qualified to do so.
- A 4 person combination could theoretically **quadruple the size of your company's early network**.
- If the founding team is too big, you may encounter problems such as slow **decision-making and not everyone contributing**.

“If you can’t feed a team with two pizzas, it’s too large.”

Jeff Bezos,
Founder & CEO of Amazon

Tweet This

Who should be on your founding team?

- This will vary according to the specific requirements of your business but a team with a good mix of complementary skills is an obvious starting point. One for technology, one for sales, one for operations, for example.
- People you know and can trust as it is this relationship that will set the tone for the whole company.
- People who share the same goal and have the same concept of success for your company.
- Previous experience (especially successful experience) in startup companies is a massive advantage.
- Previous management experience is also very useful.
- In an ideal world, people you have worked with before in a similar environment can make the process easier and the chance of success higher.

Where to find them?

This will depend very much on who you are looking for. But, with the exception perhaps of a technical founder, you are unlikely to start a company with someone who falls outside your professional network. As such you have a number of avenues open to you:

- **University contacts**
- **Previous/current work colleagues**
- **University professors**
- **Contacts within your network**
- **Successful entrepreneurs**
- **Venture Capitalists**
- **Angel Investors**


University Contacts
Somewhere else
Work Colleagues
Angel Investors
University Professors
Venture Capitalists
Network Contacts
Successful Entrepreneurs

The last two are worth noting in particular; these are unlikely simply to bring money alone to the table but will be able, and indeed will have an active interest, in offering their not **inconsiderable expertise, experience and network in order to help your business succeed**. Choosing the right investor during the early stages can be of paramount importance to the ultimate success of your venture.

In regard to finding a technical founder, if you have no technical experience, it might be worth considering employing a technical advisor to help you screen and interview potential candidates.

Additionally there are numerous recruitment sites dedicated to matching startup companies with top talent.

In truth, if you have a **clear vision of the direction you see your company taking**, you will most likely know the type of people you want to help you found the company. In line with this, you will know people within your network who can help with this process; their advice will be very useful. And if not, a professional advisor and trusted recruitment sites will help you solve this.

See 'Part 3: Technical' for information on apportioning equity among the founders and investors.

Part 2: Hiring

Introduction

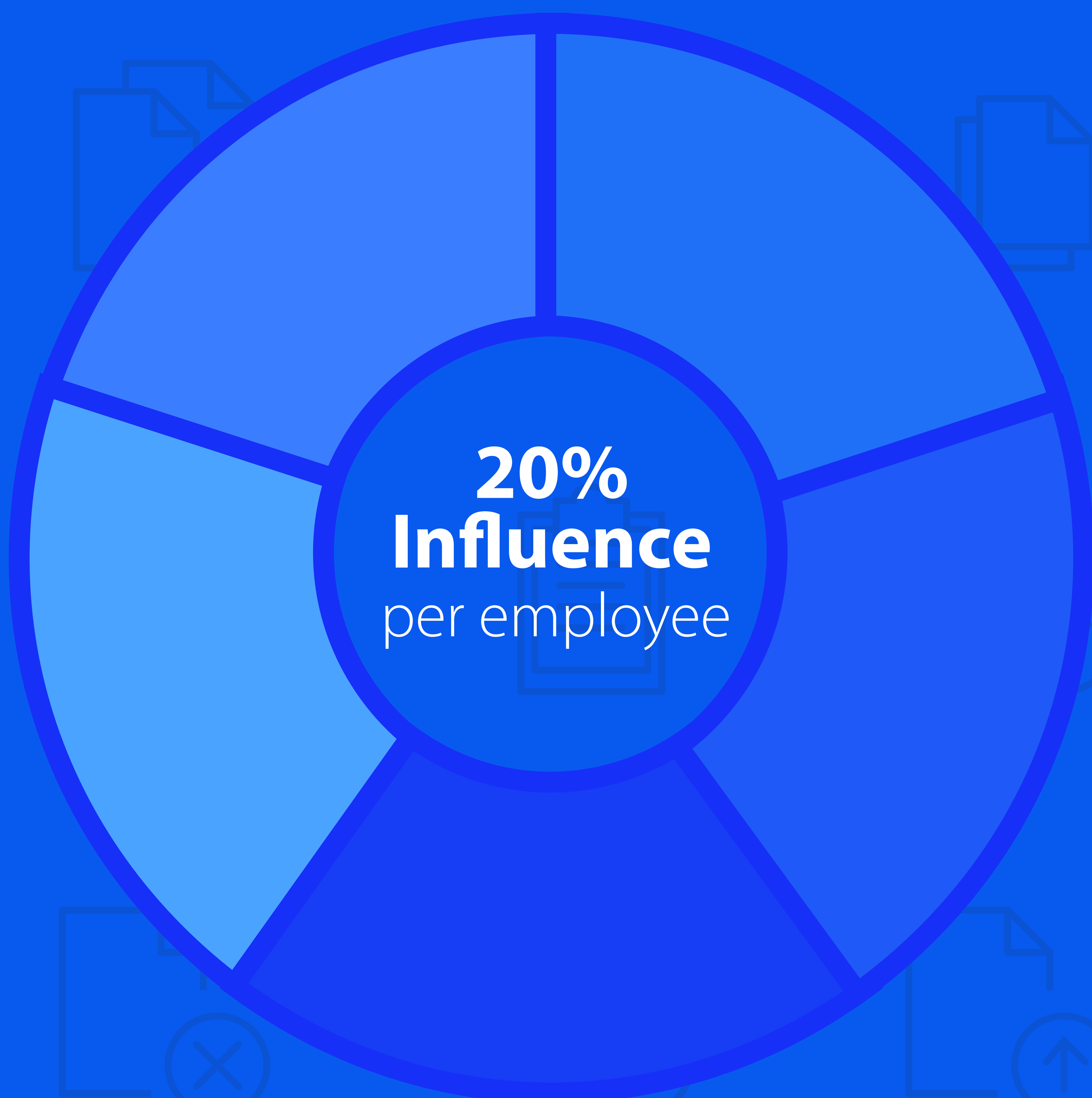
Hiring a skilled, motivated and diligent workforce will necessarily be of the utmost importance in achieving growth and success for your startup. As such it is a process that should be taken seriously; all the more so because the **smaller the number of people working for a company, the larger the percentage influence** each individual will have on the success or failure of the enterprise.

The skill to investing in startups is being able to predict sucess. Part of the semi-qualitative process that investors go through when trying to do this, is **gauging the competency of the company founders**. **Hence your ability to set out your plan for hiring and scaling your company will be an important factor in an investors decision to give you funding**.

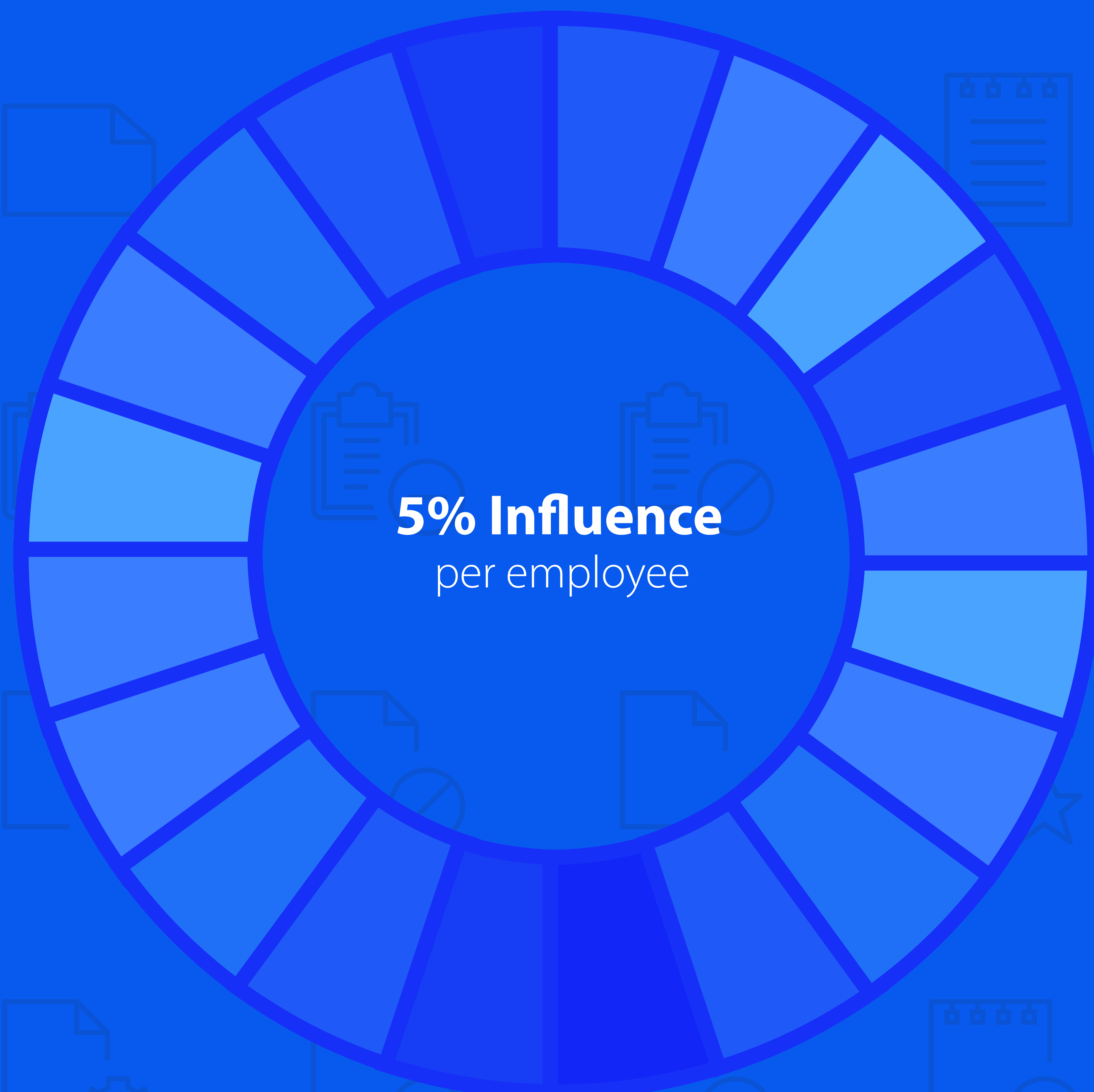
> "Hiring a skilled, motivated and diligent workforce will necessarily be of the utmost importance in achieving growth and success for your startup."
>
> Tweet This

Percentage of Influence

Small Company
(5 Employees)



Large Company
(20 Employees)



"When you're in a start-up, the first ten people will determine whether the company succeeds or not... A small company depends on great people much more than a big company does."

Steve Jobs,
Founder Apple & Pixar

Tweet This

Identify Positions

In any given company there will be a variety of roles that need filling and this will increase as the company grows. Identifying which roles your company needs is the obvious first step.

Prioritize

Once you have identified the required positions, it then becomes necessary to work out which **position needs filling first**. This will hopefully be apparent from the **circumstances your company is in** at that moment in time. If it is not apparent you probably do not need to hire anyone.

It is important to know when to hire and when not to: **hiring a role too early**, i.e. before there is sufficient demand for it, will **burn needless capital**.

Full Time

Full Responsibility for salary, expenses, tax costs and National Insurance.

Contractor / Consultant

A contracted employee will only work when there is work for them to do, and will be paid accordingly. Moreover, if their work is not up to standard you can avoid the indignity and hassle of sacking them by just not calling the contractor in for more work. Additionally, if you get on well with them you can consider changing their contract to full time employment at a later date when the company is more stable and a fixed need is apparent. This has additional benefit in that you can avoid paying (in the UK) their National Insurance and other tax costs.

Partner

By taking on a partner firm to fulfil the role you require then you offset the risk of taking on another salaried employee, you avoid the delay of getting someone up to speed and you only have to pay when there is actually work for them to do. During a company's early stages, partnerships constitute better ways of filling many of the roles required as they help avoid cash flow problems.

In what capacity should I hire them?

Full time vs Partner

If you hire someone full time you take on all responsibility for them including, obviously, their salary; if you partner with a firm that fulfils the required role then you offset the risk of taking on another salaried employee, you avoid the delay of getting someone up to speed and you only have to pay when there is actually work for them to do. During a company's early stages, partnerships constitute better ways of filling many of the roles required as they help avoid cash flow problems.

Full time vs Contract/Consultant

This follows a similar line of argument to **'Full time vs Partner'.** A contracted employee will **only work when there is work** for them to do, and will be paid accordingly. Moreover, if their work is not up to standard you can **avoid the indignity and hassle of sacking** them by just not calling the contractor in for more work. Additionally, if you get on well with them you can consider changing their contract to **full time employment** at a later date when the company is more stable and a fixed need is apparent. This has additional benefit in that you can avoid paying (in the UK) their **National Insurance and other tax costs**.

Who?

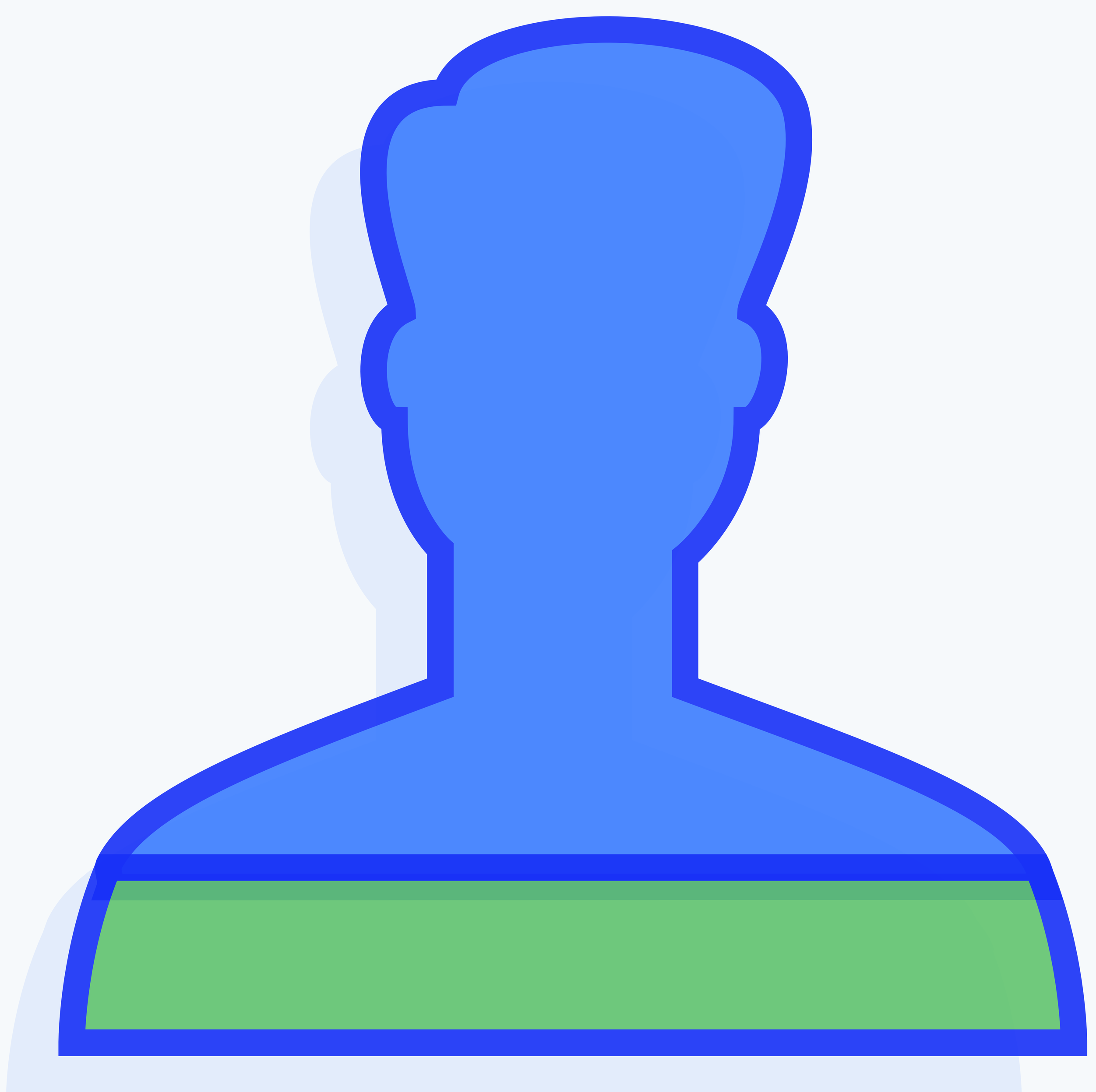
This is where having a solid network is helpful. Equally, being able to screen good candidates from recruitment sites (e.g…) can be an invaluable skill. **No one will know better than you who you want to work with**.

In startup companies it is essential that you get on both on a **personal** and **professional** level with your employees.

While you may have a good idea of type of person you want working for you, or at least know them when you meet them, for the more technical roles in which you may have very little experience, the screening process becomes more difficult. Here is where your **network and contacts** can be particularly useful as the chances are you know someone who knows someone who has used and can recommend an excellent web builder, for example.

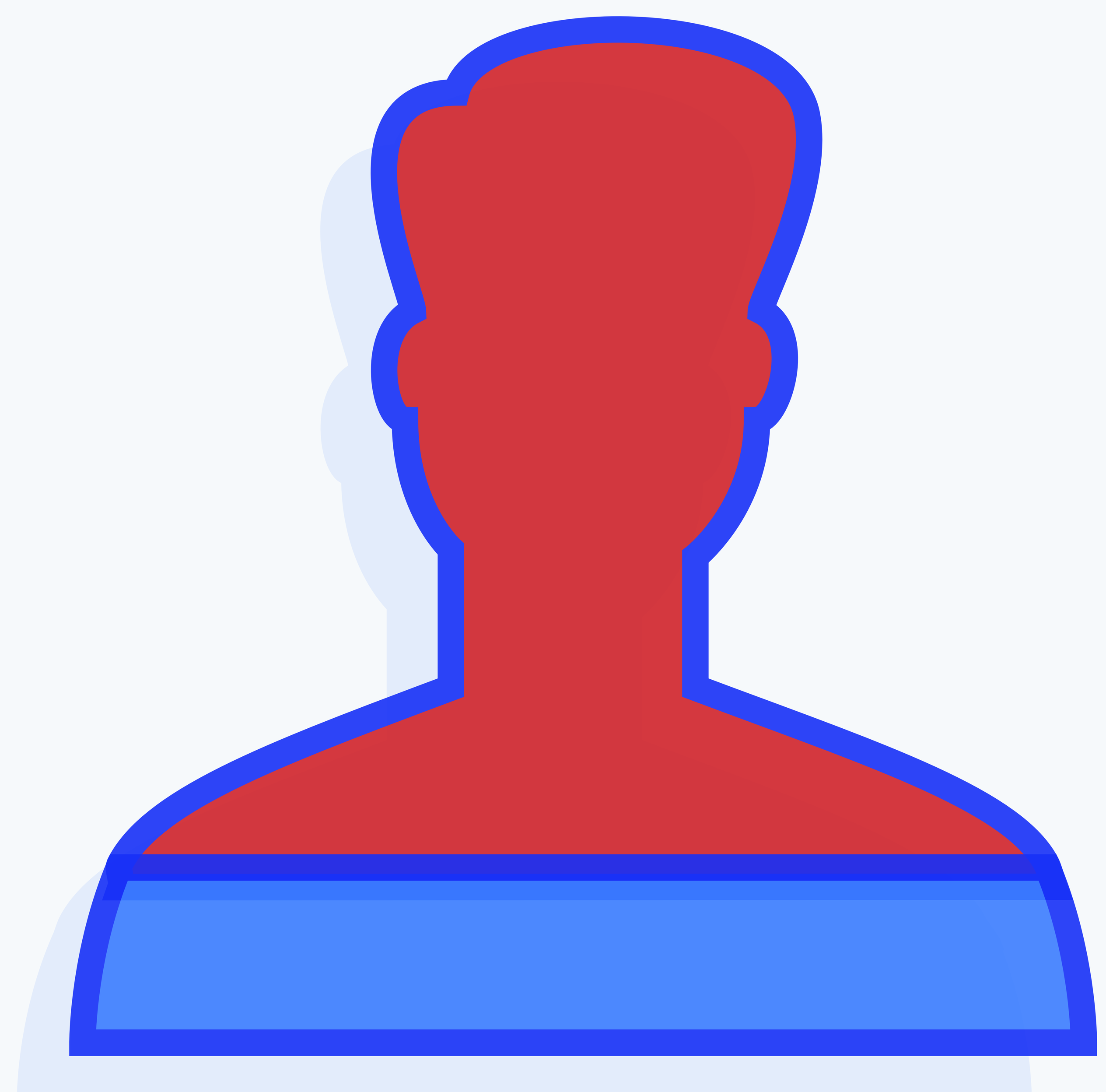
A further consideration during the early stages of your company might be to favour so-called **"stem cell employees"** who are able to react, adapt and contribute meaningfully to the varying needs of a startup in its early stages.

Interns can be a low risk and cost-effective strategy. University graduates looking to broaden their skillsets, top-up their CVs and find an exciting niche in which to excel, can provide enthusiastic and capable workers happy to work for very little (at least initially). And if you don't like them, they can be out the door in no time (depending on your agreement with them). If you do like them, you have found a capable employee, enthused and desperate to add value, who will also harbour a sense of loyalty to you for the opportunity given.



Intern

Minimum Risk / Maximum Value



Contractor

Maximum Risk / Mimimum Value

Interview

Before the interview it is worth setting a small test for your candidates in order to help create a shortlist. This will save you time and energy by avoiding needless interviews with inferior candidates. Necessarily, these tests will vary according to the position offered. But if you are looking for a **'stem-cell employee'**, asking them to review your website/idea and suggest improvements is a good way of gauging their enthusiasm, acumen and written skills.

Once you have your shortlist, then comes the interview. Interviews for startup companies are, more often than not, **just as much about the candidate finding out about you and your company as you finding out about them**. As such interviews frequently have an informal tone; and you may find yourself doing more of the talking than the candidate. Examining how they respond to the way you talk about your company can be a good way of gauging their interest, their motivation and their ability and desire to engage.

This is less true for technical roles where you may want the advice of an expert to help evaluate a candidate. That said, no matter how confined to the backend you envisage them being, it is still important in **a small company to be able to connect**.

Trialling

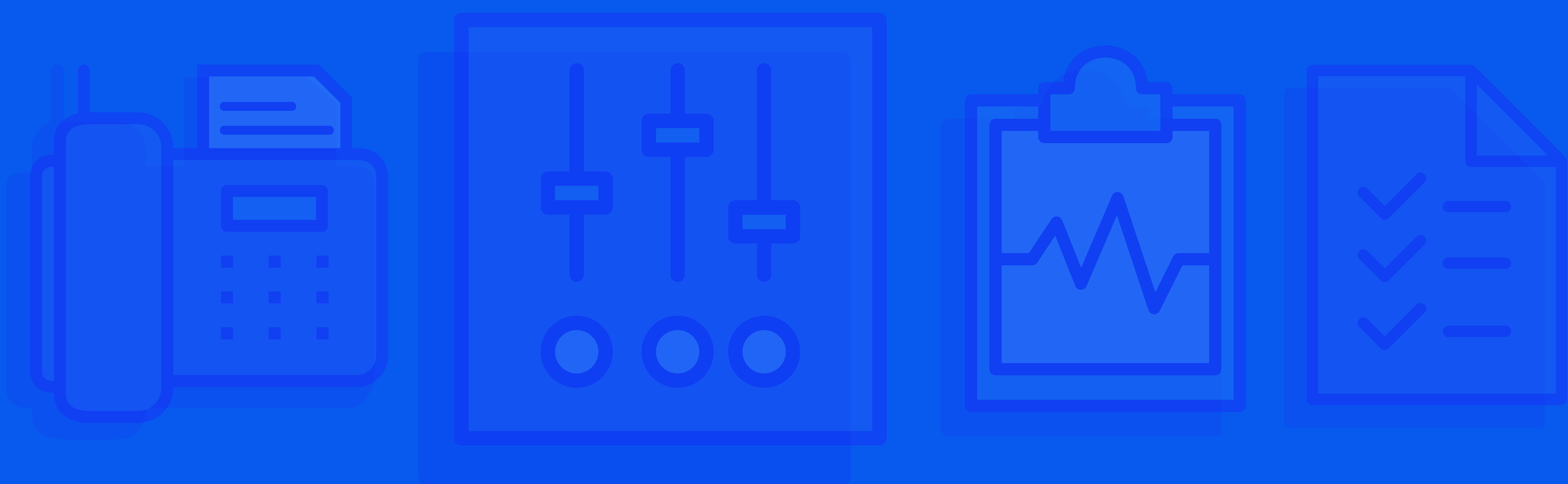
As mentioned above hiring someone full-time straight from the interview can be a risky strategy. It is far better to take on them on a contractual basis or as an intern. That way you mitigate your risk if they fail to contribute valuably.

A useful, albeit slightly hackneyed, way of looking at the hiring process, is to consider it not as hiring employees but as **finding team members** who share your passion and vision, and desire to contribute to it and move it forward. Team players will create energy; non-team players will sap energy. **You want energisers not sappers**!

What's this got to do with fundraising?

If you take seriously the **'hows'** and **'whys'** of your hiring process not only will you help your company's chance of success *ipso facto* but in so doing you will demonstrate your **competence and diligence to potential investors** which will further increase your chances!

Part 3: Technical



Why start a Ltd Company?

Sole Trader VS Ltd Company

Setting up as a sole trader and simply registering your business name is the quick and easy solution if you are the only owner of the business. By doing this, you maintain complete control over the business, keeping all the profits after tax. In the eyes of the law, you and your business are the same thing which means that if the business runs into trouble, **you will face all the legal and financial responsibility**.

In contrast, a limited company is a **separate legal entity to its directors**, limiting how much the owner is liable if the business runs into trouble. This structure could be more tax-efficient: the profits belong to the company not you; consequently you are paid as an employee, as well as a shareholder, if you take that option, which allows you to take dividends as well.

Setting up a limited company is more expensive and time-consuming than registering as a sole trader, but ultimately, it **mitigates your personal risks**. If you are registering a limited company for the first time it may be wise to seek a professional advisor.

Running your business as a limited company can create a **solid foundation** on which to grow and provide a good legal and financial base to start from. It is an exciting moment when you form something that is yours to develop; and it brings with it the opportunity for financial gain as your business grows.

Pros

- Credibility
- Higher take-home pay
- Lower personal financial risk
- Various Tax planning options are available which can save you money

Cons

- Administration- statutory obligations (e.g. submission of annual accounts, corporation tax returns, VAT Returns) can be a real headache
- Costs - higher accountancy costs and higher penalties if you get things wrong
- Directorship - Directors are obligated under the Companies Act 2006
- IR35 - you have to prove that you are genuinely self-employed

How to set up a Ltd Company in the UK

Link: www.gov.uk/limited-company-formation

Equity Structuring

To avoid costly and potentially fatal arguments down the line, it is essential to get your **equity structures** right from the start. To an outsider, these structuring tools can seem complex and intimidating, but once you get your head round them, they will likely save you a headache later on. The principal equity structure between founders and partners is called **vesting**; this is common practice in the US, but some law firms in the UK still claim it is unnecessary.

This is because it is not standard legal practice as it is in the US and so has to be written into the **shareholders' agreement**. Lawyers see it as an over complication when in fact it is fairly simple and makes **everyone's life easier down the line**.

When it comes to terms of equity, there are three things to understand: 1. **Vesting**, 2. **Cliffs**, and 3. **Acceleration**. (For all the examples below assume there are two co-founders splitting their company 50/50).

These three equity terms avoid the issues that arise if one of the **co-founders decides to quit early on**, running off with half the company's stock/equity. If that were to happen with no equity terms in place, the remaining founder would be in trouble being left without sufficient equity to **incentivise** new team members; and even if he succeeds like this against the odds, the other co-founder who ran off and contributed nothing **still owns half the company**!

Vesting

Vesting solves this issue. Everyone with equity should therefore be vested.

In our example of two co-founders, vesting means that instead of each person getting their 50% immediately, they are given it regularly over a period of 4 years. That way, if one leaves after 6 months, he would have only earned 1/8th of his 50% equity stake, that is 6.25%. If he leaves after 3 years, he is entitled to ¾ of his 50%, that is 37.5%.

This works to motivate founders to contribute and commit to the project in order to earn their full equity share.

Example of a 4 year vesting period for one founder entitled to 50% equity

Cliffs

The only problem with vesting on its own is that it can lead to lots of people owning small percentages in the company. This can make any future legal work time-consuming and generally unpalatable.

Cliffs solve this.

Cliffs allow you to 'trial' a hire or partner without immediately committing equity. You can agree on the equity amount and the vesting period from the start to help motivate the new team member, but if you part ways, for whatever reason, during the agreed cliff period, then they are not entitled to their equity.

If we add a 1 year cliff to our 4 year vesting period between two co-founders, then if one leaves after 6 months they receive no equity. But as soon as 1 year is reached and the cliff period is over, they receive a full ¼ of their 50% equity share. Then the regular instalments of equity are drip fed over the remaining 3 years of the vesting period until the end when they are entitled to their full 50% irrespective of whether they then leave or stay.

Example of a 4 year vesting period with a 1 year cliff for one founder entitled to 50% equity

Acceleration

Advisors get an extra term to their equity agreement. This is called **'acceleration'** and is usually termed **'full acceleration on exit'**.

This simply means that if the company is sold, merged or achieves IPO, any advisor immediately receives 100% of their promised equity, even if their vesting period is not finished.

This is the standard format and for good reason as it makes logical sense as both a security and motivational structure.

There are more complicated versions called **'triggers'** whereby equity is delivered not on a time passing basis but by hitting agreed upon revenue targets, for example. This can make sense but obviously is less simple and reliable as a structure than time.

Further tips

Founders are often tempted to give themselves **shorter vesting periods**, using the logic that you get more equity more quickly. This risks two things: 1. One of the founders can run off with a large proportion of the company at an early stage; 2. **Potential investors will often take a dim view of an overly generous vesting structure** – they want to see a founder who cares about the company not about himself!

Cheat sheet for Equity Structures

Founders: 4 years vesting, 1 year cliff for everyone
Advisor terms (0.5-2%): 4 (or 2) year vesting, optional cliff and full acceleration on exit.