ENTREPRENEUR'S GUIDE

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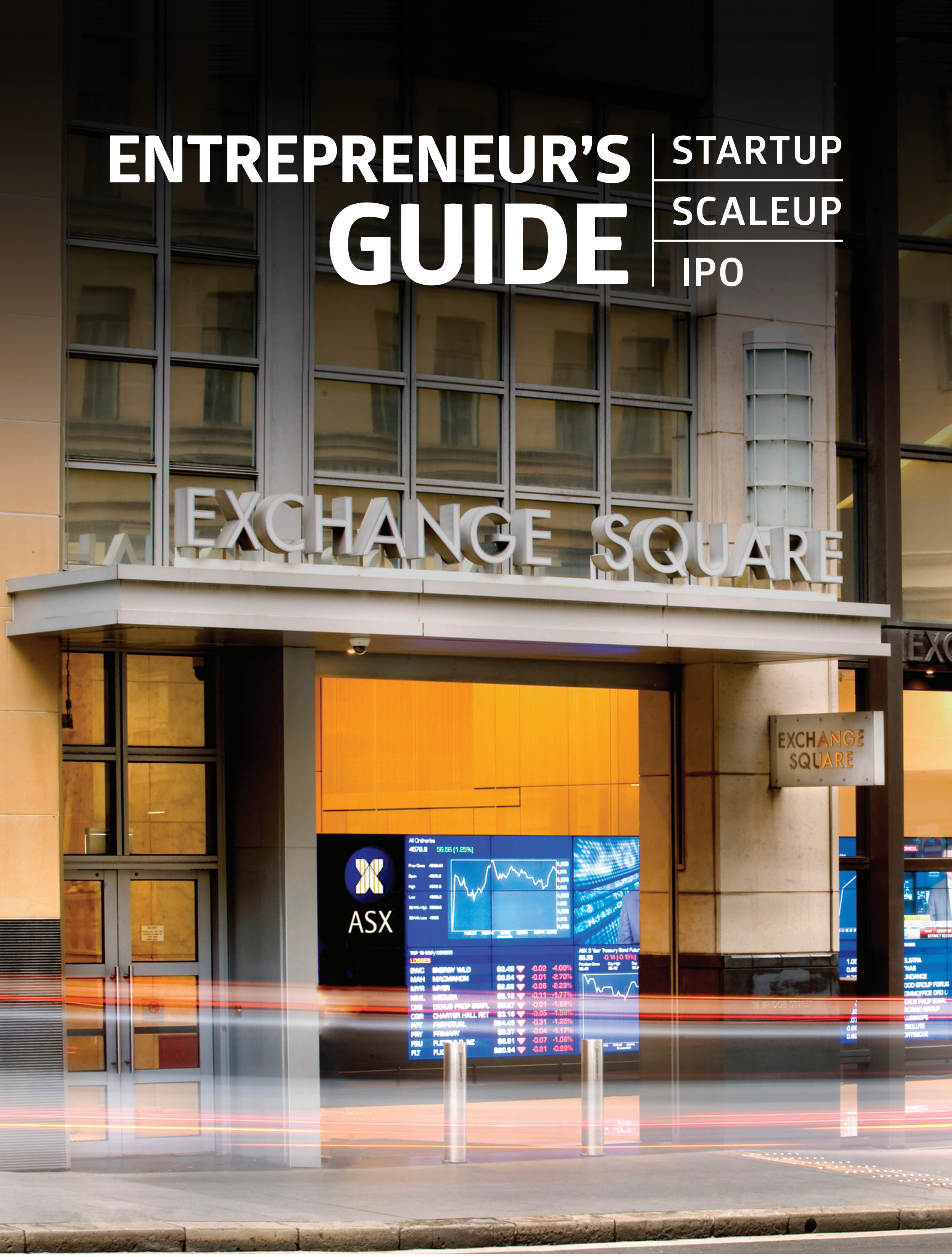

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I

INTRODUCTION

AUSTRALIAN SECURITIES EXCHANGE

Max Cunningham, *Executive General Manager – Listings, Issuer Services & Investment Products*

Becoming an entrepreneur—it is something many of us have thought about, but few actually take the plunge and even fewer succeed. It is a hard road, there is a lot of risk involved and the challenges can be immense…but so too are the potential rewards. The pride and satisfaction you feel having built or contributed to something from which others gain value is hard to beat.

While being a startup is currently in vogue, it is, of course, not a recent phenomenon, and Australia has a long history of innovation, initially driven by necessity given our geographic isolation. Indigenous Australians were our first entrepreneurs, leading the world in utilising tools and techniques in advance of other societies. In more recent times, Australia has contributed many initiatives and innovations, such as the black box flight recorder, cochlear implants and Wi-Fi technology.

Operating at the heart of Australia's financial markets, the Australian Securities Exchange (ASX) is proud to help entrepreneurs and founders bring their ideas to reality by providing the platform to raise their capital and grow their businesses. Be it a junior mining explorer, financial services firm, life sciences company or technology startup, ASX has long been a partner in raising growth capital for companies—an avenue that is not always available for early-stage growth companies in other markets around the world, but something we have been doing in one form or another since the gold rush in Victoria in the 1850s.

Entrepreneurialism is crucial in driving economic growth—global businesses have been built from Australia. Capitalising on our favourable conditions, including access to a large pool of investable funds, high regulatory and governance standards and a growing investor appetite for earlier-stage ventures, ASX is the destination for capital raising.

We are also seeing those who have successfully built and scaled up their businesses prepared to put both time, by the way of mentoring, and capital behind the next generation of emerging start-ups. By creating a sense of community among our entrepreneurs and having supportive policy settings in place to foster their growth and innovation, I am confident we will be in good hands as the next wave of disruptive businesses make their way to the mass market.

We hope this publication serves as a guide for those who are considering becoming, or have already taken the leap to being, an entrepreneur. Packed with practical advice and insights, it will provide guidance and inspiration for years to come, whatever the stage of your business.

F

FOREWORD

NATIONAL AUSTRALIA BANK

Anthony Healy, *Chief Customer Officer, Business and Private Banking*

National Australia Bank has been at the centre of the Australian economy for almost 160 years. Although the world has changed dramatically during that time, our purpose has remained the same: to back the bold who move Australia forward.

During this time, we have partnered with our customers to weather financial crises, dot-com bubbles, a once-in-a-generation commodities boom and 26 years of uninterrupted economic growth. And throughout all these events, we have seen Australia's greatest strength shine through time and time again.

You only have to look at our history of innovative Australians who have assisted with everyday activities, such as hanging out the clothes to dry on a washing line, putting food into the fridge so it keeps fresh, taking antibiotics to help a throat infection and hearing people laugh if you were born deaf.

These examples are affirmation that our greatest natural resources have always been human, not mineral. The inventiveness, tenacity and grit of Australia's entrepreneurs has underpinned progress for decades. Their growth stories were not built on a wave of good luck; they created their own good fortune.

But something is holding back the next wave of budding entrepreneurs.

Since the Global Financial Crisis, the number of small and medium-sized enterprises (SMEs) in Australia has grown by 1.2 percent year on year. At the same time and over the same period, our population has grown from 20 to 24.5 million people—a staggering 20 percent increase.

The numbers do not quite add up.

We should be seeing more innovators in this mix of population growth, more risk-takers willing to have a go and bring to life their business vision.

Seventy percent of Australian SMEs believe Australia is a great place to do business. But while they share an optimistic outlook, economic uncertainty on a global scale has proved to be a barrier to their growth.

Our job—as business leaders—is to encourage more voices in the conversation so we can plan and build the right vision that supports a prosperous nation of entrepreneurs. We are proud of our role in backing businesses so that they can be bold. This idea sits deep within our DNA and is the foundation for Australia's next growth story.

Enabling growth-minded business owners and entrepreneurs to achieve their goals is key to cultivating a vibrant, confident and capable business sector in Australia. This is why we are proud to partner with the Australian Securities Exchange and other corporate contributors on this great initiative.

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STARTUP

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WHY AUSTRALIA?

STARTUPAUS

Alex McCauley, *Chief Executive Officer*

Australia is famous for its beaches, its relaxed lifestyle, its beautiful (if sometimes intimidating) wildlife and its remote geography. Its distance from Europe and the Americas give a romantic mystique to the Land Down Under.

This perception of Australia is neither untrue nor unwelcome to locals; however, it is only part of the story. Behind the myth lies a modern, multicultural society with technological, political and economic complexity. A modern Australia offers five key factors for entrepreneurs:

1. Local market tech adoption
2. Ease of going global from an Australian base
3. Strong startup fundamentals
4. A strong talent base
5. Government support

AUSTRALIA'S FIVE ADVANTAGES AS A PLACE TO BUILD A HIGH-GROWTH STARTUP

1. LOCAL MARKET TECH ADOPTION

Australia's economy is the 13th largest globally and the fourth largest in the English-speaking world. Australia's 24 million consumers are also some of the wealthiest in the world, earning around US$59,000 per capita in 2017, according to the International Monetary Fund.

Australia is economically resilient. It currently holds the record amongst the developed world for the longest period of time without a technical recession—it has been over 26 years since Australia saw two consecutive quarters of negative growth.

Australia's wealth and distance from much of the rest of the English-speaking world have driven a high rate of technology adoption. Companies like Google, Twitter, LinkedIn and Airbnb consistently report out-of-proportion penetration and per capita revenue figures from Australian operations.

For FinTech firms, Australia's funds management industry is particularly appealing. At US$1.6 trillion in 2017, Australia's managed funds sector is the sixth largest in the world.

These domestic market fundamentals have historically allowed successful Australian-based tech firms to build and iterate in a responsive, lucrative local market while developing global growth strategies.

2. EASE OF GOING GLOBAL FROM AN AUSTRALIAN BASE

Global expansion is the core aim for most high-growth startups. As the largest English-speaking country in the broader Asian region, Australia is uniquely positioned as a bridge between East and West. Typical expansion paths for Australian entrepreneurs have been to the U.S. and Europe (particularly the U.K.), but increasingly, young tech entrepreneurs are looking to markets in Asia.

Australia's long history in Asian markets provides a strong base for prospective Asia-focused entrepreneurs. For decades, the majority of Australia's biggest trading partners have been in Asia. Currently, Australia's largest trading partners are China and Japan, with Korea, Singapore, Malaysia and Thailand all in the top 10. Expertise in Asian markets is therefore prolific among established Australian business leaders, making Australia a natural expansion point into Asia, particularly as those business leaders increasingly become angel investors.

Australia now has formal relationships with coworking spaces in numerous Chinese cities, offering local support, networking and free office space for Australian startups looking to establish themselves in China.

3. STRONG STARTUP FUNDAMENTALS

Increasingly, Australia's major cities are developing strong startup fundamentals that are seeing the growth of genuinely global tech businesses. Australian venture capital (VC) firms have raised new funds at a fast pace over the last three years in particular, with new funds under management doubling each year. From July 2016 to June 2017, Australian VC firms raised more than US$1 billion in new funds. Global VC firms have also been involved in an increasing number of deals in Australia in the last few years, with both Sequoia and Index Ventures leading multiple investment rounds.

Startup support mechanisms have also expanded in recent years, with a proliferation in the number of incubators, accelerators and coworking spaces. Startup 'precincts' have grown, too, particularly with the development of the Sydney Startup Hub, which is now the largest startup precinct in the Southern Hemisphere.

Australia is an easy place to start a company. According to the World Bank, it is the seventh easiest place in the world to start a business, and the sixth easiest in the world to get credit. Australia's major cities also regularly rank as some of the most liveable cities in the world, with Melbourne claiming the 'most liveable city' title in *The Economist's* ranking seven years running (2011–2017). Consistently high liveability scores are built in part on Australia's excellent and highly accessible health-care, education and social support systems.

These fundamentals are the building blocks on which giants like Atlassian, Aconex, SEEK, Halfbrick Studios and Canva have built their multibillion-dollar tech businesses.

4. A STRONG TALENT BASE

Australia's world-class education system is also responsible for its strong pool of technology talent. Australia has at least five universities in the top 50 tertiary institutions in the world, and Australian computer science graduates are highly sought after globally. Startup Genome's global startup ecosystem ranking identifies Sydney as the sixth best place in the world for tech talent.

Increasingly, international tech companies are establishing engineering teams in Australia to take advantage of this talent-rich environment. Google, the largest of the international players, employs more than 700 engineers in its rapidly growing Sydney office.

Thanks to extremely simple bilateral arrangements for work visas, Australians have unique access to the U.S. Fluidity in this labour market means a higher-than-usual availability of local talent with Silicon Valley expertise. Australian software engineers with equivalent skills and experience tend to be 30–50 percent less expensive to hire in Australia than in San

Francisco. Anecdotally, they also stay with the same firm longer.

Australia's school system is highly regarded and largely publicly supported, allowing families with school-age children to relocate to Australia with confidence.

The Australian education system is so well regarded globally that it attracts over 750,000 enrolments from international students each year, including 30 percent from Chinese students, further cementing ties to Asia and adding to a vibrant, multicultural lifestyle.

5. GOVERNMENT SUPPORT

Government support for startups in Australia is strong and continues to grow. The most significant of these measures are not startup-specific but stem from Australia's broad support for encouraging new business growth. In particular, the Federal Government offers one of the world's most generous research and development incentives, refunding startups for cash spent on developing new products. Startup-specific measures include direct Government grants of up to A$1 million for promising early-stage companies, and strong tax incentives for both VC and angel investors.

With its historically strong export focus, Australia also has in place substantial Government programs to support international expansion and overseas sales. For young businesses, up to 50 percent of the cost of establishing an international market is refunded by the Federal Government.

This combination of strong support for both research and development and exports has driven many young Australian tech firms to adopt the mantra 'build local, sell global'.

State Governments, too, are keen to support local startups and invest heavily in providing a wide range of grants, incentives and support structures to grow local startups.

2

SO YOU WANT TO BE AN ENTREPRENEUR?

TRANSITION LEVEL INVESTMENTS

Stephen Baxter, *Tech Investor*

So much about startups lately tends to focus on investment and valuation. This chapter focuses on the founder's journey when they do seek investment. Not all startups need external investment. Some of the best startups never took an external dollar; some other great ones needed to and thrived because of it. No single answer fits every situation.

The first step a founder should take is to not listen to muppets.

My first job at 15 years old was as a regular soldier. I served this wonderful nation for almost nine years. I have been involved with only two startups as an entrepreneur; both were telecoms companies. I was fortunate to find, in both cases, a great business partner (as we used to call co-founders) and then co-founder and was privileged to work with awesome teams. I was even more fortunate that both businesses defied the startup odds and managed a successful exit.

Recently, I have been not just investing in local entrepreneurs but also helping to prime the scene in Australia by starting and operating a coworking space (River City Labs), launching a pitch event in Brisbane (River Pitch), founding an organisation to help culturally transform the thinking of startup founders (StartUp Catalyst), and raising funds that have invested in tech entrepreneurs and digital creatives (RCL Accelerator and Right Pedal Studios). I have recently served as the second Chief Entrepreneur for Queensland.

Why do you need to know all of this? If you are to read this chapter and get value from what is written, you need to understand what I have done to make these words worth your time. You need to understand my journey—the way I approached things, the types of business I started and help run (a dialup/DSL Internet Service Provider and a Telecommunications Carrier); otherwise, you will misinterpret it all. If you want to get the best value from the words that follow, please research and try to understand my journey.

You need to understand the background of all people you may seek advice from. Ask them, if they are claiming to be a guru of a certain topic, where they got their experience. If you are to take their advice, do the research—to ensure that they are bona fide but also to build your filter to make sure you can calibrate their advice against their journey and then, hopefully, apply it your situation. I built software and business systems, hired great staff and fired people who no longer were on the same page, raised money and exited. I did all this as a founding senior executive—not a hired 'founder' who had to negotiate that title as part of the package. Make sure you understand the people you listen to.

IT IS ABOUT REVENUE, STUPID

A startup is a business and thus needs to focus on getting as many customers as possible. Remember that customers are the people that send you money—customers are not users, readers, subscribers or others—although those groups may also be important. ('Customers' who do not send you money despite receiving the bill are leeches; do not do business with leeches.)

People want problems solved, and if the problem is annoying enough, you can charge for a solution that fixes that problem. As an entrepreneur, your role is to build great teams that can find problems and create valuable solutions for customers whilst, down the road, turning a profit. A startup is not in the business of raising money. It is in the business of being in business. Sometimes, in order to accelerate growth, you will need to get access to capital at a faster rate than you can sell.

Investors want to invest in businesses that will return them gains, so many look for or demand some form of traction. The best traction is profit, but if you have profit you probably are in a good spot to get investment to accelerate your business. The next best traction is revenue—growing revenue; after that, usage will suffice—how are people engaging with your product? Remember, a startup is a business that ultimately must make money.

If you can prove to an investor that your company has traction, you can answer six out of ten of the questions they ask in a positive way by using data, not forecasts and maybes. If the traction you have is revenue, you also may be able to cash flow fund (bootstrap) your business, which is great because you will get to keep all (or more of) the equity.

Getting funding from an investor does not remove the one thing you will still have to do, which is sell—get customers and revenue. Business is hard, and one of the hardest things about it is selling. If you are not a natural salesperson, that will have to change, quickly. If you (or your team) are not good at selling, you need to fix that, although sometimes understanding the best path to market will not surface for many years. Many times, you need to be knee-deep in a sector before you understand how it works—how the layers are built, who sells to whom, the layers of resellers or integrators, or just how your end customers consume your product.

If you are lucky, you will find a non-traditional path to market and create a whole new way for customers to buy what you are selling. Hopefully, you can reset the way that customers can access your services, allowing you to dispense with the need for resellers and the rest—but that is rare. Many successful companies use partners to help sell—it is not the end of the world if you need to employ salespeople or work with partners to get to market!

BUILD A TEAM

Teams make things work, so investors look for great teams. A great team will have a good attitude, have the right skills and be formed for success. If your startup has tech at its core, it will need inherent tech skills in its founding team or at least need to have the tech talent equity incentivised to massively increase its chance of success. Yes, some startups without tech on the team get going, and they rarely hit it out of the park. (Would you bet on a horse with a fat jockey?) If you want to set up for success, then get tech on the team!

Avoid screwing up the company on day one with a dumb agreement between the founders. It is all well and good to have equal shares in the company, but tie it all together with a shareholders agreement that allows for non-contributing founders to be exited cheaply. Have an agreement with vesting and default clauses and good/bad leaver clauses because when things go wrong and you need a founder out, you need all of the levers you can pull. Make sure that all persons signing the shareholders agreement read and understand it. Take 20 minutes to read your constitution—it is a good primer on how your company will corporately function.

As a founder, you may be chief executive officer, director, shareholder, coder, salesperson, head cook and bottle washer! You need to understand what this means: you have to get used to wearing different hats and making the right calls. If you have investors on board, that is a lot more serious—you are playing with other people's money now. It may involve making awkward decisions that affect the team, which can be harder if friendships are involved. Somebody needs to run the show—take that responsibility seriously.

Legally, you will be required to have a board. There are lots of opinions about boards, such as who should be on them and how many members they should have. If you are an early-stage company and spend a lot of time thinking about this issue, you are probably concentrating on the wrong thing. Many investors will insist on more formal boards and processes, which is not always a bad thing. Some investors will insist on board seats, which is where things get tricky. Boards should comprise people who add value to the company—not people there to 'watch their money'! Be wary of investors who want a board seat because they do not trust you. If they do not trust you, they should not invest. Investors are okay to have on boards—just be sure that they add real value.

OBTAIN INVESTMENT CAPITAL

Looking for investment capital can be exceptionally value destructive to your startup. Remember that you should be in the business of being a business, not in the business of raising money. If you are busy selling your equity, you probably are not selling your product! Understand why you need the capital. It is hard to get, so have lots of clarity on this process.

Investors do not GIVE you money. They purchase your equity. You sell that equity. You need to treat it like a sales process, not Christmas day. If you do not know what a sales process is, your business needs far more than investment dollars—it needs a leader/founder with a clue—go and get clue. Understand what it is you are selling, list out the investors, research them, look at previous investments they have done and talk to other founders. Remove from your list those who will not invest in your company. Use software: Customer Relationship Management systems were designed with this issue in mind. Treat it like a sales process because it is a chunk of your company that you are selling.

You need to network widely—always be networking. One of the best investments I have (Go1) is not because they sought me out, but because I heard of them through another source and sought them out. You need to get in the minds of investors in any way possible. Many investors will depreciate advances made via a 'submit your pitch' link. To me, this always seems disingenuous because they all seem to have such links on their websites. It seems almost like a test—if you use the link, then you must be a poor networker, which is a little unfair. But this is business; it was never designed to be fair. The best contacts with investors that you can make are the ones through a trusted network, so always be networking!

I started or helped start numerous industry associations and cooperative organisations in my two businesses because I knew there were smarter people out there (my competitors) and I needed to talk to them. We were lucky; we all had one main competitive threat (Telstra, also our largest supplier), so it was easy to galvanise action and get a meeting going. I learnt so much from making friends with and talking with peers in the industry. I am not saying you need to start an industry body but, if one exists, join and participate. I know I gave as much as I got from those conversations. If you want to extract value from networking, it is a trade—treat it as such. Do not give away the crown jewels, but be prepared for give as well as take.

WORK WITH INVESTORS

The capital market in Australia for early-stage tech startups is getting better. Lots of funds have been raised, the Government has chipped in with the Early-Stage Innovation Company 20 percent tax-offset scheme, and the amount of visibility the sector is getting through winners such as Atlassian and others is bringing more capital all of the time. More and more venture capital firms have raised large funds for later stages than before, so things are improving.

Still, getting capital in Australia is hard, and it is also hard in Silicon Valley. Look at the startups that decamp from Australia and head to California, where the streets are paved with gold—the investment rate is probably lower than for those staying put. Many times, deals that do get done outside Australia are more founder friendly than we see here, though, which is a sign of the maturity difference between the markets.

Remember that investors typically want to retain an option to invest. They may not like where you are at now but may invest a little later if something changes. That is why you often never get a 'no'—the investor wants to stay close, just in case. Appreciate the investors who say no, ask them why, get feedback.

The level of angst directed at investors in Australia at times seems high. Common complaints are their lack of risk appetite, poor deal terms, lack of trust post-deal and timeliness of deal completion. Many of these criticisms are valid. The investors we have here are a reflection of the market we operate in, and you can curse them all you want. Don't like the local investors—go somewhere else or get revenue, and be a happy success story!

If you are tired of not finding 'smart investors', maybe you need to ask whether you are a smart entrepreneur and founder. Are you and your business worth backing? If you have approached investors and they have not invested, then something is wrong, and it is not with them. Is it you, your business, your team, your market, a broken cap table, etc.? Remember that you are selling something; cursing the buyers for not buying is a little silly. Maybe you need to fix what is wrong.

Many things make it hard to do an investment, but a non-exhaustive list of some things that make otherwise good teams hard to invest in are the following:

- *Company formation*. Uninvestable structures can complicate matters. These include trusts and group structures that segment the business and exclude investors from the whole deal. When I see complicated company structures, I immediately think that there is an attempt to rip me off—why else would they do it? Thinking more clearly—if you are a good team with a juicy problem but have yet to prove your business, putting extra work in front of investors looking to invest is just not clever. In a world where there are many deals, if investors are forced to dig into poor formation and structure, the higher the chance is that they will pass on those opportunities.
- *Capital tables*. Issues with capital tables include not just the obvious dodgy prior investors and non-participating founder issues (where exited founders retain too much of the company) but also early-stage angel/seed deals that leave founders with too little of the company. If you believe in the team, the team needs to be incentivised for the risk they are undertaking. Some 'smart' investors apply the thumbscrews to early-stage startups and end up leaving the founders with very small equity portions in return for small investments. When the chips are down and business is hard, will founders continue to work if they only own 10 percent of the company and know that further dilution may be required? The chances are poor. Leave founders with more equity—not because you like founders but because you like returns. Good and highly incentivised founders generate returns—so back them!
- *Not knowing your numbers*. 'Know your numbers' is not just a much-repeated line from a reality TV show—being dumb about basic accounting is not 'cool'; it is bad. You should know not just the day-to-day profit-and-loss numbers but also the unit economics—is your business a sustainable operation? Can you ever make a profit? This is really important stuff. Smart investors

will dig and try to figure that out. In time, you will find out the hard way if you are not positioned to be profitable—get clued up on it early.

Getting an investor on board needs to be treated as a serious undertaking because you will likely be in the relationship for the life of the company; you have to like your investors. Part of the relationship with investors should be to report to them. Update them on progress, good and bad. They cannot help out if they do not know what is happening, and bad news delayed does not make it any better. There is nothing more frustrating than a startup treating an investor like an automated teller machine—the investor only sees them when the startup shows up to get money! Investors know that, when they get no regular company updates, the sudden receipt of one likely only heralds a request for new capital. It is rude to treat investors this way—do not do it; it is a sign of a poor founder.

The journey is hard, so I hope you can do it without needing investment. The chance of success is small, and it typically comes after 7–10 years, so prepare for a long journey. The reward, though, is more than worthwhile.

Have fun, good luck and do honest business.

3

EIGHT THINGS ALL STARTUP FOUNDERS CAN DO TO 'UN-FAIL' THEIR STARTUP

STARTUP ONRAMP

Colin Kinner, *Founder*

Ninety percent of all startups fail. This stark reality is captured perfectly by Chris Dixon, a partner at Andreessen Horowitz, who said, 'the default state of a startup is failure'. Startups are working against the odds, trying to displace much larger and better-funded competitors with strong brands and a loyal customer base, and doing so with a fraction of the resources they will ultimately need and only a vague idea of how they will accomplish it.

I have worked with several hundred startup teams as a mentor and investor. Some have been successful, and many have failed. I am convinced that most startup failures are caused by founding teams making predictable and avoidable mistakes. It pains me greatly to see startup founders unwittingly make mistakes that others have made before them, and much of my professional life these days is focused on helping first-time founders to short-circuit this learning curve and emulate the behaviours of successful founders.

Following are eight things that I believe every startup founder can do to improve the odds that their startup will be successful, or to 'un-fail' their startup.

1. THINK BIG

The success of a startup is a function of volume and value—'volume' being the number of customers it can serve, and 'value' being the value it creates for those customers, which in turn dictates the economic rent the company is able to capture.

Startup founders should aim to serve as large a market as possible (and most definitely a global, not just domestic market), and ensure that their product creates meaningful value for customers. I often see founders focused on too small a market (either a narrow niche or a narrow geography) or creating products that are only of marginal value to users. Either of these scenarios can be crippling to a startup, and in combination they can be fatal.

Google uses the 'toothbrush test' to evaluate potential acquisition candidates—it asks, is this a product that a lot of people will use twice a day? Startups can apply the same mind-set when considering which market to serve and what product to build. Are there enough people who will rely on your product every day to make this an opportunity worth pursuing? (Remember that you could be devoting the next 10 years of your life to it, so the prize had better be worth the effort!)

Big does not have to be broad. Companies like Fame & Partners are having a huge impact on online fashion, not by trying to be all things to all people, but by focusing on a segment in which they can become the category owner—in this case, formalwear, which just happens to be a $6 billion a year market. By excelling at online formal dresses, Fame & Partners has built up a loyal following of customers who love their custom-designed dresses and recommend them to others. It helps that Fame & Partners is competing mainly against bricks-and-mortar retailers and large, established companies whose businesses are ripe for disruption.

Startups should focus on a narrow enough group of customers that every customer will be an advocate and recommend them to others. Referral is the cheapest form of customer acquisition, and for this reason it is better for a startup to have a small number of early customers who love their product than many customers who just like it a bit. Over time, the product offering can be expanded to broaden the customer base.

As noted by Marc Andreessen, co-founder of Netscape and co-founder of venture capital (VC) firm Andreessen Horowitz, 'software is eating the world'. Every industry is being disrupted by software companies, resulting in massive shifts of economic value from old companies to new ones. There are countless opportunities to build companies capable of disrupting multibillion-dollar markets, so why create a company that is serving a narrow niche or focused just on the Australian market?

2. DO COMPETITOR RESEARCH

One of the most common reasons that startups fail is that they build a product that already exists. There is no need to be the first in the world to do something (just look at Apple's success as a fast follower), but it is also not a good strategy to be the 100th to do something.

Having some competitors is good because it validates that the opportunity exists, but too many Australian startups are building products that compete with large numbers of well-funded overseas companies. I recently met with a founder who was more than a year into his startup before he sat down and did some serious online research to see who he was really competing with. To his dismay, he found a much larger number of direct and indirect competitors than he had realised, including some large companies with deep pockets.

A modest amount of competitor research is a great use of your time before you commit to building a product. I often suggest to founders that they adopt an investor mind-set before deciding whether to pursue their startup idea. If you think of yourself as an investor (in this case, of your own time and money), would you agree to an investment of that finite resource without a clear understanding of who else is out there and some idea of how you will compete?

If your research tells you that you can only ever be the Australian version of an existing overseas company, maybe you should rethink your idea.

3. TELL EVERYONE ABOUT YOUR IDEA

I am often asked by startup founders whether I think they should tell others about their idea before their startup has launched. Founders are often concerned that someone will steal their idea, and this fear leads to either keeping their idea a secret or asking people to sign a confidentiality agreement before talking to them. In my view, neither of these approaches is helpful for most startups.

Keeping your idea a secret is depriving you of valuable feedback from others who may have useful insights. It is also preventing you from making connections with customers, mentors, investors and others who can help you on the journey.

In more than 20 years of working with startups, I have not seen a single instance of someone stealing another person's startup idea. Why? Ideas are just not that valuable. Millions of people in the world have startup ideas. Most of those ideas will prove not to be valuable. What matters is execution.

The same logic applies to disclosing your startup idea to investors. Any reputable investor lives or dies by the strength of their reputation, so there is absolutely no sense in an investor stealing your idea. They have better things to do with their time, and the feedback you will get from good investors more than outweighs any risk there might be in talking to them about your idea.

As for confidentiality agreements, it is rarely a good idea to ask someone to sign one before you tell them your idea. Do not ask investors to sign them because the answer will always be 'no'.

There is one scenario in which it might be wise to keep your idea a secret, which is when your product is patentable (and worth patenting) and you have not yet filed a patent application. In this case, a public disclosure of the idea may be enough to prejudice any future application for a patent. This issue can generally be avoided by limiting what you disclose to generic information that does not give away the 'secret sauce', or by filing a patent application first.

My advice to startup founders is to always be pitching and always look for opportunities to tell others about their idea and gain valuable feedback.

4. TALK TO CUSTOMERS BEFORE YOU BUILD ANYTHING

Just about every startup founder knows the term 'lean startup', but, sadly, owning books such as *The Lean Startup* by Eric Ries or *Running Lean* by Ash Maurya is not enough. Startup founders need to validate their startup idea with customers before they start building their product.

I have seen too many startup founders burn through their cash reserves building a product before engaging fully with potential customers. Founders can end up wasting many thousands of dollars and months of their lives building a product before validating that it solves a real problem and can be monetised.

Some great (and free) tools can help founders validate their problem and solution hypotheses—including the Lean Canvas by Ash Maurya and the Validation Board from Lean Startup Machine. Both focus on getting founders out of the building and engaging with customers.

A similar argument can be made for engaging with customers instead of writing business plans. Writing a business plan for an early-stage startup is one of the least valuable ways founders can spend their time and is largely an exercise in creative writing because most of what goes into a business plan is pure speculation. As Franck Nouyrigat, co-founder of Startup Weekend, puts it, 'Business plans are as good as following directions given by a blind chimpanzee'.

5. BUILD THE RIGHT TEAM

The ideal startup founding team has a mix of skills spanning sales, domain knowledge relevant to the target market and tech skills to build the product. Yet I see many startups with a sole founder who, in many cases, lacks domain expertise and/or tech skills.

Sole founders generally struggle for several reasons:

1. Startups require a diverse mix of skills, and it is extremely rare for a single person to have all the bases covered.
2. The amount of work needed to build a successful startup is massive, and one person simply cannot get it done quickly enough.
3. Founders need to be able to bounce ideas off each other and test their thinking. No amount of mentoring can make up for an absence of co-founders.
4. Startups are hard, and having others with you on the journey provides much-needed moral support to help you get through the tough times.

Having tech skills is also vital to building tech companies. Australia has a disproportionate number of startups in which the founding team has no tech skills and instead outsources product development—either to a local or overseas agency, or to freelancers via platforms such as Upwork. I think this is a recipe for disaster and can only think of a small handful of startups that have ever succeeded from this position.

As several prominent Australian investors have pointed out, a tech company that lacks tech skills within the team is simply not investible. Australian VC fund Blackbird Ventures refuses to invest in companies whose tech capability is outsourced to an agency. According to a 2017 blog post by Blackbird partner Nick Crocker, 'Employees care 10x less than founders. And agencies care 10x less than employees'.

Pre-revenue startups need to conserve cash, and haemorrhaging cash to pay an external developer is a poor alternative to having the tech skills in the team and available at little or no cost.

6. SEEK OUT ADVICE FROM EXPERIENCED FOUNDERS

The Australian startup ecosystem is growing rapidly, but is still immature, and a large proportion of Australian startup founders are doing their first startup. These founders need guidance from others who have done it before, but unfortunately, experienced founders (especially those who have been through the startup loop multiple times) are in short supply.

My advice to first-time founders is to surround themselves with experienced founders, investors and others who have worked with large numbers of startups. Doing so will help them to short-circuit the learning curve and avoid making predictable mistakes. Being part of a startup community is a great way to benefit from the learnings of others. The larger and more diverse the community, the more valuable it is as a source of peer learning.

The emergence of large-scale startup hubs is starting to make it much easier for new startup teams to learn from more mature startups. One of the important roles of these hubs is to accommodate larger startups (or 'scaleups') as their teams grow, avoiding having them leave the startup community prematurely to find space to grow. These more mature companies have experience that is valuable to earlier-stage companies. Having small and large startups co-located is therefore vital to capturing the learnings of companies as they grow.

Fundraising is one area in which founders benefit most from the experience of others. Raising a funding round is a difficult and time-consuming task for any startup founder, and probably the area in which first-time founders struggle most.

Many founders do not understand how investment works, or what investors are looking for, and as a result spend a lot of time pitching investors before they are ready or approaching the wrong investors.

Startup founders need to build relationships with investors over time rather than show up and ask for a cheque. Good investors like to get to know founders before they pitch for funding and are happy to offer them advice. As the adage goes: 'If you want to raise money, ask for advice. If you want advice, ask for money'.

Getting fundraising right is crucial for startups because they have a finite runway and cannot afford to spend time talking to investors who will never invest. I often tell startup founders that their job is to find investors who share their vision and deeply understand the problem they are solving, rather than attempt to convert investors who either do not understand their business or are sceptics.

7. GET THE COMPANY NAME AND BRANDING RIGHT

If I wanted to start a company called Facebook today, I would not be able to have the domain facebook.com (for obvious reasons)—nor would it make sense for me to try to register facebook.io, facebo.ok, getfacebook.com, facebookapp.com or any other variant.

Still, I see lots of startups making this mistake and compromising the strength of their brand from the outset by choosing a name for which the dot-com domain is not available. Instead, they settle for an inferior domain such as [company].io or .biz or engage in domain hacks such as the examples cited earlier. I strongly believe that Australian startups that plan to go global should have the dot-com domain from the outset.

Apart from causing confusion among customers and making it harder to find the company, the biggest issue I see with this brand compromise is that it signals weakness. As pointed out by Y Combinator founder Paul Graham, startups that choose a marginal domain are often viewed as marginal companies.

A great name should have the following attributes:

- Is short (ideally no more than ten letters and three syllables)
- Is memorable (think Google, Uber, Atlassian; avoid names based on descriptive terms)
- Is easy to spell (if you tell someone the company name, can they reliably spell it back to you?)
- Is easy to pronounce (and not ambiguous)
- Has a dot-com domain that is available to register or to purchase for a modest fee (get the .com.au as well, but it is not as important as the .com)
- Avoids domain hacks (such as hyphenation or use of .io, or .biz)
- Has social media accounts that are available
- Does not infringe any other company's trade mark (a trade mark attorney can help with this)
- Is flexible (does not describe what the company does too narrowly, ensuring that the name can still be used if the company pivots to a slightly different product or market)

It is getting harder to come up with good startup names, but my advice to founders is not to settle for a mediocre name. Keep working on it and make offers on multiple domains that are available for sale, and your efforts will pay off.

8. IMPLEMENT FOUNDER VESTING

Most startup teams are reasonable people and want to split the equity in the company equally among the founders from the outset.

Unfortunately, this approach has two major drawbacks: first, it fails to recognise the reality that in most startups the founders' contributions are not equal. Some investors view an equal split of founder equity as a sign that the team makes lazy decisions or is unable to have a robust conversation about the relative contributions each will make to the company.

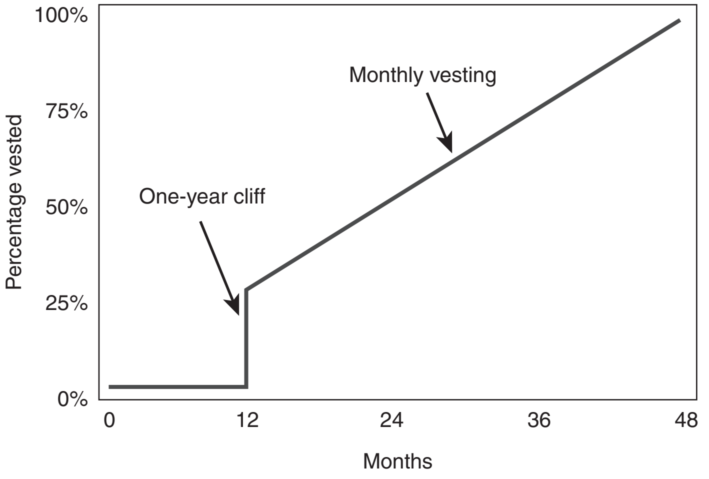
The second issue relates to issuing shares up-front. It seems reasonable enough for co-founders to issue shares when the company is incorporated. However, problems arise if one of the founders quits in the early stages, as often happens when things get tough, or when financial pressures mean that a founder needs to get a job to cover their living costs.

This scenario is surprisingly common, and one that sees the departing founder walk away with a large chunk of the business and become a passive shareholder. This situation can be a major demotivating factor for the remaining founders (who are working their backsides off but for no additional benefit) and makes the company much less attractive to investors.

A better approach is to adopt 'founder vesting', in which each founder earns their equity in the business over time, which is contingent on their ongoing involvement. Typically, a founder vesting schedule has two components: a one-year cliff and monthly vesting (Figure 1). A 'one-year cliff' allows for 25 percent of each founder's shares to vest at the end of the first year. If they depart within the first year, they forfeit all their shareholding on the basis that they really have not contributed much value to the company. The second component is 'monthly vesting', in which the remainder of their shareholding is vested in equal instalments over the next three years.

Founder vesting is important because it allows for the departure of founders in the first few years of the business without causing major harm to the company's prospects.

FIGURE 1. The two parts of a founder vesting schedule



CONCLUSION

There are plenty of pitfalls that can lead to startup failure, but fortunately there are also some reasonably simple things that any startup founder can do to improve the odds that their startup will be successful. There is also a growing pool of experienced entrepreneurs, investors and mentors in Australia who can provide good guidance to first-time founders. Those who engage fully in their local startup community, seek out high-quality guidance and are prepared to work hard have a great chance of success, and I'm looking forward to seeing more of them build globally meaningful companies.

4

FROM PEPPERCORN TO UNICORN: SEVEN WAYS TO FLY OR DIE

POTTINGER

Nigel Lake, *Co-Founder and Executive Chair*

Change and confusion create short-term commercial opportunity, but most success stories take a decade or more to write.

Are you building a business that will continue to thrive in 2028, not just one that will win a pitch competition in 2018?

Launching a new business is exciting, daunting, stressful and rewarding in various measures. It may require one of the biggest leaps of faith that you will make in your career, or you may become a founder almost by accident. Either way, you will find naysayers who talk down your successes long after you have reached critical mass, and optimists who encourage you to keep going when you would be better advised to quit. You will find good news and opportunities where you least anticipate them, and unexpected hazards that emerge from left field. Wherever your founder's journey leads, one thing is guaranteed: you will emerge with much more wisdom, business experience and commercial acumen than you could ever accumulate working for someone else.

We know. In the 15 years since we launched Pottinger, we have seen extraordinary change and opportunity. In that time, Airbnb, Facebook and Uber were founded, Apple launched the iPhone and iPad, and SpaceX launched the world's first reusable orbital rocket. Solar energy has moved from cruising yachts to urban rooftops, and the best cars are now electric. Much of the world's knowledge is captured in Wikipedia, most of the world's music can be streamed to your phone and many subjects can be studied online for free. In business, new products, new competitors and new business models have emerged, and new technologies are reshaping telecommunications, energy, healthcare and other major sectors. For the first time, three of the top 10 U.S.-listed companies are less than 25 years old.

OPPORTUNITIES FOR ENTREPRENEURS

Most large businesses now live in fear of disruption. Transformation projects have become the latest corporate obsession as incumbents scrabble to keep up with the pace of change. As often as not, little is achieved by these processes, leaving startups to deliver what their older, wiser and better-financed competitors could not. Looking forward, automation, digitisation and artificial intelligence are poised to drive the most extensive industrial restructuring ever seen.

This situation opens up a huge playing field for entrepreneurs, along with many risks. Change and confusion create short-term commercial opportunity, but most success stories take a decade or more to write. You need to build a business that will continue to thrive in 2028, not just one to win a pitch competition in 2018. Today's fad may fly with deal-hungry angel investors, but it is highly unlikely to carry you to $50 million Series B financing, let alone a rewarding exit. To succeed, you must focus resolutely on the long term, just as Google and Berkshire Hathaway have done, despite the many distractions posed by an obsessively short-term world. You must also carefully consider the societal impact of your business, particularly as the impacts of robotisation spread through the global economy.

SEVEN TIPS TO GO FROM STARTUP TO SUCCESSFUL BUSINESS

So, how can you make sure you concentrate your energy on the right opportunities? How can you keep your investors and co-founders happy, not to mention staying connected with your friends and family, whilst building value in your business and staying sane? As you navigate through the forests of commercial opportunity, here are seven guiding stars to follow if the startup foal paying peppercorn rent for a garage is ever to mature into a billion-dollar unicorn.

1. Address the future, not the present. To gain traction with your product or service, clearly you need to address a problem where people feel pain today, to ensure that there are enough early adopters to help you begin to grow. But the scale of the opportunity and length of the growth pathway is much more important than how rapidly you progress in the first 24 months. Facebook's early revenue growth was relatively slow, but the glue of its relationships with consumers—an online social network—has proved exceptionally resilient in the face of dramatic changes.

2. Start the race you want to run. Where you launch your business defines the mountain that you will need to climb. For example, startups in the U.S. and China benefit from huge domestic economies, and hence many more opportunities to gain early commercial traction. They have larger prizes to win from early sales, and much broader and deeper investment markets to finance growth. Phenomenal businesses can also be built from other centres, particularly if you have a way to drive early adoption with large customers in your home market. But, as Atlassian has demonstrated, you will need a rock-solid approach to international marketing, business development and sales if you are to make it on the global stage, not to mention the appetite for a lot of long-distance travel.

3. Recognise that you must win in the U.S. or China. Wherever you start, to reach meaningful global scale, you will need to establish a strong position in either the U.S. or China. So far, virtually every large-scale success story is centred on one of those markets. Businesses in Australia benefit from a natural affinity with both those countries, but before long, you will need boots on the ground and major customers in one or the other. This need is of profound importance to your customer development strategy and marketing plans and may have important implications for your product and platform, too.

4. Realise that scalability is as important as scale. Your products and services, operational platform and business model all need to be scalable. In the early days, it is tempting to cut corners as you race to machine a 'minimum viable product' and push to demonstrate that you have 'product market fit'. But no matter how critical these steps are, remember that, if you start to achieve real traction and rapid growth, there will be even less time to re-engineer your technology platform, operations and market approach for scalability and enterprise-grade reliability. So, design and build in anticipation of this from day one.

5. Focus outwards on your customers. As your company grows, remain resolutely focused on your customers' needs and how they perceive the solutions you offer to their problems. No matter how phenomenal you think your product might be, if you start to focus inwards on your technology and intellectual property, you will begin to let massive opportunities slip through your fingers. These missed opportunities may seem small at first, but may grow large enough to disrupt your entire business. And, as the march of automation and artificial intelligence continues, exploit these technologies to *increase* human interactions with your customers rather than just cutting cost.

6. Understand startup math. A complex equation links founders' equity, early traction, revenue growth, company profile, talent attracted, perceived risk, capital raised, profitability, exit value and investors' eventual returns. This equation plays a fundamental role in whether you can raise capital, not to mention at what valuation, and thus drives your ability to access the financial oxygen your company needs to breathe and grow. With the stars aligned, some companies can raise Series A funding at 30x revenues or more, giving huge firepower for very modest dilution, and making later, much larger funding rounds easier to structure. Conversely, if you give up too much equity before you achieve material revenues, investors will worry that the founders do not have enough skin left in the game, making it harder to raise further investment—the ultimate Catch-22 for startups.

7. Consider the endgame from the beginning. Think through carefully how you will personally make money out of your venture. And if you are not relentlessly commercial, find someone who is. Even if you are not driven by financial results, financial sustainability is critical to the ability of your business to achieve maximum impact. Develop a commercialisation strategy from the outset so that you understand how all the different jigsaw pieces can be brought together. This strategy will help you to build the business that started out as a flash of inspiration in your mind in a way that realises your dreams.

These seven guiding stars traverse many business disciplines and topics, so if you can only remember one thing, remember this:

Strategy + Investment + Risk +
Disruption + People = Success.

This is the formula that drives great businesses of all sizes and types, and it is the bedrock of the multidisciplinary advice we provide at Pottinger.

MARKETING, TEAM BUILDING AND OTHER ISSUES

Of course, many other issues should be considered. You need the right business model, technology stack, sales strategy, pricing structure, team and culture, to name just a few. You *must* have a clear strategy for 'crossing the chasm'—navigating the marketing abyss that lies between the small number of enthusiastic, natural early adopters and the high-volume mainstream—so read the iconic book by Geoffrey A. Moore, *Crossing the Chasm: Marketing and Selling High-Tech Products to Mainstream Customers*. Although positivity is critical in a startup, you must also be realistic about factors that can stand in your way. Many of these are entirely outside your control, as we have explored in our white paper, *Entrepreneur or GoneTrepreneur*.

You cannot anticipate all the problems or know all the answers. Ideally, your founder team will include two or three individuals who combine strategic vision, technical excellence, selling skills and the ability to build and lead a team. If you are lacking one of these critical elements, consider adding to the founder group if you can find the right person. And remember that your team does not stop at the office door. Finding the right external collaborators, advisors, promoters, mentors, investors and board members will, to a large degree, determine whether your business flies or dies. Generously reward partners who make a real difference to your profile and growth—this will be one of the best investments that you will ever make.

Finally, no matter what people say about the benefits of failing fast, losing is enormously less rewarding and much less fun than winning, even if the latter takes longer than you first planned. We wish you phenomenal success in unlocking the full potential of your business. Whether that is realised via an IPO on the ASX, or a trade sale to one of the world's leading companies, or through another path entirely, we hope to be there to help you celebrate the milestones along the way.

5

FINANCING THE STARTUP SECTOR IN AUSTRALIA

NATIONAL AUSTRALIA BANK

Owen Hereford, *Business Development & Strategy*

The key features that distinguish a startup from any other small business are the potential for high growth and scalability.

The business and economic case for funding startups extends far beyond high potential upside returns for investors. The startup sector contributes significantly to jobs, sales and exports in the Australian economy, which is hugely disproportionate to the size of the sector. An April 2015 research paper by the Department of Industry and Science estimated that 1.04 million full-time equivalent jobs were added to the economy between 2006 and 2011 (Hendrickson, L., Bucifal, S., Balaguer, A., and Hansell, D. *The employment dynamics of Australian entrepreneurship,* Department of Industry and Science Research Paper 4/2015. Canberra, Australian Capital Territory: Commonwealth of Australia). By supporting entrepreneurs in achieving their goals, Australia can foster wealth creation and drive growth across the economy.

Australia has all the requisite components to become a hub of innovation and technological disruption, with a globally competitive startup sector. Startups in Australia now have unprecedented access to capital, and our exceptional higher education sector is producing innovative, entrepreneurial talent and world-class research. Our current Government and regulatory environment is focused on an agenda that supports entrepreneurship and innovation. Notwithstanding, there is still a lot of room to grow. The surplus of demand for startup financing is still present across startup industries, inhibiting the growth of startups or driving entrepreneurs to seek funding elsewhere. New fundraising vehicles are being developed overseas and, although there is appetite by domestic investors to explore these alternative asset classes, assimilation into the Australian capital market is slow. Our regulatory framework is improving to support innovation and foster entrepreneurship, but according to international best practice, considerable scope and opportunity for further development and reform still exists. And although we house world-leading universities and our research is best-in-class across many disciplines, empirical evidence suggests that Australia falters at the commercialisation stage (Commonwealth of Australia, Department of Industry and Science, *National survey of research commercialisation 2015 review report, July 2015*).

In this chapter, we consider perspectives on different types of financing for a startup against the current backdrop of the Australian startup sector.

INITIAL FINANCING FOR GROWTH COMPANIES

Accessibility of capital is integral to growth and innovation in the startup sector, allowing entrepreneurs to fund scale and expansion. The past decade has seen a growing trend towards companies remaining private longer, with a decrease in listed equity raisings and comparatively less capital raised through initial public offerings, while private equity has prevailed as the dominant source of funding after founder bootstrapping.

Although there is no prescribed formula for fundraising, the most common source of initial funds for startups (after the founders' own private capital) is from friends and family of the founders.

Different types of private equity financing for early-stage businesses are discussed in the following sections.

FUNDS FROM FRIENDS AND FAMILY

The pre-seed round is the riskiest private equity round to invest in but can reap the highest financial rewards if the company is successful. These rounds are typically small and usually take c.5–10 percent ownership of the company. Entrepreneurs generally use this funding to build a proof of concept for the idea or to begin developing an initial prototype.

It is common for entrepreneurs to use informal documentation when raising funds from their friends and family. A lack of rigour in the documentation of investor rights at this juncture can, however, prejudice future fundraising efforts when more sophisticated prospective investors may be involved. Therefore, it is highly recommended to set the tone of the relationship early by formalising documentation from the start.

The second round of equity financing comes from VCs, angels or angel groups, corporate venture capitalists or alternative finance platforms.

FUNDS FROM ANGEL INVESTORS AND ANGEL GROUPS

Angel investors are professional investors, business executives or successful entrepreneurs who actively participate in pre-seed and seed-funding rounds. These rounds range from A$100,000 to A$2 million in size, and investors usually take c.20 percent ownership of the company.

Angel investors provide a vital secondary function in supplying intellectual capital, linking inexperienced entrepreneurs with seasoned experts and mentors, providing advice on strategy and execution and helping with capital raising, as well as being a sounding board for operational issues such as staffing, marketing and sales strategies.

Founders often relinquish some control when using angel financing, because angel investors are often assigned a board seat in the startup and are more actively involved in the management of the company than other equity partners are.

A limitation of angel-sourced financing is that individuals alone can seldom supply the level of funding required by the startup. To mitigate this factor, it is common for angels to amalgamate to form an *angel group* to finance a startup. These groups can be informal, with investors predominantly acting independently, or highly sophisticated funds akin to a small venture capital fund.

VENTURE CAPITAL FUNDS FOR EARLY-STAGE COMPANIES

Venture capital (VC) funds are typically the first institutional money invested in the company, and venture capitalists will often take a non-executive directorship position on the board. Practically, VCs can have multiple funds that invest in different stages of a firm, but it is useful to define VCs based on funding rounds:

- micro-VCs
- seed funds
- Series A for early-stage companies
- Series B and C for mid-stage companies
- Series D or later for a late-stage company

The focus here is on pre-Series B funding rounds because VCs typically provide Series B and later funding, once a successful business has already been established and needs to expand. Larger VC funding rounds for further developed companies looking to expand, 'scaleups', are discussed in a later chapter.

A *micro-VC* is a fund with only one general partner, typically an experienced angel investor with a track record of successful investments. The funding raised from this round is typically used for idea conception, initial product development, hiring a small team, product validation and raising the next round.

Seed funds are typically syndicates of angels and micro-VCs and rarely invest in rounds after a Series A. Seed-funding rounds are typically in the low single-digit millions and are used to launch the product, hire more staff, develop business practices and strategies and begin to develop traction to raise the Series A round.

Series A funds are established VCs that typically have multiple large investments across a portfolio of startups at once. Series A fund rounds are generally undertaken once a startup has established product traction and has a user base. Series A rounds typically raise A$2 million to A$10 million and are typically used to scale distribution domestically, improve and optimise product and add to operational capability.

There is a trade-off between raising capital and diluting founder ownership. Above-average funding rounds will give the startup more time to achieve targets before needing to raise another round but will dilute founder and employee ownership. This situation creates two key problems:

- The next round will be more difficult to raise because there is 'less equity to go round'.
- Diminishing founder control can act to disincentivise the company's key leaders at a critical time where the business is evolving and the ultimate direction of the company is being explored.

VCs' general consensus tends to recommend that pre-seed rounds should be limited to 10–15 percent of the startup's valuation and 20–25 percent for seed rounds.

EQUITY CROWDFUNDING

Digital disruption and innovation in the financial services industry has precipitated the development of new private equity financing mechanisms such as equity crowdfunding. Crowd-sourced equity connects small, unlisted companies seeking financing directly with institutional and accredited individual investors, in turn creating a powerful global network of investors.

Equity crowdfunding provides three key benefits for investors:

1. investigation of investment opportunities in bulk, with a streamlined format across opportunities and no obligation to engage with any of the portfolio companies
2. advertising of available funding to solicit pitches from startups
3. aggregation of other investors to form a small VC fund or syndicate for desirable opportunities.

As such, equity crowdfunding leverages the economies-of-scale benefits of a venture capitalist with the flexibility of an angel investor. Although alternative financing platforms are growing rapidly overseas, the take-up of this technology has been comparably slower in the Australian market, primarily because of the regulatory environment.

OTHER SOURCES OF INITIAL FUNDING

Another increasingly common source of private equity funding is corporate venture capital (CVC). CVC funds are created by established companies to make investments in early-stage growth companies. Examples of CVC include NAB Ventures and Telstra Ventures. Globally, CVC is a vital component of the innovation economy, but it is only just re-emerging in the Australian market (addressed in detail in another chapter).

A fundamental financing challenge encountered by early-stage entrepreneurs is the onerous terms from equity providers, particularly the dilutive costs of raising equity. Founders will often look to complement equity capital and their own cash contributions with non-dilutive sources of financing. Most commonly, this capital comes from debt financing, which is addressed in detail in a later chapter. But another key source of non-dilutive growth funding can come from public and private commercialisation programs.

Government funds

The Australian Federal, State and Local Governments have established various VC funds and grants aimed at accelerating the growth of innovative startups, such as the Commonwealth Scientific and Industrial Research Organisation's (CSIRO's) *Main Sequence Ventures* (A$200 million), South Australia's *Venture Capital Fund* (A$50 million) and New South Wales's *GO NSW Equity Fund* (A$150 million). Funding is provided either in exchange for an equity stake in the startup or as a one-off grant.

Accelerators and incubators

Accelerators and incubators help entrepreneurs build and grow young businesses by offering office space, corporate services, mentoring, workshops and training. Key accelerators and incubators in Australia include Slingshot, BlueChilli and muru-D (backed by Telstra).

Accelerators and incubators provide four key functions:

1. Develop and validate ideas and the business.
2. Train and develop entrepreneurs.
3. Grow and scale.
4. Provide small amounts of non-dilutive funding.

Participation in these programs is usually offered for free or in exchange for an equity stake in the startup and is always determined through a highly competitive application process. Although the distinction between an accelerator and an incubator varies, there is general consensus that the distinguishing feature of an accelerator program is the presence of an equity stake in the startup. Incubators may also provide a cash injection in the startup in the form of an award or prize money at the end of the program.

Many Australian universities now house their own accelerator and incubator programs to help academics and students commercialise their research. They include ANU Connect Ventures (Australian National University), Hatchery Ideate (University of Technology Sydney), Incubate (University of Sydney), ilab (University of Queensland) and the Melbourne Accelerator Program (University of Melbourne).

THE STARTUP SECTOR IN AUSTRALIA

TARGETED GROWTH

Startups in Australia have increasingly better access to capital. VC fundraising grew immensely in the past five years, with the total size of the sector more than *eight times* its size in 2013.

Since 2015, a concentrated effort has been made by the Government to drive innovation and foster commercialisation of research in Australia, which has catalysed a national movement towards a more diversified and knowledge-driven Australian economy. The benefits of the National Innovation and Science Agenda, the research and development tax offset scheme and other targeted policies at the State and Federal levels (e.g., Ignite Ideas and MVP grant) are starting to actualise. Australia has begun the journey and has taken the first steps in cultivating its innovation capabilities, which will be realised in the near future and will likely be augmented significantly by the Government's policy response to the recommendations proposed in the recently published Innovation and Science Australia 2030 white paper (Innovation and Science Australia 2017, *Australia 2030: Prosperity through innovation,* Australian Government, Canberra).

INTERNATIONAL PERFORMANCE

Although the startup sector has grown domestically, relative global performance indicates there is still a large opportunity for growth. A notable outflow of entrepreneurial talent and significant underfunding in the Australian technology sector has occurred and is partially attributable to the substantial Government and private sector focus on resources and commodities since the turn of the century. This situation compelled many Australian technology companies to source funding overseas or relocate completely to access growth capital, engendering a relatively young and underdeveloped VC sector compared to most Organisation for Economic Co-operation and Development (OECD) countries today. VC investment as a percentage of gross domestic product (0.023 percent) is less than half the OECD average (0.049 percent) and ranks behind New Zealand, Latvia and South Africa. Australia also ranks last amongst OECD countries for commercialisation of research.

Density in the physical proximity of startups has proved an important factor in the growing success of startup ecosystems worldwide. Purposely co-locating startups precipitates the co-location of auxiliary companies, such as venture capitalists, investors, financial institutions and other service providers. Countries with a mature startup ecosystem have demonstrated the importance of creating a physical precinct in the development of the startup sector, such as Tech City (U.K.), Silicon Sentier (France) and the MaRS Discovery District (Toronto). Australia's predominant startup hub is Sydney, and Sydney is ranked 17 out of 20 in Startup Genome's longitudinal study of the startup ecosystems, with significant room to improve.

INHIBITORS TO GROWTH

Additionally, some policies may prove to hinder the growing startup ecosystem. The *StartupAUS Crossroads 2017 Report* surmises that the tightening of the skilled migration visa last year has contributed to a talent void in critical areas and encumbered Australia's ability to attract high-quality talent from overseas. It particularly affects prospective migrants with skills in program development and management, digital areas and technology.

Further consideration needs to be given to overcoming prevailing cultural inhibitors and political resistance to innovation and a knowledge-based economy. Implementing effective policy measures to support entrepreneurship requires alleviating the strain of technology-driven job displacement and shifting labour force dynamics by facilitating the retraining and further education of employees in low-skilled jobs.

FINAL THOUGHTS

Comparable jurisdictions have demonstrated that innovation economies do not emerge organically. To foster an internationally competitive startup sector, a more deliberate and sustained effort by Government, financial service providers, tertiary institutions and research agencies, as well as the small business and technology sectors, is required.

6

FROM A FOUNDER IN THE STARTUP TRENCHES

SILICON VALLEY FOUNDRY

Elias Bizannes, *Chief Executive Officer and Founder*

I am sitting here overlooking a beach on the Pacific coast of Mexico. I am tempted to do what anyone on Instagram does: post a picture to make people jealous. This is, after all, the life of an entrepreneur/founder, right? Freedom to do what you want, whenever you want. No boss to tell you what to do. Work that you decide to do when you want to.

Behind the picture, however, here is the real story: I am here for my co-founder's wedding (more out of obligation than escape). The app we released barely has any users, and worse still, no recurring users. That is not the problem, though: what is troubling is that my cash is about to run out.

But if I sound calm, it is not just because of the piña coladas. It is because I have been through this situation before.

I was born in Australia, and at age 25 I moved: I have now lived in and around Silicon Valley for eight years. I have worked at a startup that was making $10 million a year when I left, a venture capital (VC) firm that was the first to invest in Twitter, and I have bootstrapped to profitability two businesses that made up to $1 million a year at their peak. I also nearly went bankrupt three times.

Will I succeed on my new business? I probably have less risk than the typical entrepreneur in executing due to my history. But that does not mean much: success with a startup is based on the right idea, with the right team, the right market, and at the right time. You need luck. But as I like to think of it, luck favours the prepared mind.

What follows is a set of things that I have learned and applied this year with my startup. With that said, I have not built a billion-dollar company, so take these suggestions with a word of caution. (But I am a founder in the trenches, and I have found that advice from that kind of person is the best type of advice you can get, given that every man and his dog seem to have 'advice' to give you.)

I will cover techniques in ideation, product development and the factors of production, and conclude with the most important topic of all: you.

THE IDEA

In 2011, I learned two powerful lessons about the business idea you work on. The first lesson was from my VC work—the power of vision—which was actively coached into me by my boss and superstar VC George Zachary. Vision matters for many reasons: it is what VCs expect, it is what you use to recruit employees and it is what gets you out of bed every day. So, although it is a very simple point to make that 'you need vision', it is harder is to teach the 'right' vision. The best entrepreneurs are able to distill what they are doing into a simple statement.

Can you?

My friend Mike Casey, a Kiwi entrepreneur who built the biggest graduate recruitment website in Australia (GradConnection), once said to me that, 'entrepreneurship cannot be taught but it can be learned'. What follows is a technique to have you learn this powerful concept of pitching the right vision.

I call it the 'Wow test'. Your vision statement needs to be a one-line statement that you can tell a random stranger you have just met. And that person's reaction needs to be 'wow'. (I will note that an angry rejection of the idea is a flip of the same emotional response—like love is to hate—which actually may be preferable: it is the abnormal ideas that win.) Sometimes, and for some businesses, getting a 'cool' reaction is adequate (but not if you are building a billion-dollar business). But you definitely do not want to get a response of 'OK'—that is basically someone acknowledging they have understood the English you have put to them.

Go for wow.

My second lesson was from T. 'Scott' Case, a co-founder of Priceline, who had taken on a new job as chief executive officer (CEO) of Startup America, a nationwide effort to export Silicon Valley to the rest of the United States. Scott introduced me to a framework called Theory of Change. Scott summarised it to me very simply, and I have used it with over 50 founders whom I have mentored, with great effect.

Theory of Change has three components:

- your statement of change (which I liken to your vision statement; your decade-long goal, if you will)
- your assumptions (which, if you read out, should hold your vision/statement as true)
- your activities (the specific things you are doing today).

I have had founders do this framework with sub-assumptions and hundreds of activities: you can make it as complicated as you want. But the key here is the process to uncover your assumptions and activities. Ideally, you have three to five assumptions.

If you struggle, do not worry: you can start by listing all your activities and then clustering them into assumptions. A good exercise is to rank your activities in order of importance, and very quickly it will reveal if you are wasting your time on the wrong thing right now. The value of the assumptions is that in one stroke of a pen, you will realise if you are wasting your time on a set of activities (or if you have missed a bunch altogether).

To me, creating this document is the closest thing to a useful business plan in the startup world. It gives you the power to look 10 years ahead and then drill down into what you need to be doing today. I consider it a living document and continue to refer to mine as I progress on my journey.

THE PRODUCT

You can build three kinds of startup products: products people can use personally (consumer), products for business (enterprise), or products for entertainment (such as media and gaming). This discussion will focus on consumer businesses.

These are my four tips to building a solid consumer product:

1. *Do one thing really well.* Brandon Leonardo, a co-founder of Instacart, told me this. When you build a product, do not get caught up in the hoopla of 'minimal viable product', which has now become a synonym for 'build a crappy basic product'. Brandon's advice is simply to nail the experience on one thing and one thing only. Of course, he has built a billion-dollar business based off the mobile phone, and when it comes to mobile apps, they can only really do one thing well. But the point remains: do not get too carried away. Do one thing, and do it well.

2. *Find the single-user value.* Farhad Mohit, a founder who became successful during the dot-com years and more recently built Flipagram into a business with 100 million users, asked me this question about my idea at the time. The lesson for me is that you can get carried away with your vision and big-picture strategy of big data and network effects....but only when you have nailed the single-user experience (meaning, a product that does not rely on network effects). If you can do that, you have built the foundation of a business that *can* have network effects, the magic thing that makes technology scale unlike any other industry.
3. *Do a daily product log.* Brian Chesky, the CEO of Airbnb, in a podcast called 'Masters of Scale', talks about the five-star experience. I highly recommend this podcast: Chesky describes how he tried to think about what would be the five-star experience for a customer and how that translates into a product. Using that idea as inspiration, my team once set me a challenge to do a daily product log where I would record every day when I would need the product. Even if it was for only one minute a day, I would document when in my day I would need to use the product and the circumstances around it. This process helped us distill a list of requirements of what our application needed to do. It is such a powerful exercise because it really puts you in the shoes of your user and can guide your product development on the things that matter.
4. *Develop a prototype.* I raised my first $100,000 off a clickable prototype. All you need is a good designer, who can wireframe and draw up the screens of your product, and then you can use one of the dozens of prototyping tools available, such as Framer, which we are using now, or Flinto, which we used when we were first ideating on the product. Before you spend any money on writing code, you should double down on building a prototype. They can look so real that people will think it is a real app, so the feedback you will get from this process could save you hundreds of thousands of dollars, if not more. What is great about this approach is that anyone can develop the skills to prototype. All you need is some Adobe Creative Suite skills and knowledge of the tools I mentioned. What are you waiting for?

THE FACTORS OF PRODUCTION

Economic theory suggests that there are three main factors of production: labour, capital and land (with entrepreneurship a silent fourth, given its role in organising the other three factors). In the tech world, two critical factors dominate your thinking: talent and fundraising. You will not be able to hire talent unless you have capital, so we will start there.

In the dot-com days, the first money a startup would receive would be called 'Series A'. During the last decade, Y Combinator created a new industry of 'accelerator' for which they would 'seed' money (originally $25,000, now more common is $100,000 or more). This year, I have seen a new term become the norm: 'pre-seed' (which is the new Series A).

The way I explain it is that pre-seed money is literally the start, which is used to build a product. Seed money is used when you optimise for product/market fit and where you really sort out your unit economics (i.e., the cost of acquiring a user and determining their 'Lifetime Value'). Series A has now turned more into a growth equity stage, for when your startup is ready to scale into a high-growth business. For enterprise businesses, things are slightly different because investors typically invest in the team (versus in the consumer, which is about market traction), so using Series A as the first money is not uncommon.

Your pre-seed money is sourced from the three Fs: Friends, Family, and Fools. Your seed money is sourced from angel investors and, increasingly, now from micro-VCs (that would mean a small-cap fund of $10–50 million). According to my research, about 500 entities like this exist in the world right now. Your Series A would be more regular VCs (typically $200 million funds and above).

If you raise investment, you are basically committing yourself to the above track. I could write a whole chapter on fundraising, but here are the main points:

- *Fundraising is challenging.* It is also a full-time job for six to nine months for you to get a meaningful outcome. Build that into your plan.
- *Your first cash will be from you and people you know.* Trying to get a stranger to invest in your idea pre-product is not just a waste of your time, it is also extremely frustrating to the investors who have this happen to them all the time.
- *As a rule of thumb, when raising money, aim for 18 months' runway.* This means allowing 18 months of cash based on your monthly burn (cash outflow). Less than 12 months' runway is too little, and you are undercapitalising; more than 18 months' runway is too much, and you are overcapitalising.
- *Revenue is the best capital you can get.* Throw everything I have said out the window if you have a chance of funding your business through revenue.

My entrepreneur friends all seem to agree that one of the essential traits of a founder is his or her comfort with uncertainty. Another essential skill of a founder is managing working capital. The preceding discussion concerned ways to inject cash, but do not underestimate the power of renegotiating expenses. Acquiring basic accounting knowledge can teach you these techniques, and I can speak from experience that using payment plans was one of the ways I managed to avoid going bankrupt earlier in my career.

Another important topic, which you will never be done learning about, is managing talent. The following are two lessons that I have known for years that have hit me just last week and that I hope will guide your management style:

- *Focus on output.* We live in the information age, not the industrial age. Do not hold your employees accountable to hours and face time; hold them only accountable to output. The implication of this approach is to give them 'unlimited vacation' (although it is not really unlimited: if they disappear for too long, they will be replaced), and let them work from Timbuktu for the week. Who cares how they get their work done, as long as it gets done? Your job as a manager is to maximise employees' motivation, prioritisation, and scope of work—with motivation the hardest one to earn and the most damaging to lose.
- *Reduce latency wherever you can.* I have built an entire business where people build startups on a bus for three days and which has consistently amazed anyone who has done it when they realised how much more productive they were. So, you would think I would know better for my new startup and adopt this approach. Instead, I have semi-outsourced my development functions where my head of product has her own agency and I use one of her Lebanese-based engineers. It was great for the startup to bootstrap a first product, but the communication costs alone have resulted in too much wasted time and money. There is no right way to approach building a business, but I can give you the simple advice to reduce latency as much as possible between your talent (or factors of production). People working from the same room or the same time zones, or even just having fewer people: all those things are latency factors.

ON YOU

One of the biggest lessons I learned with my other businesses is the importance of looking after yourself. I will share two specific things about it.

The first is beware of burnout. The year I nearly went bankrupt, I was working 7 days a week. I lived and breathed my business. And thankfully, I survived. But in the process, I burnt myself out—and it took a year before I realised it.

Burnout is like depression: you do not have energy or motivation; you do not place any value in the work you do. You can be bumbling along thinking you are fine because you are happy otherwise, but the truth is, when you burn out, your capacity to work is so greatly reduced that you are best not working at all. Since having this pointed out in me, I have now seen this situation in dozens of founders I have mentored and have realised that it is a common problem.

Fortunately, the solution to burnout is simple: stop working. Disconnect for 10 days. Do not check email, do not do anything remotely linked to working. Our always-on-and-always-connected culture has put a heavy chain on our long-term productivity, but by simply disconnecting for a bit, you will come back rejuvenated. I have even had discussions with my co-founders about making changes when things stabilise, to mandate every quarter that every employee is required to take a week off. This approach is a way of selfishly ensuring long-term output from our team because burnout affects everyone. However, the difference with your staff is they have less control over fixing the situation due to the power dynamic with you, the boss.

A related topic is managing your stress, which is critical. I have found that daily exercise before work shoots me up like a drug and works for me. The founder of Uber and former CEO Travis Kalanick would take 10 minutes of every day doing a breathing exercise, and that was enough to supercharge his day when the press was pursuing him. Naval Ravikant, the CEO and founder of AngelList, swears by meditation every day.

I suggest that you do all of the above. Your business depends on the clarity of your mind and the control of your emotions.

I hope that I have given you a snapshot and a set of techniques that can help you be successful. As for myself, the waves are crashing, and I am going to sleep on one of the many decisions I need to make, such as firing employees, not for bad performance, but because I cannot pay them.

(Ping.) That was my WhatsApp, which went off as I was editing this chapter. I have just had a friend verbally confirm a $20,000 investment into my startup. That amount is enough for me to not fire staff and keep development going for a few extra months. When people refer to the roller-coaster of being a startup founder, this is an example of just another day.

7

STRUCTURING YOUR STARTUP FOR SUCCESS

LEGALVISION

Lachlan McKnight, *Chief Executive Officer*

Launching a startup is a nerve-wracking endeavour, with daily challenges as well as huge ups and downs. It is not surprising that many founders do not spend a significant amount of time dealing with the legal side of things when they first launch. The reality is that a startup lives and dies by its product, its ability to make sales and, often, its ability to raise capital. No founder has built a billion-dollar business just because of a solid legal setup! Nevertheless, structuring your startup for success from launch is crucial to your future success. Although setting things up correctly may not make you successful, not doing things properly can easily lead to the collapse of your startup.

So, what does structuring your startup for success look like? The first step is simple—do not spend too much time and money on getting your legal structure right. Although the legal structure is important, you should be focused on getting the basics sorted out so you can quickly move on to building your product and sales pipeline. In terms of the nuts and bolts, you need to focus on four key areas:

1. Company structure
2. Intellectual property (IP) protection
3. Getting your customer contracts right
4. Making sure that you are hiring, incentivising and managing employees correctly.

If you lock down the above-mentioned basics, you will have structured your startup for success, which means you can get back to growing your business without worrying that things will come apart at the seams due to inadequate initial structuring.

1. STRUCTURING YOUR BUSINESS

WHY HAVE A COMPANY STRUCTURE?

Once you have decided to take the plunge and launch your startup, you will need to start thinking about your business structure. Every business operates through a business structure of some kind. Many small businesses choose to use a sole trader structure, while others operate through a unit trust or discretionary trust structure. None of these structures are appropriate for a startup that is looking to scale. The most important reason for this is that fast-growth startups often seek to raise external capital from investors. A sophisticated investor will generally only invest in a company structure. It therefore makes little sense to set up anything other than a company when launching an Australian-based startup.

It is important for founders to understand how a company is governed. The details of governance will be set out in your company constitution and shareholders agreement, which are two important legal documents that every startup needs if it has more than one shareholder. In general, the shareholders of a company will be empowered to make certain decisions affecting the company, and other decisions will be made by a board, the members of which are appointed by shareholders in accordance with an agreed-upon formula. It is vital that you understand the details of your shareholders agreement, particularly the sections that relate to control of the company. If your startup raises external capital, your investors will have rights as shareholders, and potentially the right to one or more board seats.

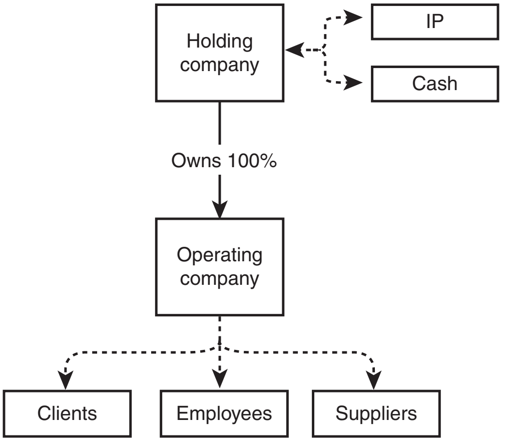
SHOULD I CONSIDER A DUAL COMPANY STRUCTURE?

If you decide to operate your business through a company structure, you should consider whether to use a dual company structure. A dual company structure involves setting up a holding company that owns 100 percent of the shares in one or more subsidiary operating companies. The holding company will generally own the startup's IP, as well as any capital that is not needed for day-to-day operations, while the operating company will enter into contractual arrangements with clients, suppliers and employees.

A significant benefit of setting up a dual company structure is to protect your startup's major assets (IP and excess cash). In circumstances where the operating company is sued, these assets are, to a degree, protected. Another advantage of a dual company structure is that it allows management to set up more than one subsidiary to operate different business lines, or overseas entities, if required. This flexibility is valuable to startups that are looking to rapidly scale into several vertical markets or jurisdictions.

You should, however, be aware of the additional costs associated with a dual company structure.

FIGURE 1. Dual company structure



IP = intellectual property

Furthermore, in some limited circumstances, a dual company structure may not operate as intended, and the assets held by the holding company may not be protected. Nevertheless, if you are planning on building a large startup, it is worth thinking about setting up a dual company structure (Figure 1).

HOW SHOULD FOUNDERS OWN THEIR SHARES IN THE HOLDING COMPANY?

The last question founders should ask themselves from a structuring perspective is how they plan to hold their shares in the holding company. Two main options are

- holding them personally
- holding them through a discretionary trust.

Owning them through a discretionary trust makes sense for two main reasons: (1) asset protection, and (2) tax planning.

As the startup founder, it is likely that you will be a director of your company. In certain circumstances, you could be held personally liable for debts incurred by the startup. If this situation were to happen, you would be much more comfortable if your assets (including any shares you own in the startup) were held by a separate legal entity, such as a discretionary trust. Founders rarely want to think about downside protection, but not all startups are successful!

Owning your shares through a discretionary trust also makes sense from a tax planning perspective. If you eventually sell your shares in the startup, or indeed choose to start distributing dividends, a discretionary trust can give you discretion to distribute the proceeds to beneficiaries on lower marginal tax rates. This approach can significantly reduce the amount of tax payable in either circumstance.

It is generally advisable to set up your discretionary trust at the same time that you incorporate your startup. Any transfer of shares from an individual to a trust is a capital gains tax event, so making a change after you have had some initial success is unlikely to be financially viable. By investing in the most appropriate structure early, you can save yourself significant difficulties.

2. PROTECTING YOUR INTELLECTUAL PROPERTY

Intellectual property (IP) protection is a significant issue for startups. Much of the value generated by many startups is in their IP, such as their code or content. This is not always the case, but even for startups that are not creating their own IP, brand protection is important.

WHEN SHOULD I LOOK TO PROTECT TRADE MARKS AND DOMAIN NAMES?

As with many business decisions, founders often have to make trade-offs around trade mark and domain name protection. In the early days, it is tempting to try to save on costs and not trade mark your business name until you have firmly settled on it. But once you have decided on a business name, you should take action quickly. If your startup gains traction, your brand will become valuable, and by then it could be too late to protect it. At the same time, you should make sure that you purchase all relevant domain names (generally the .com and .com.au for Australian startups).

WHAT CAN I PROTECT?

Trade mark law is relatively complex, so it is important that you seek advice when taking steps to register your trade mark. As a general rule, you cannot register generic words that are commonly used to describe a type of business, such as ‘online clothes store’. Geographical names, the names of international organisations and offensive marks also cannot be registered.

SHOULD I REGISTER MY LOGO AS A TRADE MARK?

When you register a word trade mark (for example, your business name), you are protecting the word or phrase. If you choose to register your logo, you are protecting the image and its overall impression, taking into account the shape, orientation and configuration. If your logo is just a stylistic representation of your name, then you may be sufficiently protected by registering the name or phrase only as a trade mark. However, if your logo has a distinctive appearance or is key to your branding, you should also consider registering the image to ensure maximum protection of your IP.

SHOULD I APPLY FOR A PATENT?

Patents are designed to protect inventions. Most startups do not invent anything new, which means they do not need to consider patent protection. If, however, you have invented a new device, substance, method, or code, it is worth thinking about patenting it. There are two types of Australian patents:

- a standard patent
- an innovation patent.

A ‘standard patent’ offers protection for up to 20 years and goes through a rigorous examination by IP Australia. An ‘innovation patent’ has a lower threshold of patentability, but it only provides up to eight years’ protection. Although cheaper, innovation patents are much more limited in their use. An innovation patent is granted automatically if the formal requirements are satisfied, but it is not enforceable until IP Australia has substantively examined the invention.

If you are considering patenting, the first thing you should do is speak to a patent attorney. A good patent attorney should discuss your invention with you and then provide guidance on whether it is worth pursuing either a standard or an innovation patent.

WHAT ABOUT GLOBAL IP PROTECTION?

As your startup gains traction, you will start thinking about international IP protection. For most startups, the cost of international IP protection at launch will be prohibitive, but it is vital that you remain aware of the opportunities for international trade mark and patent protection as you scale your business.

3. DEVELOPING CUSTOMER CONTRACTS AND WEBSITE DOCUMENTS

Unless you are building a deep tech startup, you will be looking to sell (or at least provide services) to customers very soon after launch. Making sure your customer contracts are legally correct from the get-go is vital. Startups often operate through business models that are unfamiliar to potential customers. One example is a software as a service (SaaS) business model. It is therefore vital that your business terms are clear, concise and enforceable.

WHAT DOCUMENTS DO I NEED TO HAVE IN PLACE TO SELL PRODUCTS OR SERVICES TO CUSTOMERS?

Every business enters into contracts with customers. These contracts are often verbal, but this does not mean they are not enforceable. Of course, it is better to make sure all your contracts are in writing, and if possible, it is better to ensure that you offer similar terms to all your customers.

The document that most startups use to set out the terms upon which they are selling goods or services to their customers is generally called 'business terms and conditions'. The type of business terms and conditions you provide to customers will differ depending on the type of business you are running and the types of clients you are selling to. For instance, a startup with an SaaS business model will need to put in place an SaaS Agreement, and an e-commerce business will need a set of sale terms and conditions. Both documents would normally be provided online through a 'clickwrap agreement' (i.e., an agreement that the customer agrees to by clicking to agree). Service-based startups will need to provide a client agreement to their customers.

It is important for an early-stage startup to provide a legally enforceable contract to customers. An equally important reason for investing in a high-quality set of business terms and conditions is that they will make your startup look serious and professional to prospective customers. This factor can be incredibly important when trying to close sales as an early-stage startup.

WHAT DOCUMENTS DO I NEED FOR MY WEBSITE?

Ideally, we would like every website visitor to turn into a customer, but unfortunately that is not really the way things work! It is therefore important to ensure that you put up a set of 'website terms of use' on your website. These terms are designed to govern your relationship with visitors to your website. They help protect your IP and limit your liability in relation to matters such as third-party links, service outages, prohibited or unintended use and loss as a result of reliance on information (but only to the extent allowed under the Australian Consumer Law). Website terms of use can be drafted cost-effectively, so do not spend a significant amount on getting them drafted. Finally, it is also prudent (and often required) that you provide a 'privacy policy' on your website, which sets out how you will be dealing with any personal information you collect from visitors and customers.

4. INCENTIVISING YOUR EMPLOYEES AND STAYING COMPLIANT WITH EMPLOYMENT LAW

Australia has a relatively complex industrial relations environment. There are no exemptions from employment obligations for startups, so it is vital that you comply with all relevant rules or regulations—if not, you are putting your business at risk. The next section covers a few key questions that you should ask yourself when bringing new team members on board.

IS THE TEAM MEMBER AN EMPLOYEE OR A CONTRACTOR?

When hiring new team members, the first thing you need to consider is whether they are an employee or a contractor. Taxation, superannuation and employment law obligations differ for each, and this issue can get early-stage startup founders into trouble. Some factors that determine whether a worker is a contractor or employee are set out in Table 1.

Importantly, you cannot call a worker a contractor while treating the person as an employee (this is also known as 'sham contracting').

DO I NEED EMPLOYMENT CONTRACTS FOR MY EMPLOYEES?

All employees need employment contracts. It is remarkable how many founders do not bother with ensuring that their employees have an agreement signed in the early days. Your employment contracts should address several standard issues (IP, restraint of trade, leave requirements, etc.). In the startup space, it is especially important to include an extended probation period (ideally, six months). Startup life is not for everyone, and a lengthy trial period helps both the startup and the team member work out whether there is a good fit.

HOW DO EMPLOYEE SHARE SCHEMES WORK?

You want the best person for the job on the job. But as a startup (unless you have raised plenty of capital), it is unlikely that you can pay top dollar for team members. This is where an Employee Share Scheme (ESS) comes in. Under an ESS, you can offer team members shares or options to buy shares in the company. Nearly every high-growth startup will have an ESS. Offering team members shares or options in the startup can help bridge the gap between their startup salary and an equivalent corporate salary. An ESS is also a great way to ensure that your employees feel like they have a real ownership stake in the business and that their interests align with your startup. The startup's success will be their success.

In July 2015, the Australian Taxation Office (ATO) made changes to how they taxed the ESS in startups. If certain eligibility criteria are met, you can issue shares or options to purchase shares

TABLE 1. Factors determining employee versus contractor status

Has control over work	Does the hirer have the right to exercise detailed control over the way work is performed, or does the worker have full autonomy?
Has a separate place of work and advertises services	Is the worker required to wear a uniform or display material that associates them with the hirer's business?
Provides and maintains significant tools and equipment	Is the worker required to supply and maintain any tools or equipment (especially if expensive)?
Has the right to delegate or subcontract work	Is the worker free to work for others at the same time? Can the worker subcontract the work or delegate work to others?
Has income taxation deductions	Is taxation deducted by the hirer from the worker's pay?
Is remunerated by task completion	Is the worker paid according to task completion rather than receiving wages based on time worked?

to employees, and they will only be taxed when they make a financial gain (usually when they sell their shares). In other words, the ATO will not tax your employees when you issue shares or options to them, when their shares or options vest or when they exercise their options (if applicable). After all, it does not make sense for employees to pay tax on something that may ultimately prove worthless if the startup goes under.

Once employees sell their shares (generally on an exit event), any gain made will be taxed as a capital gain. If employees have held the shares or options for longer than one year, they should be eligible to receive a 50 percent reduction in the capital gains tax they must pay.

As previously mentioned, certain eligibility criteria must be met for the tax concessions to apply. You will need to speak to a lawyer or an accountant who understands the startup space to get advice on whether your startup qualifies.

CONCLUSION

A successful startup journey is a long one. If you are lucky, you will rarely be dealing with legal issues, but the best way to ensure this is the case is to set up your business correctly from the get-go. Because of the explosion in startup activity in Australia over the last five years, several legal advisors with a significant amount of experience in assisting startups are available. This means that you will not have to spend huge amounts to get your startup set up in a strong position from the start. Good luck with the journey!

8

SUCCESS STARTS FROM WITHIN

EMPLOYSURE

Ed Mallett, *Managing Director*

At the start of your entrepreneurial journey, you envisaged your big, innovative idea—a revolutionary product or service to solve a customer's problem, a unique way of doing things or a novelty concept for the customer's world.

When you set off, you primarily think about the customer, because it is the customer who matters—their needs, their wants, their motivators. It is fair to say that most entrepreneurs do not start a business to become an employer. But starting a business means that you will more than likely become an employer—a leader with the responsibilities that come with employing people. Before you assume that this chapter is a Branson-inspired motivational lecture on being a great leader and listener, we should talk about the basics imperative to the success of your business.

Although running a business naturally comes with challenges, becoming an employer means many more complexities need to be considered. Not only do you need to manage the safety of your people, but you also need to manage the relationship with them while simultaneously staying focused on growing your business.

Australia's workplace relations system is a highly regulated minefield. Because you are operating in one of the most complicated employment relations systems in the world, navigating your way through the system can be difficult, but you must get it right. Managing employee paperwork, conduct, behaviour and performance can be time-consuming—even for experts.

Often, employers become familiar with the employment relations system only when something goes wrong. They may have had a claim or a complaint made against them with the Fair Work Ombudsman or Fair Work Commission.

Positively, employees can also be the business's best assets when the relationship is healthy and you have the foundations built for a successful business.

DO YOU KNOW THE LAW?

As an employer, you need to adhere to certain requirements to guarantee that employees are treated fairly and that your business complies with the Fair Work Act. Regardless of your specific business model or industry, employees are granted certain rights and entitlements associated with your industry (most notably, a minimum rate of pay). It is important for employers to understand their obligations under Fair Work legislation as well as maintain them within their businesses. Failure to do so can result in serious consequences, such as investigations and fines.

Two bodies govern the oversight of the Fair Work Act's practical application in Australian workplaces—the Fair Work Commission and the Fair Work Ombudsman.

These agencies work in tandem to administer, govern and ultimately oversee the principles of fair work within Australia and ensure that employees and business owners adhere to what is included in the legislation.

With this idea in mind, it is important for you to be aware and informed of any requirements and obligations under the Fair Work Act. The Act includes all variances and instruments of employee entitlements and regulations, including the National Employment Standards (NES), Modern Awards and Enterprise Agreements. These standards, Awards and Agreements are mandatory, and individual employment contracts cannot override the minimum entitlements outlined in the NES or any corresponding Modern Award.

The Act changes frequently, so it is important to keep up-to-date with changes across the following:

- updates to parental leave
- concurrent parental leave
- minimum wages
- flexible working arrangements
- anti-bullying or harassment measures.

AWARDS—AND I DO NOT MEAN TROPHIES

An Award sets out the minimum wages and conditions for a certain job or industry. For example, a shop assistant may be covered by the General Retail Industry Award 2010, and a hairdresser may be covered under the Hair and Beauty Industry Award 2010. Awards apply automatically unless your employees are covered by a registered agreement. Awards apply on top of the NES and can include information on the following:

- minimum wages—including annual wage or salary arrangements
- types of employment—full-time, part-time or casual
- extra payments—penalty rates, overtime and allowances
- work arrangements—rostering or variations to working hours
- extra leave—annual leave loading and arrangements for taking leave
- superannuation
- procedures for consultation, representation and dispute settlement.

Some employees are not covered by an Award or Agreement. These employees are still covered by the NES and the National Minimum Wage.

WHAT GOES IN AN EMPLOYMENT CONTRACT?

You would not enter into a commercial relationship without a written agreement, so why would you enter an employment relationship without one? It is best practice to provide contracts for your employees, even where there is Modern Award coverage or an existing Collective Agreement.

A contract should provide a simple and useful reference point for both parties across all aspects of the employment relationship. It must provide the same or more generous conditions than the NES and any relevant Award or Agreement and cannot undercut an employee's minimum entitlements.

Payment is also an important element in the contract between an employer and an employee. Details of the rate of pay and the method and frequency of payment should be shown in the employee's contract of employment.

WHAT SHOULD YOU PAY YOUR EMPLOYEES?

The Government sets minimum levels of pay that are dependent on a variety of factors, including business sector and job duties. An employee's minimum pay rate is set by the relevant Award or Agreement.

Where there is no Award, pay rates in a registered Agreement cannot be less than the National Minimum Wage. This rule only applies to base pay rates, while penalties, loadings and allowances still come from the Agreement.

If employees are not covered by an Award or Agreement, they are entitled to be paid at least the National Minimum Wage.

In addition, there are ‘pay as you go’ (PAYG) taxation deductions that you are required to make from your employees’ pay on behalf of the Australian Taxation Office. Also, be conscious of your business’s obligations under the Superannuation Guarantee.

You are required by law to issue an itemised pay statement to each employee within one working day of payday and to keep records of these for seven years.

Pay slips must cover details of an employee’s pay for each pay period. The pay slips should include the following:

- the employer’s name and Australian Business Number (ABN)
- the employee’s name
- date of the payment and the period the pay slip covers
- before and after tax amounts
- if paid hourly—the employee’s hourly rate, the hours worked at that rate and the total amount paid at that rate
- if paid a salary—the employee’s salary rate
- loadings/allowances/bonuses/incentive payments/other separate monetary amounts
- any deductions
- super contributions made or required for that pay period and the fund name or name and number.

You can pay employees weekly, fortnightly or monthly—it is up to you, but you must pay the correct amount and on time. Payment to your staff must be your first priority.

WHAT ARE EMPLOYEE ENTITLEMENTS?

Employees take leave for many reasons: to go on a holiday, because they are sick, or to take care of sick family members. There are minimum leave entitlements for all employees—an Award, Agreement or contract of employment can provide for other leave entitlements, but they cannot be less than what is in the NES.

ANNUAL LEAVE

Unless your employees are casual, they are entitled to a minimum level of paid annual leave. The amount of leave should be decided on before your employee joins your business.

Your permanent employees’ amount of leave will be calculated on the basis of an accrued annual entitlement, and part-time employees will receive an amount *pro-rata* to the entitlement of your full-time employees. For example, a full-time worker working five days a week may receive 20 days of annual leave in a year. A part-time worker working 2.5 days a week may receive 10 days of annual leave.

The leave year starts on each employee’s start date, with their entitlement accruing from there. Annual leave is cumulative from year to year.

You should keep accurate records of the precise holiday entitlement for each employee, including their entitlement on termination of employment.

Unless your business has fixed shutdown periods throughout the year during which your employees must take their holidays, your employees will choose when they wish to take holidays and will make a request for the time off, subject to an accrued entitlement.

SICK LEAVE

The attendance of your employees at work is vital to the smooth running of your business, and you are entitled to expect your employees to attend to carry out the work you have employed them to do.

It is best practice to have an employee handbook outlining the rules and procedures in place within your business. The handbook should include a section that relates to the way in which employees should notify you if they are sick and therefore absent from work.

It is a good idea to keep track of the amount of sick leave with a process for recording.

An employee is required to inform you if he or she is sick and will not be attending work. Most businesses require notification by telephone, but you can choose to accept other forms of notification, such as a text message or an email. If notification is not made in accordance with your conditions, you should consider bringing this matter to the attention of the employee.

Your policy will detail at what stage an employee needs to provide a medical certificate from a medical practitioner. Typically, it is on every occasion when employees are sick, but some employers may only require this after two days—it is up to you.

WHAT EMPLOYEE RECORDS DO I NEED TO KEEP?

Record-keeping and pay slip obligations ensure that employees receive correct wages and entitlements, and employers can use them to show they have paid employees correctly.

You need to keep detailed records for each employee about his or her employment, such as pay, hours of work, leave, superannuation and other matters.

These records must:

- be readily accessible to a Fair Work Inspector
- be legible and in English
- be kept for seven years
- not be changed, except for the purposes of correcting an error
- not be false or misleading.

Employees need to be issued a pay slip within one working day of being paid, either electronically or in hard copy.

WHAT IF AN ISSUE ARISES?

Often, workplace issues arise because employers and employees do not know what the law is or because communication has broken down. If problems arise in the workplace, it is important to take time to understand and discuss the issues with your employees.

Most workplace issues can be resolved with the right tools and communication (Table 1).

HOW CAN I BEST MANAGE EMPLOYEE PERFORMANCE?

Good employee management is linked to lower staff turnover, higher productivity and business success. Effective managers know how to motivate and communicate with their employees. They also understand their legal obligations and promptly deal with any problems arising in the workplace.

PERFORMANCE REVIEWS

You should regularly assess the performance of your employees in a formal process; this can be done quarterly, biannually or annually. It is a way to ensure that your staff members are aligned, engaged and performing well in their roles.

It is important to remember that performance reviews should not be used as part of the disciplinary process, nor should a performance review meeting be used as an opportunity to raise disciplinary issues with an employee.

TABLE 1. Resolving workplace issues

1. Check the process.	2. Discuss the issues.	3. Put all actions in writing.
Most Awards and Agreements have a dispute resolution procedure. If unsure, check with workplace specialists.	Prepare yourself for the conversation. Make time to talk to the employee without interruptions. Listen, keep an open mind and consider all points of view.	Document all conversations and agreed next steps in writing to set out issues or outline any courses of action that are agreed to.

DISCIPLINARY ISSUES

Where you notice an employee's performance has begun to decline to a level causing you concern, the reason for the decline could be one of many. Whatever the reason, you will need to take measures to try to restore the employee's performance to a satisfactory level.

EMPLOYEE ENGAGEMENT

A great way to start on improving employee engagement is to speak with employees and ask the hard questions. Feel comfortable to ask your employees what they want from management and what satisfies them in their role.

Some key questions may be:

- Is the work you are performing challenging enough?
- What are your career plans?
- Do you understand how your work contributes to the business?
- What do you most enjoy about working for the company?
- What can I do to assist you in your role?

Once you know what you need to improve, you can begin implementing changes to help engage your employees.

WHAT SHOULD YOU DO WHEN EMPLOYEES LEAVE YOUR BUSINESS?

Termination of employment is when an employment relationship ends. This situation can happen for several reasons, including redundancy, resignation or dismissal.

Full-time and part-time employees are entitled to a certain period of notice of termination, or payment in lieu of notice. The notice needs to be given to them in writing, and the amount of notice depends on the employee's length of service and age. It is important to check the Award, employment contract or Agreement to see whether there are any conditions and if a longer notice period is required.

DISMISSAL ISSUES

If you are going to dismiss an employee, you have to make sure you do it 'fairly'. If an employee makes a claim for unfair dismissal, the Fair Work Commission will look at two main factors when assessing whether the dismissal was fair or not.

The Fair Work Commission will look to see whether the dismissal was for a valid reason, and whether a fair process was followed.

The only reasons considered valid for termination are:

- conduct
- capability
- genuine redundancy.

Consideration will be given as to whether the termination was a justified and reasonable response in the circumstances. Even if it is established that the dismissal was for a valid reason, the business must still be able to show that it followed a fair process. Whether a termination was fair or unfair will essentially be for the Fair Work Commission to decide by using the specific facts of each case.

With *all* dismissals, it is vitally important to follow any applicable dismissal procedure and the provisions of any applicable dismissal code. For example, the *Small Business Fair Dismissal Code* allows employers with less than 15 employees to dismiss an employee within the first 12 months of their work for justifiable reasons only. The justifiable reasons include a genuine redundancy or during a proven time of hardship for the business. However, caution should be given about following a fair dismissal process that is well documented with evidence, such as written warnings, statements or witnesses.

Because of the often-complicated and wide-ranging nature of circumstances involving dismissing an employee, you should get expert advice before considering dismissing an employee.

WAYS TO MINIMISE DISMISSAL CLAIMS

Follow these five steps to minimise the risk of being hit with an unfair dismissal claim:

1. *Have clear descriptions of unacceptable behaviour.* Train your staff on good conduct and include clear descriptions of unacceptable behaviour in employee handbooks. These trainings and descriptions can cover every aspect of employee functions (absenteeism, sick leave, performance and, most importantly, conduct).
2. *Do not keep policies in a drawer.* You have gone to the trouble of creating workplace policies, so it is important that staff know about them. A written or computer quiz could ensure that employees have read and understood the policies.
3. *Consistency is key.* All disputes should be dealt with consistently. This means that you should adhere to your own policies and procedures to the letter, in every case. Consistently addressing conduct issues will help staff perceive what is appropriate workplace behaviour and what is not.
4. *Have meetings before the situation gets out of hand.* If an employee is stepping out of the defined code of conduct, you are within your rights to schedule a disciplinary meeting to clearly outline the employee's unacceptable behaviour. Following this meeting, a formal, written warning may be justified. If the misconduct is repeated or it constitutes serious misconduct, this situation could ultimately justify dismissal.
5. *Get the best advice.* Get expert advice to develop solid employee contracts, workplace policies and performance management programs to put you in the best position possible before a dispute occurs. You should not act hastily, but instead use expert guidance to gain knowledge of your rights and obligations as an employer.

HOW CAN YOU CREATE A WORKPLACE WHERE PEOPLE WANT TO BE?

Having engaged employees within the workplace can greatly impact the culture of your business in a positive way. Good business culture can lead to:

- mutual trust between management and employees
- reduced turnover rates, and therefore reduced recruitment costs
- attraction and retention of talented employees
- improved customer service
- employees who are often more adaptive to change in a competitive climate
- increased employee commitment, which can lead to increases in profitability
- employee advocacy—engaged employees recommend the company's products and services.

Although ping-pong tables, nap rooms and casual dress codes are nice to have in a workplace, none of these get to the heart of what culture is.

Culture starts by defining your core business values. Getting clear on values means establishing how your staff interact with each other and the guiding principles for how you conduct business with customers.

The next step in clarifying your culture is to state what the values will look like in daily life: how you want them to show up as patterns of standard behaviour. For example, Commitment as a value could be defined as three behaviours, such as: *Our word is our bond: when we say we will do something, it gets done every time to the expectations with which the commitment was made. We avoid overcommitting and underdelivering*. If the value is Adaptability, then the behaviours could be illustrated as: *We are consistently improving approaches to work, based on prior experiences. We are not afraid to commit to areas outside the role or* *comfort zone.* These are great examples: they are clear and simple, they are visible—you could easily see whether someone was behaving in this way—and they are well connected to the values of commitment and adaptability. Defining your values in this way allows you to use them practically in creating the culture you want: in hiring, rewarding, granting promotions and fostering development.

Once you have chosen what you stand for, embedding the values into the business as normal practice involves a combination of offering skill development or knowledge, establishing incentives, removing barriers and supporting management—even holding yourself accountable to consistently model those behaviours reflecting the values.

Approaching your business culture in this way is more effective than just putting up a values poster in the break room and talking about culture. The good news is, it works. You are much more likely to end up with a culture your people enjoy being a part of, where they do their best work and take pride in working with others to create a successful business.

THE TAKEAWAY

Because the most important resource for any business is its people, it pays to give close attention to employee issues. You cannot afford not to.

A business that does not treat its staff fairly and safely will never be successful—after all, a fair and safe workplace sets solid foundations for success. For that reason, the requirement for employee management is a perpetual investment as your business grows, evolves or changes.

In practice, employee management can quickly take over if you do not get proactive. Start success from within.

9

WHAT MAKES YOU DIFFERENT? HARNESSING THE FULL PULLING POWER OF BRANDING

PRINCIPALS

Wayde Bull, *Planning Director*

In the early days of your new venture, many practical issues will scream out for your attention: the need to structure your finances, define your launch offer, get a measure of your customers and competitors and shape a winning pitch to foundation investors and staff.

It is easy to let the topic of branding slip down your to-do list, given so many fundamental business challenges to solve. But we would encourage you to think about branding as more than a cosmetic afterthought.

WHY DOES BRANDING MATTER FOR STARTUPS?

Branding strategy is about establishing, as early as possible in your startup journey, the meaningful differences you will deliver to customers that will help you to carve out clear market space versus your competitors'. Then, seek to amplify these key differences through everything that your business does.

A question you will be asked by potential customers, investors and employees alike is, 'What makes this business different?' In each of these challenging marketplaces—for customers, capital and talent—you need to be able to confidently set yourself apart by identifying your essential differences from competitors that will help make your business a lasting winner. As strategy sage Michael Porter explains, 'A company can only outperform rivals if it can establish a difference it can preserve' (What is strategy? *Harvard Business Review,* Nov./Dec. 1996). Nailing your differences early will make it easier for you to tell a consistent brand story to the many audiences you need to win over.

Of course, the most immediate impact that branding will have on your business is to shape your physical identity through a name, logo, colours and illustrations. But branding today is about more than just the way your business looks. It is also about the way your business thinks, speaks and acts: forms of differentiation that can be sustained in the long term, beyond momentary product or service advantage.

Customers today expect brands to deliver great experiences that extend beyond purely functional features and benefits. There is a need to create a total delivery culture around your new business that is customer-centred, purposeful and full of personality. Your brand is the mechanism to help to capture your distinctive culture and help it to spread, as your team, your customer base and your market presence grows.

Michael Bierut describes a brand as ‘an empty vessel into which meaning is poured’ (*How to use graphic design to sell things, explain things, make things look better, make people laugh, make people cry, and (every once in a while) change the world*. London: Thames & Hudson, 2015). As a startup entrepreneur, it is exciting to consider the handful of big ideas that will define the meaning of your new brand. From day one of your business, that metaphorical glass is being filled. Will the ideas that you choose to fill it with distinguish your business from others, or mark it down as just another ‘me-too’ brand? The choice is yours.

PURPOSE, PERSONALITY AND BREAKTHROUGH VALUE HELP DEFINE SUCCESSFUL CHALLENGER BRANDS

In our experience, the upstart brands that quickly reshape markets have colourful identities combined with a crystal-clear understanding of the breakthrough value they unlock for customers. Brands that are purposeful, characterful and obsessed with customer value have the greatest chance of toppling incumbents.

THE POWER OF PURPOSE

Purpose has emerged as a powerful leadership concept because it is about building a sense of shared meaning between organisations and their users. As innately social animals, we are energised by the idea of coming together in the pursuit of worthwhile change. And startups are especially invested in this idea of bringing change to markets for the benefit of many.

Howard Stephenson wryly describes entrepreneurship as ‘the pursuit of opportunity beyond resources controlled’ (Eisenmann, T. R. [Jan. 10, 2013]. Entrepreneurship: A working definition. *Harvard Business Review.*). Therefore, think of your brand’s purpose as a means to help unlock other people’s resources, by getting them inspired and excited about the change that your new business is seeking to bring to the world.

CASE STUDY: FOX SPORTS

Fox Sports is a big and deeply resourced brand in Australia, yet one that still thinks like a challenger, seeking to overturn tired conventions in free-to-air sports broadcasting. Its purpose is ‘to share our love of sport in ways that include, entertain and surprise our fans like no other and get them closer to the game’. This purpose statement is designed to speak to Fox Sports people in a way that is both inspiring and directive. It seeks to encourage staff to share their deep knowledge and passion for sports while tirelessly searching for new ways to get their viewers closer to the action, whether it is through fresh camera angles, insightful statistics or outspoken commentary.

Ask yourself: in what way does your brand help customers to access something they care deeply about, that your team can get equally excited about delivering?

THE POWER OF PERSONALITY

Most markets today are crowded with high-quality brands offering remarkably similar functional performance. Think airlines, cars, personal tech—it is now a rarity for a brand in any of these sectors to win by appealing to a customer’s rational instincts alone. The brand with the longest list of product features no longer wins. There is a need to inject emotion into every buying decision and to help customers to relate emotionally to a brand’s story.

The simple motive behind brand personality is to imbue your business with positive human traits that help to make the brand more likeable. Just as we build friendships with people because of their shared values and endearing behaviours, the same theory applies to building friendships with brands.

Think about brand personality as the way that your business chooses to speak and act, in a consistently characterful way, to build customer rapport and loyalty over time. Give your brand a sense of character, a point of view, maybe even a sense of humour, to make it more memorable and more interesting for people to get to know.

Never underestimate the potential, as a challenger, to stand out from established competitors because of a more colourful and provocative personality. Big brands in big sectors tend to be safe, unexciting and beige. Offer up change enthusiastically—and build a brand that more viscerally engages people's emotions.

CASE STUDY: UBANK

In 2007, National Australia Bank had the idea of creating a free-spirited new bank that would offer a complete break from 'big four' thinking, a bank with low rates, great service and a totally direct relationship with its customers. UBank was born with the goal of changing banking for the better, forever.

The way that UBank thought about building its personality was to promise a complete counterpoint to (begrudgingly) accepted big-bank norms:

- We're inventive and smart-working, not passive or shirking.
- We're completely service driven, not waiting to be forgiven.
- We're challenging the status quo, not going with the flow.
- We're focused on you, not who's next in the queue.
- We're in it for customers, not in it for ourselves.

Ask yourself: how should your brand turn up in its sector and behave in a way that is refreshingly different to current brands?

THE POWER OF BREAKTHROUGH VALUE DELIVERY

Startups have immense latitude to reshape markets through the smart application of technology and fresh thinking unconstrained by legacy. This 'blanksheet advantage' can lead to exciting breakthroughs in customer value delivery.

The most differentiated brands in Australia, based upon Principals' 2017 Brand Alpha study, are Ikea, Apple, Bunnings, Aldi and Amazon. All relatively new-to-town businesses, they have scaled their competitive advantage through bold branding, characterful personalities and out-of-the-ordinary customer value delivery, executed through proprietary delivery models. (Note that all these leaders have their own dedicated distribution channels, enabling them to deliver upon their brand promises with total integrity.) These brands think, look, speak and act differently to all others in their sector—and are richly rewarded for doing so.

CASE STUDY: EVERLIGHT

Everlight is a global radiology practice borne out of an opportunity to connect specialists around the world through telepresence technology, to share their workflow and dramatically reduce diagnosis times for hospitals and patients. By working across multiple time zones, tracking the sun, Everlight is able to confidently claim 'It's never after hours' in its practice. Given its incredible diagnostic pace and accuracy (with 99.5 percent of urgent reports delivered back within one hour), the brand promises 'everyday critical' support to hospitals and corporate radiologists everywhere: delivering highly personalised care, wherever in the world it is needed, on demand.

Ask yourself: how might your brand dramatically reshape the market it is entering by redrawing the traditional boundaries of geography, time, cost or quality?

FIVE STEPS TO BOOT YOUR BRAND

1. BUILD A BRAND STRATEGY ON A PAGE

Bring together your team (and anyone who is close to the needs of your target audience) and seek to capture on a page:

- *Your brand purpose:* In a sentence, seek to express 'why you do what you do'. A great purpose statement connects your personal motivations for starting the business with a big, exciting change that you are seeking to deliver to your users. Keep it simple and heartfelt. For example, Simon Sinek explains that his purpose in life is 'to inspire people to do the things that inspire them' (Sinek, S. [2016]. *Start with why: How great leaders inspire everyone to take action*. Joosr Ltd.).

- *Your brand personality:* Avoid assembling a laundry list of adjectives. Instead, isolate just three traits that capture the spirit of your new business—a rational trait (to help build respect), an emotional trait (to help build relatability) and a reaction trait (the overall feeling you want to leave with users, as a result of experiencing your brand).
- *Your breakthrough value proposition:* In a sentence, link together a definition of your target audience (recognising that upstarts are smart to focus on a small yet attractive slice of the total market at first), your key competition (who or what you are principally competing against) and, most critically, the unique value that you intend to deliver to knock out your targeted competition.

For startups, it is impossible to overstate the importance of cut-through thinking in your brand proposition. To displace more familiar and trusted competitors, you will need to offer their customers something tangibly better to convince them to switch. In 1989, John Lyons colourfully described a strategy as 'a carefully designed plot to murder the competition' (Lyons, J. *Guts: Advertising from the inside out.* New York: AMACOM, 1987). He offers this challenging checklist for your brand proposition:

- Any premise that lacks a killer instinct isn't a strategy.
- Any premise that doesn't reflect or include a customer's crying need isn't a strategy.
- Any premise that can't make up its mind, overburdened with more than one objective or idea, isn't a strategy.
- Any premise that is embalmed in stiff, predictable language—phrases like unique formula, the best possible, state of the art, leading edge—isn't a strategy.
- Any premise that addresses the whole world—women 3 to 93—isn't a strategy.
- Any premise that's interchangeable with that of another product or category isn't a strategy.

2. SECURE A NAME FOR YOUR BRAND

A tough early test is to secure a legally registerable name and URL for your new business, given that practically every common-use word in the dictionary is already registered or, frustratingly, reserved for possible future use. You will need to brainstorm hard to come up with a fresh and category-relevant name. Three classic styles of names can be considered, and we encourage you explore them all with an open mind:

- *Literal names:* These seek to anchor a business in a fact or a category that is tangible. Brands like National Australia Bank (NAB), Broken Hill Proprietary (BHP), Snowy Hydro and Australian Gas Light Company (AGL) have this direct, no-nonsense, 'does what it says on the tin' quality. But keep in mind that if you are a new entrant into an already crowded market, it is going to be difficult to come up with a literal name that feels fresh and different—and is also registerable as a business and online entity. This territory tends to be dominated by heritage brands, registered long ago.
- *Lateral names:* These seek to combine something that cues the category with something fresh and new. Think brands like Boost Juice, Jetstar, Mind Your Own Business (MYOB) and James Squire's beer (in tribute to Australia's first brewer). By introducing a fresh dimension to a business name, the chances of registerability are dramatically improved.
- *Coined names:* These break entirely with category specifics and offer maximum latitude for creativity. Think Atlassian (referencing the mythical titan Atlas), Accenture (a name supposedly derived from the idea 'accent on the future'), Florigene (a biotech company that genetically modifies flowers) and Zinifex (alluding to zinc, the key commodity traded by this business).

Brand naming is more art than science. Do not fall heavily in love with just one name. Draft a long list of candidates, favouring lateral and coined options, and do preliminary checks for registerability as a business (via https://asicconnect.asic.gov.au) and as a domain name (choose a registrar or reseller via https://auda.org.au). Consider twists and misspellings in order to make names registerable (think Vodafone and Solagard). Ultimately, choose the name that best echoes key themes in your brand purpose, personality and proposition—because names with an underpinning of logic will give you a head start in the market.

3. DEVELOP A COHESIVE BRAND IDENTITY SYSTEM

Work with a branding agency that can help you to build a cohesive identity system made up of the following core elements:

- a logo
- a set of fonts
- a set of primary and secondary colours
- an illustrative and/or photographic style
- a distinctive tone of voice.

Even the largest brands in the world build their identities from these foundation elements. A great deal of thought—and debate with your team—will go into their creation, but once agreed, these elements can be 'locked down' in a set of practical brand guidelines to help your team to develop consistently 'on brand' communications.

Although most startups recognise the need to manage the consistency of their brand's visual identity, the opportunity to manage their brand's tone of voice—as an equally powerful source of differentiation—is often overlooked. Think about the way that Virgin has consistently harnessed the power of cheeky, playful language to differentiate itself from 'square' competitors. It is an element of its branding system every bit as powerful as its visual identity. Do not forget to tap the power of characterful language for your brand.

4. CRAFT YOUR ELEVATOR PITCH

As you prepare to launch your brand to the world, develop an elevator pitch to share with all staff and partners. Draft your pitch using this simple construct: 'Brand X is a (what we do) that (the way we do it) so (our core target audience) enjoys (benefits 1, 2, 3)'. This model yields a short, sharp benefit-led statement ideal for use in team-building sessions and conversations with business partners and investors.

For example: 'Subaru is a performance carmaker that fuses design and technical brilliance so our drivers enjoy exceptional performance, safety and retained value'.

5. DEVELOP MEMORABLE BRAND SIGNATURES

Marketing used to be about the 'management of claims' that brands made about themselves, largely in paid media. Today it is about the 'management of experiences' that are delivered through every interaction with a user.

Think about the way we have come to know a breakthrough brand like Uber. Although this brand has not been conventionally advertised, word has spread via enthusiastic early adopters. We download the app, dive in and give it a try. And quickly discover it is a thoughtful service, with its disarmingly simple prompt, 'Where to?' We can see several cars within reach, moving across our phones in real time. The moment a car is ordered, we feel confident about making our destination on time, as the hired vehicle starts moving towards us, with its estimated time of arrival and driver contact details right on hand. We take a ride, enjoy a free bottle of water, reach our destination and simply walk away from the car with no payment hassles. Too easy.

Uber is a great example of a business focused on the delivery of memorable end-to-end user experience, with branding cues deeply embedded in its user interface. Start early to think about ways to make your customers' brand journey as effortless as Uber's. But do not forget to add in elements that are memorable signatures for your brand—what is your equivalent of Uber's supremely simple 'Where to?', their cute animations, their free bottle of water or their effortless just-walk-away payments protocol?

Many brand signatures today are screen based, like Google's ever-changing Doodles or Instagram's love heart. But think about brand signatures designed to engage the other senses: sound effects like Intel Inside, the inescapable smell of entering a Victoria's Secret store or the pleasingly tactile experience of releasing a new Apple device from its beautifully snug packaging. These small yet thoughtfully designed interactions speak volumes for brands.

CONCLUSION

Start as early as possible in your startup journey to debate your brand's purpose and personality and the nature of the value breakthrough you can deliver to customers. These features are the key sources of meaningful difference that can be amplified through your brand—its name, identity, story and signature experiences. Consistently celebrate difference in your business. Aim to think, look, speak and act differently to others in your sector—and you will be rewarded.

10

DEVELOPING AN IP STRATEGY

SPRUSON & FERGUSON

Sylvie Tso, *Principal*

Natalia Blecher, *Senior Associate*

David Müller-Wiesner, *Patent Attorney*

The 'To-Do List' of a typical seed-stage company overflows with mission-critical tasks. To many, considering intellectual property (IP) in its corporate strategy might seem premature or a luxury not permitted by the available time and budget. However, early consideration and deployment of a well-formulated IP strategy can assist your organisation to plan, capture, track and protect the outcomes of its investment in innovation. It positions your company to attract and retain investment at any stage of the growth curve, generates returns from the IP developed in the course of your business and lays the groundwork to protect markets from competitors.

It is worthwhile pursuing these outcomes and allocating appropriate resources to supporting them from the outset. This chapter offers guidance on how to develop and deploy an IP strategy that is appropriate to support your venture.

WHAT IS AN IP STRATEGY, AND WHAT IS ITS PURPOSE?

Ideally, IP should be integrated into your business model canvas. Developing an IP strategy means considering IP when developing your business strategy and goals. An IP strategy:

- articulates how to use IP to protect and grow your business, capture market share and deter competitors from encroaching on your rights
- captures and categorises your enterprise's IP
- allows intelligence and insights to be fed back to your core operations.

Having an IP strategy assists a growing organisation in a variety of situations. During market discovery, an IP strategy can be used to generate market intelligence around competitors' positions in the market or highlight opportunities to secure rights in markets of interest by registering relevant IP.

When raising funds to grow an organisation, or when commercialising IP, having a well-considered IP strategy and 'IP schedule' (which is a form of register that lists your organisation's IP) can de-risk venture capital. Well-defined IP rights and obligations also facilitate risk management when defining partnership or joint venture agreements (where the seed-stage organisation often ends up the disadvantaged junior partner).

Although these eventual outcomes may appear daunting or far on the horizon, a relatively modest initial investment of time and seed funds to consider IP in a company's corporate strategy can reduce the overall costs incurred in growing its business.

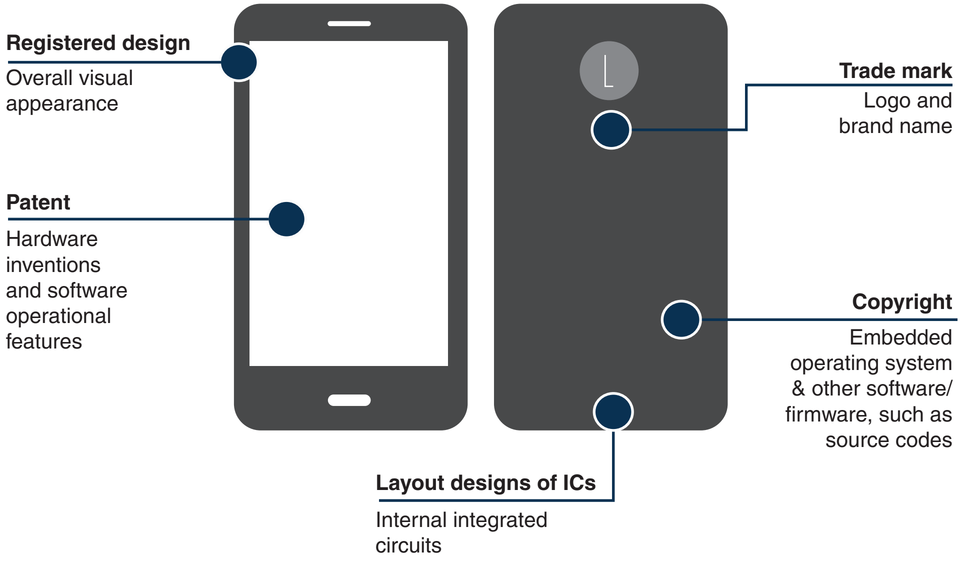
IP STRATEGY DEVELOPMENT BASICS

As yet, there is no off-the-shelf IP strategy solution. This is no surprise. IP is not a goal in itself, but a means to achieve the commercial goals of an organisation. Each IP strategy necessarily depends on the unique position, objectives and risk appetite of each organisation. Some essential elements, however, should be considered in the development of any IP strategy.

The process usually starts with introspection. Set aside a few hours to perform a topographical review with your co-founders, floating and capturing your thoughts around each of the issues flagged below:

- *IP leadership:* Consider who within your organisation will be responsible for driving, reviewing and updating the IP strategy over time. Depending on the skills available within your organisation, and the importance of IP to your core activities, this may be yet another hat for an executive or a dedicated position. It may be that this role is supported by an IP professional or advisor with good access to and knowledge of your core commercial activities.
- *Your products and services:* Consider the products and/or services that your organisation is offering and the extent to which they may be protected by IP. (Figure 1 illustrates the different sorts of IP protection that may be available in respect of a mobile phone.) Estimate the likely lead time for your products or services to get to market and their life cycle once they arrive, because these factors may affect your priorities when it comes to IP spending. It is advisable to include all current, in-development and 'pipe-dream' activities as part of this process so that the IP strategy is appropriately forward-looking.
- *Geographic footprint:* Identify where your products or services are manufactured or provided and whether the processes of manufacture or service provision will be undertaken directly by your organisation, contracted out or undertaken pursuant to a joint venture. Consider putting in place confidentiality or IP ownership provisions in the relevant agreements.
- Also identify your key sales markets and rank them based on anticipated returns, projected launch timing and whether the market is business-critical or more of a 'nice to have'.

FIGURE 1. An example of intellectual property protection for a mobile phone



Tier 1 markets would typically be high-value markets into which you have concrete plans to operate (including your home territory). Because IP rights are territorial in scope, the laws governing the requirements for protection and enforcement of IP tend to vary from country to country. Matters where local law may have a large impact, such as branding selection, freedom-to-operate in light of prior rights, parallel imports of your products by licensees, and industrial standards that may apply must therefore be considered on a market-by-market basis. This situation may affect the growth and sales strategies of your organisation and should be considered in the market discovery phase of your company.

- *Licensing and distribution:* Consider what your distribution network will look like if all goes according to plan. Identify those outside your organisation who will or may be interested in licensing your IP. Consider product markets and geographic markets beyond your immediate focus that could generate revenue for your company through IP licensing.

Having conducted an introspective analysis based on the above factors, you will be better placed to determine which IP is core to your business, which non-core IP could be used for tangential revenue generation at a later stage, and the markets in which you intend to protect and exploit that IP.

You should then consider the broader competitive IP landscape in which you operate. This approach will position you to make an informed selection between minimalist, defensive or offensive strategies for the use, management, protection, commercialisation and enforcement of your IP.

- *Competitors:* Identify your competitors, what their IP portfolios look like, the aggressiveness and sophistication of their IP strategy (so far as you can ascertain this), and what available intelligence sources say about challenges they have faced in securing or enforcing their IP, including disputes to which they have been a party.
- *Tendency for encroachment/litigation and appetite for risk:* Consider the extent to which players in your space tend to keep their distance from the IP rights of others. If possible, get a sense of the incidence of IP litigation in your field and whether parties to disputes tend to be large and well resourced. Relatedly, consider the value proposition of your IP to potential infringers (i.e., the costs of licensing relative to the costs associated with infringement proceedings). These factors are likely to influence the IP cost/benefit equation, which is at the heart of determining your company's appetite for risk.

IP GOAL SETTING

Once you have completed the introspective analysis and considered the topographical industry-specific issues, you can determine the value of IP to your organisation and what approach to take to protect and exploit your IP. Your organisation may take a strictly minimalist, defensive or offensive approach to IP. Typically, however, a well-formulated IP strategy adopts elements of all three approaches to support the company's commercial priorities.

THE MINIMALIST APPROACH

It may be that, based on the information gathered so far, you form the view that IP is unlikely to shape or significantly affect decisions regarding product or service development, manufacture, supply or distribution. You might consider that a worst-case IP scenario is unlikely to emerge, or if it does, that your company is well placed to escape relatively unscathed. In this case, you might opt for a fairly minimalist strategy that emphasises risk management over the pursuit of a robust rights portfolio.

To avoid or manage risks, one must know where the risks lie. Professionally conducted clearance searches can be undertaken to identify prior rights that may pose risks to your planned operations. The results of those clearance searches should provide a realistic picture of the obstacles in your path. It is valuable to retain these insights in a simple IP schedule to avoid confusion or double-spending down the line.

Clearance or name searches conducted as part of a minimalist strategy should also be fed back to commercial decision makers, because the intelligence could be useful in planning sales strategies or identifying new opportunities.

Armed with knowledge of the obstacles lying ahead, you can consider appropriate risk management strategies. Such strategies may include obtaining legal advice on any infringement risks that were identified, negotiating licences from holders of prior rights, developing contingency plans in case a worst-case IP scenario does arise, and designing around any IP obstacles arising in a particular market.

THE DEFENSIVE APPROACH

Enterprises in which IP supports actual or planned revenue-generating activities usually adopt, at minimum, a defensive stance with respect to their IP. Defensive strategies utilise IP as a shield to fend off allegations of infringement by third parties and to deter the incursion of would-be infringers. For most organisations seeking capital investment, a defensive strategy is a must to de-risk the injected capital.

Any effective defensive IP strategy is underpinned by a well-articulated IP protection program. The key here is to know what protectable IP exists within your organisation. This means identifying the nature, scope and strength of each relevant IP right and, critically for nascent corporations, knowing who owns what. A well-articulated IP protection program does not necessarily call for all identified IP to be registered, but it means that the decision whether to proceed with protection is structured for, and informed by, your organisation's commercial goals.

All forms of IP should be looked at, including patents, trade marks, designs, copyright and trade secrets, and the ownership of such forms of IP should be ascertained. If your organisation did not begin life with an IP schedule, now is the time to create one. Creating an IP schedule provides visibility of your company's entire IP landscape and facilitates the implementation of strategic IP decisions.

You can easily search publicly available databases for IP rights in the name of your organisation. You can also canvass your organisation's collective physical and mental memory to check for any IP rights (registered or unregistered) that may exist. If the information proves elusive, IP service providers can be engaged to conduct an audit that:

(a) summarises all identifiable IP rights in existence

(b) identifies possible gaps in protection.

Armed with a clear picture of existing IP within your organisation, you can work with your IP service provider to formulate a protection plan and obtain recommendations regarding the registration of rights for defensive purposes.

By this stage, you should have secured all necessary company and business name registrations and domain names licences. These items are not IP rights per se, and they do not confer enforceable rights against competitors. However, it is convenient to consider these registrations as species of 'quasi-IP', which are worth documenting in an IP schedule.

Defensive IP strategies typically incorporate the 'due diligence' aspect of the minimalist model; namely, clearance searches to identify prior conflicting rights that might present risks to your organisation. That same information can now be used to identify and develop strategies for surmounting obstacles to the use or registration of your organisation's IP.

THE OFFENSIVE APPROACH

An offensive IP strategy focuses on acquiring and protecting IP that gives your organisation an advantage over its competitors. Therefore, IP is part of the ammunition that drives your commercial goals. In general, an offensive IP strategy requires a robust set of rights supported, if possible, by the resources to enforce them. Ideally, the IP rights block likely 'design around' alternatives, so far as this is possible having regard to the existing prior art.

An offensive IP strategy aims to rigorously defend core markets. It incentivises others to bring themselves within the fold of a licensing program rather than risk the wrath of your organisation should they infringe, or even come close to infringing, your IP. A good offensive strategy is visible to the world because of your preparedness to execute on it. To that end, it is prudent to undertake routine maintenance of your IP schedule and to monitor relevant markets for competitor activity.

To develop an offensive IP strategy, you will need to assess the extent to which your product and your sales channels can be protected in relevant markets and the strength/enforceability of your IP rights. The IP schedule, already being maintained as part of a defensive strategy, should identify your IP rights. However, an IP schedule maintained as part of an offensive strategy will typically be a more sophisticated document that includes data on IP-related spend and income.

Table 1 provides a 'menu' of options for minimalist, defensive and offensive IP strategies.

TABLE 1. Approaches to intellectual property (IP) due diligence, protection and enforcement

Minimalist	Be aware of IP considerations during initial design and development. Check that works created for the company (e.g., website content, images, software code) are not copied. Conduct clearance searches against IP databases in core markets, and consider competitor searches/watches. Develop a basic IP schedule determining who, within and outside your company, owns what IP, and consider necessary assignments. Ensure that potentially patentable methods and future products are communicated to IP decision makers.
Defensive	Ensure that IP developed for the company is owned by or otherwise licensed to the company. This is especially important for copyright in works created by independent contractors or other individuals who were not employees at the time that works were created. Seek protection of critical IP, where available. Ensure that persons handling confidential information are aware of disclosable and non-disclosable details of your operations, and train these persons to use your IP schedule. Enforce IP where necessary to safeguard your monopoly, prevent confusion or protect a product/service category from incursion by competitors.
Offensive	Seek protection in respect of less critical IP. Consider broad and/or defensive filing programs. Maintain watches on IP databases and core markets. Monitor competitor activity, oppose problematic IP filings and enforce IP to thwart competitor activity, stymie market incursion or capture market share. Send letters of demand and/or letters putting competitors on notice of your company's IP. Register copyright where applicable. (Australia does not offer a copyright registration system.) Conduct routine portfolio reviews and take steps to fill gaps in protection. Have a robust distribution network underpinned by appropriate agreements with IP and confidentiality provisions.

SUMMARY: STEPS TO KEEP YOUR IP STRATEGY ON TRACK

A typical seed-stage company may think that considering IP in its corporate strategy is more trouble than it is worth. That sentiment is understandable, particularly for companies with shoestring budgets that simply do not accommodate deployment of some of the more advanced strategies discussed earlier. However, decisions at the seed stage lay foundations for what will become a world-class IP strategy during the growth and expansion stages of a company. Like many other commercial decisions at the seed stage, a small commitment early on can more than pay for itself down the track.

Here are some simple, cost-effective measures that can be taken by any venture to get on the front foot with its IP:

1. *Assign responsibility.* Someone should take the lead on considering and keeping an eye on IP in its corporate strategy and adjusting the level of resource commitment to the organisation's needs and changing circumstances.
2. *Keep records.* Maintain a schedule of the IP related to particular business activities. As the company grows in sophistication, the schedule may be used for other purposes, such as registration prioritisation or market development. At a minimum, an IP schedule should identify the form of IP, ownership of such IP and the territory in which it exists.
3. *Clarify ownership.* Although this task is nominally part of keeping IP records, a seed-stage company often has some catching up to do in clarifying, centralising and recording ownership of IP assets. Failure to appropriately record ownership can result in protracted conflicts with departing founders, employees or investors.
4. *Build IP currency.* It is impossible to capture IP that is not being brought forward by the IP generators. Ensure that technical and creative staff understand what sorts of intellectual output may be registrable IP or worthy of being internally designated as a trade secret. Educate your staff as to the 'dos' and 'don'ts' to effectively protect your IP.
5. *Keep the IP strategy alive.* Your IP strategy should not be rigid. It is important to conduct periodic reviews and to adapt your IP strategy to reflect changes in commercial priorities, appetite for risks, competitor activity and other matters.
6. *Provide information and feedback.* Inform appropriate decision makers in your organisation of significant shifts in the IP landscape. A major filing program of your competitor may significantly affect the rollout or target markets for a product or service. Similarly, a highly litigious competitor might affect pivot decisions during market discovery.
7. *Involve IP professionals.* Good IP professionals understand the commercial constraints on seed-stage companies and work with you to develop appropriate budgets for advisory and other IP work. Early involvement of IP professionals can prevent costly mistakes that may otherwise only present on, and grow with, the success of your company.
8. *Sell your hard work.* Including your current or projected IP position (edited for disclosure management) in press releases, website material, presentations and reports builds your reputation as an organisation on top of its IP. At the very least, this information can be attractive to investors and make competitors think twice before wilfully infringing your rights.

11

FUNDING ISSUES AND INNOVATION

GLASSHOUSE ADVISORY

Tracey Murray, *Director – Innovation Incentives & IP Economics*

Funding the development of an innovative product or service is often as challenging as the innovation itself, especially for startups or businesses with limited capital reserves or cash flow. Lack of funding to progress through the various stages of development is often cited as the most common reason innovation ideas do not reach commercialisation. What can businesses do to make sure this issue does not stand in the way of getting their products or services to market?

THE ‘CYCLE OF INNOVATION’?

Put simply, the ‘Cycle of Innovation’ outlines the steps any business needs to pass through during its journey from ‘ideation’ (the development of the idea) through to commercialisation, together with the forms of Government funding that could be available for each stage within the ‘Cycle of Innovation’ (see Figure 1). Knowing what Government funding is available for each stage of the development life cycle, well in advance of entering each stage, makes planning for grant applications more structured and therefore increases the likelihood of success.

PLAN THE ‘CYCLE OF INNOVATION’

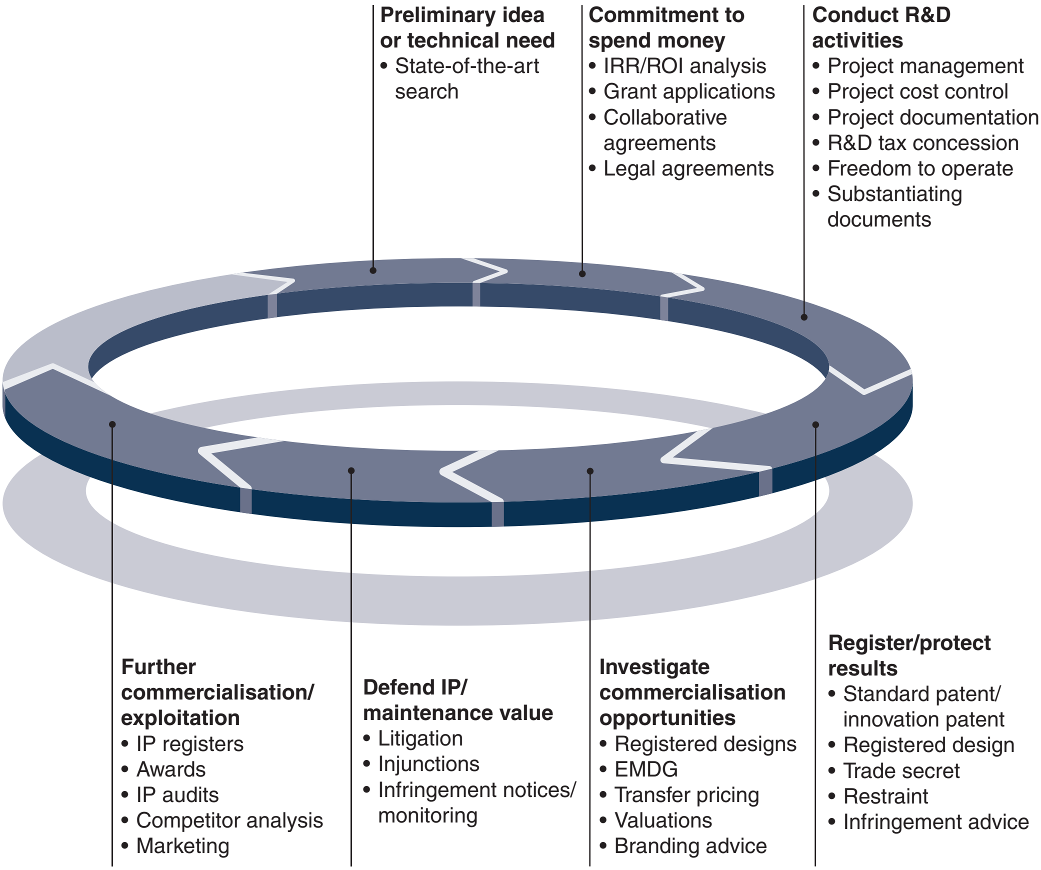
Most businesses developing a new product or service tend not to spend enough time considering the various stages of the innovation life cycle, including milestones, key performance indicators around when to stop the project and funding options for the various development stages. However, a good understanding of the ‘Cycle of Innovation’ will not only provide a more structured approach to the development process (and thus, an increased chance of success), but will also assist in identifying various Government funding opportunities to match each stage within the ‘Cycle of Innovation’. This approach will ensure that any application for Government grant funding is lodged in a timely fashion, is specific (in terms of reason for funding and expected outcomes) and is focused on the objective of the grant and the outcomes the Government is seeking to achieve from the grant.

GENERAL ADVICE ON IDENTIFYING AND ACCESSING GRANTS

Several Federal Government–based websites provide up-to-date information regarding availability of Federal grants. These include:

- www.grants.gov.au
- www.business.gov.au

FIGURE 1. The ‘Cycle of Innovation’



EMDG = Export Market Development Grant; IP= intellectual property; IRR/ROI = internal rate of return/return on investment; R&D = research and development

Several grants are offered by State Governments. It is prudent to undertake a comprehensive search prior to the conduct of any development activity, to assess the range of potential grant opportunities available before progressing too far down the development track. Indeed, several grants are announced and then closed within a very short time frame (i.e., three months). If you know that the Federal Government routinely announces grants to assist in increasing jobs in Tasmania and South Australia, you can start identifying any projects that fall into this category of grant prior to the grant being announced. By adopting this strategy, key grant eligibility documents (such as business plans, financial budgets, management capability documents, etc.) are prepared and ready to form part of a specific grant application, once the right one becomes available.

Your company can apply for competitive or non-competitive grants:

- *Competitive-based grants:* These grants are assessed against merit criteria and against the merits of other applicants. They generally have a defined pool of funds and are periodically released to achieve a specific Government objective, such as regional growth, jobs, training or growth in a specific industry. Competitive-based grants are unpredictable both in when they will become available and in the potential for success, because it is not possible to ascertain the strength of other applications to these programs.

- *Non-competitive–based grants:* These grants are merit based and are assessed for eligibility against merit criteria, but not against other applicants. Key examples of this type of grant are those from the Research and Development Tax Incentive Program and the Export Market Development Grant (EMDG). Although this form of grant is not assessed against other applicants, the level of funds available is limited. Statutory limits can apply, such as $100 million maximum in research and development (R&D) expenditures. Funds can also be limited via the operation of a defined pool of funds, such as the EMDG program, where 100 percent of the grant is often not paid because of oversubscription to the program.

KEY ADVICE IN ASSESSING GRANT FUNDING

In applying for grant funding, if progress through the 'Cycle of Innovation' is dependent on grant funding (particularly competitive grant funding), it is important to have a clear Plan B (equity or debt funding) because the receipt of grant funding can never be guaranteed. All Government grants need the support of the Government—in multiple instances, a change in Government circumstances (such as via a Budget announcement, a change in Government or the calling of an election) has resulted in a stalled or revoked grant program. Furthermore, for some grants (specifically, competitive grants), it can take up to 12 months before a decision is made, during which time any expenditure incurred is ineligible, even if the business is successful in its grant application.

Having a clear and implementable Plan B to fund each stage of the 'Cycle of Innovation' is critical to the business maintaining control over the rate of development and the speed of commercialisation.

The following sections summarise key Government grants that are available during each stage of the 'Cycle of Innovation' within Australia.

1. PRELIMINARY IDEA OR TECHNICAL NEED

Opportunities to secure Government grant funding at the ideation stage of the 'Cycle of Innovation' are very limited. This stage is all about identifying the opportunities and barriers around the initial idea. However, a range of grants is available to assist with improving various aspects of a business or to assist the business to make the best of any opportunities for growth. For example, the Department of Industry, Innovation and Science currently has ongoing 'Business Growth' Grants, which provide non-competitive funding of up to $20,000 to engage a consultant to provide improvements via business evaluations, supply chain facilitation and similar activities. Most State Governments offer some form of small grant or workshops for small to medium enterprises that are aimed at enhancing underlying financial or management capability to ensure that businesses are best positioned to take advantage of growth opportunities.

2. COMMITMENT TO SPEND MONEY

At this stage of the 'Cycle of Innovation', businesses should be looking at what specific grants are available over the development/commercialisation phase of the product life cycle. Most competitive grants require the company to provide details of financial history, budgets, projected spend, quotes for key stages, equipment, size of the market and so on. In concert with searching for specific grants to aid in financing future development, companies should be committing resources to ensuring that the 'business basics' of the project are well detailed and documented.

3. CONDUCT R&D ACTIVITIES

This phase of the 'Cycle of Innovation' is resource intense, from a technical personnel perspective as well as financially. This phase is, however, where significant financial assistance is available from both competitive and non-competitive grants.

The most relevant grant offered by the Federal Government during the R&D phase is the 'R&D Tax Incentive' program. This grant applies to all industries as long as they meet specific eligibility criteria, including the following:

- The company must be incorporated under Australian Law (there are several exemptions for foreign branches).
- An activity within the project must meet the definition of 'experimental activities' (i.e., the experiment seeks to validate a hypothesis, is conducted systematically, seeks to generate new knowledge and addresses a current knowledge gap).
- The activities must be conducted on the claimant's behalf.
- R&D activities must be registered with AusIndustry within 10 months of the end of the company's financial year.
- Activities and costs have not been paid for by a third party.
- Expenditure is deductable for tax purposes (i.e., not capital).
- There is sufficient documentation to evidence eligibility to each criterion.

The R&D Tax Incentive program is an eligibility-based Government program that is highly accessible across a range of industries. It provides businesses with up to 8.5 cents in the dollar tax credit for business with an aggregate turnover of more than $20 million, and up to 43.5 cents in the dollar for loss-making entities with an aggregate turnover of less than $20 million. However, unlike competitive Government grants, the tax benefit is paid as part of a company's income tax return rather than as an up-front payment, which means companies challenged by cash flow might also need to establish interim funding opportunities until their R&D tax rebate is received.

Other Government grants available to conduct R&D activities are generally assessed on a competitive merit basis and currently include the following:

- Australian Research Council grants
- Department of Education and Training 'Educational Support' grants
- Department of Infrastructure and Regional Development 'Regional Development' grants
- Department of Industry, Innovation and Science's 'Entrepreneurs Program – Accelerating Commercialisation' grant.

Grants change from time to time, so it is important to keep an eye on grant availability and deadlines when in this phase of the 'Cycle of Innovation'.

4. REGISTER/PROTECT RESULTS

Although this is a very important stage in the 'Cycle of Innovation', opportunities to secure Government grants are very limited. An exception is the EMDG (discussed in detail in #5).

5. INVESTIGATE COMMERCIALISATION OPPORTUNITIES

The primary Government grant available to support this stage of the 'Cycle of Innovation' is the EMDG.

Under this program, applicants must be an Australian business and have an Australian Business Number, have a turnover of under $50 million, and be seeking to export eligible goods or services. Applicants can claim up to 50 cents in the dollar for eligible expenditures, up to a maximum of $150,000 for up to eight grants.

The types of costs that are eligible under the EMDG program include the following:

- *Overseas representative:* The cost of maintaining a long-term representative to market/promote products overseas.
- *Marketing consultants*: The cost of using marketing consultants to undertake market research regarding overseas markets.
- *Marketing visits:* Costs associated with overseas marketing visits include airfares and a daily travel allowance. If you undertake a trip with multiple purposes (i.e., visit an overseas foundry/manufacturing facility and visit potential customers overseas), applicants can claim the portion of the trip that relates to marketing.
- *Free samples:* The cost of providing free samples to promote your products for export.

- *Trade fair attendance and presentations:* Costs associated with attending or presenting at trade fairs or seminars.
- *Marketing materials:* External costs associated with producing brochures, branded goods, videos, advertising and similar materials for use in overseas markets.
- *Trips for overseas buyers:* The cost of bringing potential overseas buyers to Australia to view the businesses facilities/production capabilities.
- *Intellectual property (IP):* Registration and/or insurance of eligible IP in overseas jurisdictions (i.e., patents and trade marks).

Applicants must have spent a minimum of $15,000 to apply, and grants follow the standard Australian financial year (30th June each year). Applications open 1st July each year and must be lodged by 30th November the same year (for self-lodgers) or 28th February the following year for applicants lodging via approved EMDG consultants, such as Glasshouse Advisory.

6. DEFEND IP/MAINTENANCE VALUE

Unfortunately, very limited grant opportunities are associated with this aspect of the 'Cycle of Innovation'.

7. FURTHER COMMERCIALISATION/ EXPLORATION

This phase refers to opportunities to extract the maximum value from a company's investment in innovation, by investigating awards and related approaches that could be applied for following the success of a program of R&D activities.

Government grants for this phase of the 'Cycle of Innovation' are limited.

EQUITY AND DEBT FUNDING

Self-funding and government funding usually have to be supplemented by raising equity and debt. This process can be particularly difficult for early-stage and high-growth companies with few tangible assets. Lack of revenue, or losses caused by investment in R&D, together with a weak balance sheet, often present roadblocks to investors.

Depending on its stage of development, entrepreneurs can gain equity funding from a range of sources, including crowdfunding, angel investors, private equity, corporate investors or listing on the Australian Securities Exchange. These sources of funding are covered in more detail in other chapters and summarised in Table 1.

TABLE 1. Sources of equity funding

Type of Funding	Investment Goal or Strategy	Overview
Crowdfunding	Crowdfunding relies on getting your idea out to as many people as possible. Because the funding is based online, most rewards-based crowdfunding campaigns are short but intense campaigns requiring extensive marketing by founders.	The most common way to crowdfund is online, through social media and other platforms using crowdfunding websites (such as Kickstarter and GoFundMe). Every crowdfunding campaign has two components: raising funds and fostering brand awareness/promotion. Both are equally important. The four types of crowdfunding are: 1) charitable 2) reward based 3) debt/loan based 4) equity-based. (Equity-based crowdfunding is currently not legal in Australia under Corporations Act 2001)

(Continued)

TABLE 1. Sources of equity funding—*(continued)*

Type of Funding	Investment Goal or Strategy	Overview
Angel investors	Some angel investors are looking for 'the next big break'. Others are looking for a good risk-adjusted return. Angel investors are diverse and, from a purely practical aspect, can range from somewhat conservative to high-risk takers and philanthropists with extensive networks.	Angels make decisions typically on their own and are not beholden to anyone except perhaps their spouses. Meanwhile, VCs (micro-, institutional and corporate) will have an investment committee whose members work together to make decisions so that they are as objective as possible and will not be swayed by just one member's excitement over a deal. Angel investors are more likely to work with founders and prepare founders for seed funding through VCs.
Micro-VCs	Micro-VC funds finance early-stage companies and are quick decision makers.	Micro-VC funds offer fast, smaller-scale investment, usually in initial seed rounds. These resources are controlled by experienced investors looking to get in early with the 'next big break' (and take more of a risk in doing so), but the investors inherently still rely on an investment committee.
Institutional VCs	Institutional VC funds are looking for startups that have gained traction and are growing fast. Institutional VCs like to control more aspects of the investment in return for more significant investment and prestige.	Institutional investors are considered more proficient at investing due to the assumed professional nature of operations and greater access to companies and management because of their size. It is common for them to invest in post-seed rounds (after an angel round or micro-VC round). Many will restructure a business for initial public offerings.
Corporate VCs/investors	Corporate VCs/investors tend to be acquisition focused. They are funded and backed by large institutional investors, including government agencies and banks.	They are focused on the balance sheet. Corporate VCs and investors are looking for an outsized return on investments that tend to have strategic objectives such as synergies with other parts of their business. Many large corporations have their own VC arms, and these look for the same things as institutional VC funds by way of organic growth and returns.

VC = venture capital firm

In Australia, most debt funders require an established cash flow or the use of fixed property for collateral. In time, it is likely that more innovative providers will consider high-quality IP property rights as collateral. In the U.S., the market has developed significantly since the 1997 Bowie bonds and Sears 2007 US$1.8 billion trade mark–backed bond issues. Within Asia, the Singapore and Malaysian governments have for some years promoted IP financing schemes for small and medium-sized companies. It is a matter of time before an Australian lender gains the expertise to assess the quality of earnings and risk profile of IP, thereby effectively pricing IP-based loans.

COMMUNICATING VALUE TO INVESTORS

Despite the recognition of the importance of intangible assets (such as technology and brands), meaningful assessment of these assets often falls through the gaps between commercial and legal due diligence. Few investors have the integrated capability to evaluate the legal, functional and economic characteristics of these complex assets, so it is in the entrepreneur's interest to communicate and substantiate the value of these assets in information memorandums.

The good news is that it is possible to rigorously assess the earnings potential and risk profile of intangible assets, even early-stage technology. A robust discounted cash flow valuation helps substantiate a business plan by providing a line of sight between the market, the competitive advantage of the target company and the expected cash flows. Description of key intangible assets substantiates the building blocks of enterprise value and the associated risk.

A valuation is an opinion, not a statement of fact. However, a well-constructed valuation can withstand investor scrutiny by illustrating the linkages between value drivers and assumptions in the valuation model. Important building blocks of a valuation include:

- assessment of the attractiveness of the target market's size, growth and competitive forces
- evaluation of your company's differentiation, including the incremental commercial utility of technology relative to alternatives
- identification and valuation of intangible assets within the business, including a review of the extent to which technology, data and brands are legally protected, and the useful economic life of these assets
- details of distribution models
- cost structure
- expected market penetration, reflecting the extent of differentiation, distribution channels and pricing strategy
- risk assessment, covering development, market and asset-specific risks.

SUMMARY

Although not all phases of a company's 'Cycle of Innovation' can be funded or subsidised via Government grants, a significant element can. The key to securing successful funding is to be prepared (in terms of business information and documentation) and frequently investigate potential new or exciting grant programs. Furthermore, the successful funding of innovation often requires a multi-pronged approach where Government funding is supplemented by raising equity and debt. An understanding of the value drivers of intangible assets developed through innovation can greatly assist in communicating and substantiating the building blocks of enterprise value to investors.

12

RAISING YOUR EARLY ROUNDS OF CAPITAL

LEGALVISION

Jill McKnight, *Practice Leader*

Raising external capital does not make sense for every startup, but the renaissance in the Australian startup ecosystem over the last five years has led to a significant amount of capital opening up to early-stage startups. Even with this growth in the Australian startup investor base, raising a round is not easy. It is therefore vital that founders understand the basics of capital raising, from both practical and legal perspectives. This chapter will cover the following topics:

1. whether to raise or not
2. whether to raise a debt or an equity round
3. the different types of equity structures
4. the key documents a startup will need to enter into to raise a round.

With this knowledge in hand, you will be well positioned to raise your seed round or Series A round!

TO RAISE OR NOT: THE DECISION-MAKING PROCESS

It does not make sense to raise external capital just because you can. The decision to raise a round needs to be made in a structured, thought-through manner. Many startups have successfully bootstrapped their way to success (Atlassian in Australia and Basecamp in the U.S. are two examples). If your company can grow rapidly without bringing external investors on board, it can often make sense to do so.

Ultimately, the decision should be framed around the following question: 'Do I believe that raising external capital is going to help me build a more valuable company than not raising?' You will not know the answer to this question for a significant amount of time post-raise, but your thought process in relation to a potential capital raise should focus on this question.

Raising may make sense for several reasons:

- *Minimum viable product* (*MVP*) *build*: Although it is getting cheaper and cheaper to launch a startup, some startups, particularly deep tech or hardware startups, usually need capital to build and launch an MVP.
- *Rapid scaling:* Paul Graham, the founder of Y Combinator, defines a startup as a business that is rapidly growing. Although a startup might raise a seed round to build an MVP, by the time you are raising your Series A, you should be looking to scale. Having capital allows a startup to scale because it allows you to run at a

loss, hiring team members to build product and spending on marketing. Many startups grow at 5–20 percent month-on-month. The most successful startups maintain huge month-on-month growth rates year after year. These startups are the ones that end up as billion-dollar businesses.

- *Cash crunch:* Finally, many early-stage startups raise capital because they have no choice. Their costs are higher than their revenues, and they have no quick way to get to profitability. In these circumstances, you can either raise a round of capital or go out of business.

If you choose to raise capital, it is important that you understand that you have chosen a specific path, which has obvious benefits but also downsides. By taking on venture capital (VC) or angel investors, you have entered into an agreement with your investors that you will be building a business that will generate an acceptable capital return. Venture investors are not interested in a regular stream of small dividend payments. They want an exit, whether it be through a trade sale or an initial public offering. This means you will need to build a particular type of company—a big one. Do not enter into this bargain if you do not want to spend the next 10 years of your life scaling at pace!

DEBT OR EQUITY?

Once you have decided to raise, you will need to start thinking about how you are going to structure the round. The first question you will need to answer is whether you are going to raise a debt or an equity round. The vast majority of startups will not have this option—early-stage startups, in particular, are very unattractive borrowers.

Nevertheless, raising debt at a Series A stage is becoming more common in Australia. This process is generally done through a specialist venture debt fund. Venture debt funds invest in startups that have consistent and growing cash flows and a clear investment plan that will lead to profitability in the medium term. Most startups will not be suitable for a venture debt investment, but for those that are, the structure can work very well. The obvious benefit is that the existing shareholders will not be diluted and will maintain their control of the company.

The downside of raising an early-stage round using a debt structure is the risk that your startup will not be able to repay the debt. This is why most early-stage startups choose to go down the equity-raising path. Nevertheless, if your startup is generating consistent and growing revenues and you are not too far off profitability, exploring the venture debt option can make sense.

CONVERTIBLE NOTE, SIMPLE AGREEMENT FOR FUTURE EQUITY OR EQUITY ROUND?

If you have decided to raise an equity round, you will need to make several decisions around structure. An early-stage round can have three possible structures:

- a straight equity round using ordinary or preference shares
- a convertible note
- a Simple Agreement for Future Equity (SAFE).

WHAT IS AN EQUITY ROUND, AND HOW DOES IT WORK?

In an equity round, the startup issues new shares to investors in exchange for a cash injection. The key points of negotiation when raising an equity round will generally involve the company's pre-money valuation and the rights investors will be entitled to upon investing.

A company's pre-money valuation determines how many shares the investor will receive in exchange for the capital invested, and therefore the percentage shareholding each shareholder will end up with after the raise.

Certain protections can minimise the risk of investors losing their money, such as (1) issuing investors with preference shares, (2) giving investors the right to appoint a board member and (3) giving investors a veto right in respect of critical business decisions.

Understandably, investors will want to protect their investment. But it is unwise to give away too much control over your startup, particularly in its early stages. You want to maintain day-to-day operational control because you are in the best position to make decisions regarding the direction in which you want to take your startup.

WHAT IS A CONVERTIBLE NOTE?

A convertible note is a hybrid of debt and equity. It involves an investor making a loan to the startup; the loan converts to equity in the startup on a predetermined trigger event (generally the raising of a priced round or a liquidity event). The conversion rate is usually calculated by reference to the share price of the priced round or the liquidity event. Although a convertible note is therefore technically a debt instrument, its intended effect in a startup context is that the investor will end up as a shareholder in the company.

A convertible note will have a term (i.e., an expiry date). It is important to determine what will happen if the convertible note does not automatically convert before the term expires. Will the startup repay the note? Will it automatically convert to equity? Who decides: the lender or the company? If it is to convert, at what conversion rate?

Interest may accrue on the loan amount, and all accrued interest will generally convert into equity (along with the loan amount) upon the trigger event. Interest, however, is not a prerequisite.

The convertible note (and accrued interest if relevant) will usually convert to equity at a discount to reward your investor for backing your startup early on.

Although using a convertible note means you can technically delay valuing your business, some notes will have a valuation cap (i.e., a maximum price at which the note will convert into equity). Parties negotiate this valuation cap when raising the round, so you are effectively negotiating a valuation when raising under a note.

Startups typically use convertible notes at the seed-round stage, although they can be useful when raising bridging finance between rounds.

WHAT IS A SAFE?

The Simple Agreement for Future Equity (SAFE) is a relatively new way of raising capital. Y Combinator, a leading U.S. seed accelerator, introduced the SAFE in the U.S., and it is becoming increasingly popular in other countries with a strong startup culture.

The SAFE is similar to a convertible note minus the debt element. In consideration for paying a cash amount to your startup, an investor receives a contractual right to receive equity in your startup when a predetermined trigger event occurs. The trigger events are generally the same as those found in a convertible note (i.e., a priced round and a liquidation event).

The number of shares investors receive on conversion is linked to the up-front cash injection they make and the share price of the priced round or the liquidation event (as applicable). As with convertible notes, startups may issue equity at a discount, and there may be a valuation cap.

Because the SAFE is not debt, if the startup enters insolvency before the cash converts, then the startup should agree to pay the investor an amount equal to its cash injection before making any payments to its shareholders.

The advantages of raising capital using SAFEs, as opposed to convertible notes, are as follows:

- SAFEs do not have a term (which means that if a trigger event never occurs, then the investor will never receive shares).
- Interest is not payable on SAFEs, so the complexities involved in converting interest into equity do not apply.
- SAFEs are not debt instruments and therefore do not have to be repaid and are not regulated.

KEY DOCUMENTS WHEN RAISING A SEED ROUND OR EARLY-STAGE EQUITY ROUND

As a startup founder, you are not expected to understand the nuances of every single legal document you will encounter. Having said that, as a founder, your job is to know enough to get by. If you are closing your first round, you will be working closely with a lawyer who will guide and advise you, but ultimately you will have to make decisions. It is therefore vital that you understand the key documents you are likely to encounter.

TERM SHEET

If you are raising a seed round with friends and family or even, on occasion, angel investors, you will probably have to put together a term sheet yourself, obviously with assistance from your lawyer. If you are raising from a VC fund, the fund will provide you with a term sheet. The term sheet is an incredibly important document because it sets out all the most important terms relating to the raise. The following are some of the more important clauses in a term sheet:

- *Round terms:* If raising from a VC fund, one of the key issues to negotiate will be overall round terms, which will include how much the VC will invest and how big the total round will be. You will want to raise enough capital to get your startup to its next significant milestone but avoid excessive dilution at an early stage.
- *Pre-money valuation:* The pre-money valuation is the valuation at which the investor will invest in the company.
- *Post-money valuation:* The company's post-money valuation will be the sum of the pre-money valuation and the amount raised.
- *Board seat:* When raising a seed round or early-stage round, you will need to decide whether to give your investor(s) a board seat. Many VCs will not want a board seat when investing on a seed round, but from Series A and beyond, it is likely they will want a seat. Whether or not you agree to this will depend on the strength of your negotiating position.
- *Voting rights:* Your shareholders agreement will often set out a list of matters that will need to be decided by a unanimous or special board resolution. This document is designed to ensure that important decisions (such as selling assets or taking on debt) are agreed to by your investor(s), regardless of their shareholding and number of board seats.
- *Employee Share Option Plan (ESOP):* Most investors, particularly VCs, will want to make sure that you have set aside a significant portion of the company for an employee share option plan. At Series A, 15–20 percent is standard. The pre-money valuation proposed by a VC investor will nearly always include the options they want to be set aside for the ESOP. Thus, the effective pre-money valuation is lower than the number the investor is highlighting in the term sheet.
- *Founder vesting:* It is good practice to ensure that the shares of all founders vest over a period of four years, generally with a one-year cliff. This provision protects the startup from a founder leaving and continuing to own an unjustified number of shares. Many VCs will insist on founders vesting from the date the Series A is raised (known as revesting), although again, whether you agree to this will depend on your negotiating position.
- *Liquidation preferences:* Liquidation preferences are only applicable in circumstances when you are offering preference shares. As previously mentioned, seed rounds are often completed using ordinary shares, but it is very rare for a VC investor to invest in anything other than preference shares. A liquidation preference essentially entitles the investor to get paid out before ordinary shareholders. The standard liquidation preference in Australian VC deals is a 1x liquidation preference (meaning they just get the money they invested back), although in later-stage deals, an investor might try to negotiate a 1.5x liquidation preference (meaning they get 1.5x the money they invested back) or higher.

- *Anti-dilution rights:* Early-stage VCs will generally require startups they are investing in to provide them with anti-dilution rights. Anti-dilution rights can be structured in various ways. However, the overall goal is to ensure that if, in a later round, the startup issues shares at a lower share price than the share price that the VC has paid, the VC will receive additional shares reflecting the adjusted share price.
- *Pro-rata and right of first refusal:* Most shareholders agreements will include *pro-rata* and right of first refusal clauses. A *pro-rata* right entitles existing shareholders to invest in any future rounds on a *pro-rata* basis (i.e., invest a percentage of the round that is equal to the percentage of the company that they own). This measure is designed to protect them from dilution. It is also standard for each shareholder to have a right of first refusal, which entitles them to purchase any shares that are being sold to a third party at a price agreed to by that third party.

SHAREHOLDERS AGREEMENT

Once a term sheet is negotiated, agreed on and signed, you will move on to drafting and negotiating the operative, binding, deal documents. The most important of these is the shareholders agreement, which sets out the relationship between the company's shareholders as well as the division of power between shareholders and directors.

A shareholders agreement covers matters such as issuing new shares, selling existing shares, how board and shareholder meetings should be conducted, how decisions should be made and how disputes should be resolved.

You should ensure that you enter into a shareholders agreement as soon as your company has more than one shareholder. When you raise your first round, you will either have to replace or amend your first shareholders agreement because your investors will, of course, insist on many of the protections discussed in this section.

SUBSCRIPTION AGREEMENT

A subscription agreement formalises the terms of the investment with a specific investor. It is typically based on the final term sheet and specifies how many shares the startup is issuing, the subscription price for those shares and when the startup will issue the shares and company (and sometimes founder) warranties. Company warranties are statements that an investor can rely on saying that everything has been done in compliance with the law.

INTELLECTUAL PROPERTY ASSIGNMENT AGREEMENT

Intellectual property (IP) is critical to your startup's value. Startup founders may have owned their IP personally in the early stages. It is important to ensure you have assigned your IP to the same company in which your investor is investing. To do so, you will need an IP assignment agreement to transfer the ownership of the IP to the company. You may also need an IP assignment agreement if you use external developers without a development agreement. If you have a dual-company structure, the holding company should own the IP. It may, however, need to enter into an IP Licence Agreement with the subsidiary operating company to allow the subsidiary to use the IP.

EMPLOYMENT CONTRACTS

Some startups will raise a round without the founders having signed employment contracts, but this is rare. Investors want to make sure the startup has employed its founders.

CONCLUSION

The decision to raise external capital is a defining one. It places significant pressures on the founders of a startup, but it can supercharge your company's growth. It is vital that the founders and management team of startups looking to raise significant amounts of capital understand the basics, both from practical and legal perspectives. Be prepared, be fearless and aim for the moon!

13

IS AN ANGEL GROUP RIGHT FOR YOU? HOW TO WORK WITH ANGEL INVESTORS

SYDNEY ANGELS

Vivian Stewart, *Committee Member*

'Angel investors' are typically high-net-worth individuals who are willing to invest at an early, risky stage in unproven yet potentially high-growth companies. Angels can be lone-wolf investors or join an ad hoc syndicate when it suits them. However, when angels formally band together to identify, assess, coinvest and manage multiple startup investments with an agreed set of working principles, this is an 'angel group'.

Sydney Angels was established in 2008 with the mission to build a sustainable angel group that could enable and educate smart angel investors to fund and grow promising startups. Sydney Angels Sidecar Funds I & II were subsequently launched to increase available support. At the time of writing, Sydney Angels members had collectively invested in 53 companies and the group had approximately 100 members.

ACCESSING ANGEL INVESTMENT

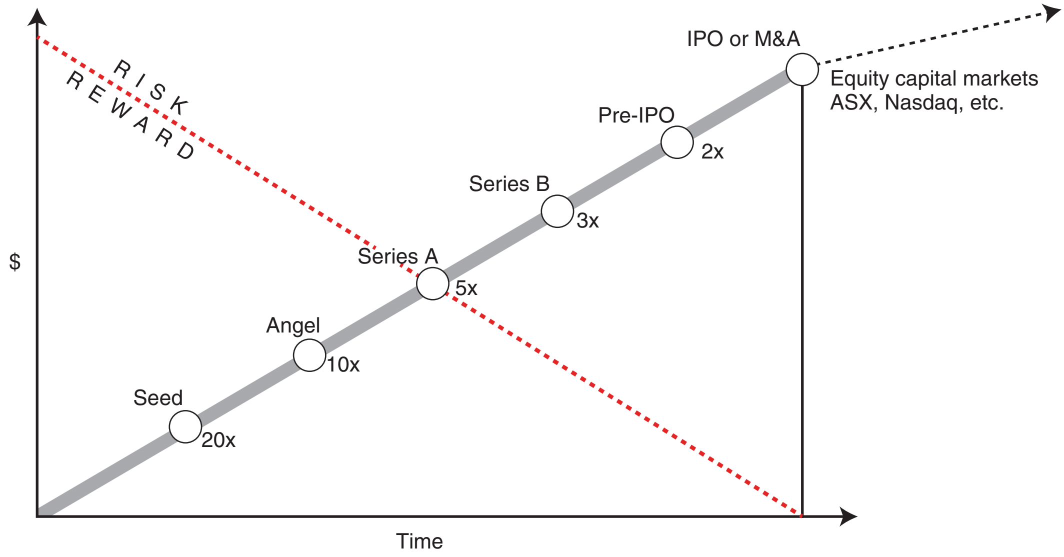
No two angels are alike, with varying availability and quantum of funds, domain expertise, numeracy, attention to detail, sophistication and any other characteristic you might observe. Working with an angel group tends to moderate the impact of these factors for the better because angels work from their strengths, spread the load, pool their capital and use an agreed process to consider investments. However, it pays to carefully observe and assess the unique personalities of the angels you interact with to learn the best way to communicate with them on the path to an investment and effective long-term relationship.

THE CAPITAL-RAISING JOURNEY

Understanding where your company is on the capital-raising journey can help identify the right types of investors. Figure 1 conceptualises a successful startup journey, although it is usually anything but a linear path!

The maturity of the company is reflected by the grey line. Companies towards the left axis are less mature, are more risky and require a much lower valuation and higher potential exit to attract investors. As a company matures to the stages towards the right, product market fit is found, customers pay for product, growth metrics become clearer, valuation increases, more money is raised and so on, typically with less demanding multiples required at exit to be palatable.

FIGURE 1. The capital-raising journey for a startup



ASX = Australian Securities Exchange; IPO = initial public offering; M&A = mergers and acquisitions; Nasdaq = National Association of Securities Dealer Automated Quotation

Source: Sydney Angels 2017

You will note that risk and reward inversely relate to stage of business. Figure 1 does not capture the failure rate of companies per stage, which also typically lessens. It is worth noting that a sale or even a public listing can occur without necessarily progressing through these stages.

In addition, the capital-raising environment has evolved, which presents more options to founders. In Australia in the last decade, there has been a tremendous change in the potential available sources of support for startups. Figure 2 illustrates an important aspect of the evolved capital-raising environment for entrepreneurs and investors. This scenario represents one round of investment and might be replicated and added to at each subsequent round.

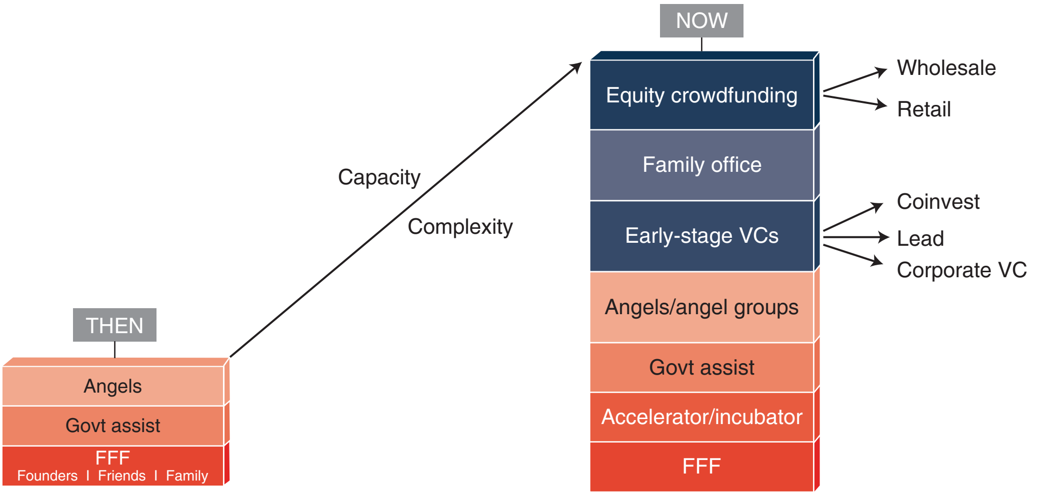
A capital-raising round can now include stakeholders with very different objectives, who may be active or passive, with different interest and capacity to follow-on. This stack can be a complex environment to navigate for a founder, but, on the plus side, the ground is far more fertile for investment, with an order of magnitude, more options and capacity for funding than in the past. Thinking carefully about the pros and cons of each stakeholder type is time well spent because you may have investors on your share register for several years, through good times and bad.

ANGELS AND SIDECAR FUNDS

Angel investors remain an important and relatively prolific source of capital. One of the larger studies ever done in the U.S. angel capital market (Center for Venture Research/University of New Hampshire. *Angel Investing Market for 2015*) found that the total amount of capital invested by angels (US$24.6 billion) was less than that of venture capital (US$59.1 billion). This study found that angel support accounted for about 71,000 deals in total versus 4,380 deals by venture capital firms—with a spread of investment across seed (25 percent), early-stage (45 percent) and expansion-stage (27 percent) companies.

This multistage support can be further amplified when an angel group is joined by a sidecar fund.

FIGURE 2. The capital-raising environment for entrepreneurs and investors



Govt = Government; VCs = venture capital firms

Source: VentureCrowd 2017

Sydney Angels created its Sidecar Funds I & II to provide a larger pool of capital to angel-funded companies, shortening capital-raising cycles and bringing additional resources to bear. For example, Sidecar Fund I provided additional funding to 27 companies, typically matching the total amount committed by the angel syndicate, and doubling available funds for the company.

An angel group with a sidecar fund brings significant benefits over individual angels.

The emergence of 'super angels' (very wealthy and active individual investors who make many small investments) upsets the apple cart a little, but Table 1 shows some of the distinguishing characteristics from the Sydney Angels' perspective.

A sidecar fund in Australia will typically be an Early Stage Venture Capital Limited Partnership (ESVCLP), an investment-friendly structure administered by the Federal Government with

TABLE 1. Angels, groups and sidecar funds

	Individual Angel	Angel Group	Angel Group + Sidecar Fund
Characteristics	• Small business network & deal flow. • Concentrated exposure. • Limited resources available for due diligence, mentoring, monitoring. • Do not have the negotiating leverage to set ideal valuations, terms & conditions. • Notwithstanding these challenges, the vast majority of angel investing is undertaken by lone-wolf angels. • Super angels may defy all these...	• Large business network & deal flow. • In this model, angels work collaboratively; investments may be individual or pooled through a trust. • Group educates angels - provides templates, guides and best practice. • Share deal flow & DD workload, pooled domain expertise, negotiate collectively and employ combined capabilities and network to rapidly grow companies in which they have invested.	• Sidecar fund investors benefit from the contacts, deal flow and resources of the Angel Group while mitigating investment risk by pursuing a diversified portfolio investment strategy. • Companies benefit from having a committed source of follow-on capital, reducing next-round capital-raising distraction and bringing extra resources for growth
	Resources: Capital / Deal Flow / Network / Due Diligence / Mentoring / Monitoring		

DD = due diligence

Source: Sydney Angels 2017

funds being provided by Limited Partners who are typically high-net-worth, sophisticated investors or institutional investors. As such, a heightened level of governance is required if you receive funds from an ESVCLP. At a minimum, this would typically include ongoing audits, quarterly financial reporting in a specific format and a right of the fund to appoint an observer or representative to the board of directors.

WORKING WITH AN ANGEL GROUP

An established angel group will receive many applications for funding, necessitating a clear process for assessing and rejecting/progressing deals. Figure 3 shows the process that Sydney Angels uses.

This deal process looks complex but has five main components: (1) application for funding, (2) screening, (3) pitching, (4) due diligence and (5) documentation. The most common mistake we see is founders failing to take enough care with their initial online application. The application makes the first impression for the screening team—rushed applications are obvious, and poorly addressed questions ensure that applicants are filtered out quickly.

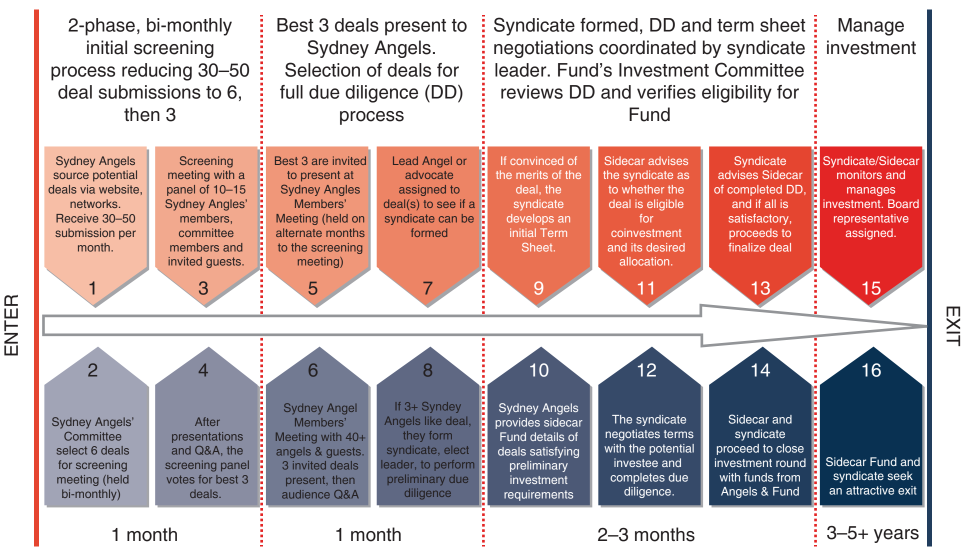
Applications go through an initial deal-screening process with a diverse group of experienced angels who assess the attractiveness of the investment opportunity. The six companies that pass this gate are invited to pitch in person at a small Deal-Screening Meeting, and the top three companies will then present at the larger Members' Meeting.

Ideally, angels are looking for opportunities that have demonstrated traction, address a clear problem, have the potential to lead in a large and growing global market, are led by a tenacious founding team with deep domain expertise and complementary sales and have members with technical, sales and financial skill sets. Perhaps your company also has paying customers, distinct intellectual property, a good advisory board and a highly scalable business model. Angels are used to seeing opportunities that do not tick all the boxes, and part of their value add is to assist you with the gaps.

DUE DILIGENCE PROCESS

Companies that make it to a Members' Meeting and receive a show of hands from interested investors now embark upon the due diligence

FIGURE 3. Sydney Angels investment process



Source: Sydney Angels 2017

FIGURE 4. Due diligence process

Source: Sydney Angels 2017

process. A syndicate of interested investors will form and share the due diligence responsibilities between them as it suits their available time and skill set. The process typically takes 8–10 weeks from commencement until the company receives cash, as shown in Figure 4.

A good syndicate will be disciplined, organised and efficient and make use of a range of guides and template documents to facilitate the process. As such, angel deals can be low overhead and relatively quick if good process is followed. The syndicate will seek to identify the most important issues to test first, and to test them quickly and efficiently. Key areas could include business model, go-to-market strategy, customer problem, target market and team. The objective of the initial 'strategic' due diligence stage is to test and verify the core merits and risks of the deal and whether the syndicate wishes to proceed to a term sheet.

VALUATION, CAPITAL AND RUNWAY

As your company progresses through the due diligence stage, key terms of the deal must also be negotiated. A critical interplay occurs between three key elements—valuation, capital and runway. Because of their collective experience and exposure to many deals over time, angels will typically have a good radar for what they want in this dynamic. It will be influenced by perceived risk, competition for the deal, confidence in the team, due diligence and any number of additional factors. The average amount of capital raised at Sydney Angels in a round is approximately $500,000.

Valuation is typically expressed as a pre-money or post-money valuation. An angel syndicate may target a 20 percent (+ or – 5 percent) post-money shareholding at a valuation that could deliver them a minimum 10x their money at exit. Capital raised should last a minimum of 12 months. This period is called the 'runway'—a conceptualisation of how long it takes the company to run out of cash (in months). The expected runway is a function of starting cash divided by the 'burn rate' (the rate at which the business uses up its investment capital). Angels will pay special attention to the business model projections in this regard. They will scrutinise whether sales and cost projections are realistic to determine if the company will use up its capital faster than planned. Angels always expect sales to be worse than projections (and costs to be higher) and will usually require some buffer for these eventualities.

POST INVESTMENT

It is easy to find detailed resources online to help founders in the capital-raising process. Investors and entrepreneurs have written articles on every conceivable aspect—from term sheets to pitch decks. However, the pickings are not as rich when it comes to post investment. This stage is where things can go wildly off script as the founding team begins the long journey of execution on an often-rocky road. After the intense capital-raising process, both founders and angel investors can be guilty of backing off too much and failing to set the groundwork for a truly constructive ongoing relationship. When it comes to your angel investors, a few golden rules are worth remembering:

1. *Build good working relationships.* Establish relationships with the syndicate leader and other syndicate members if you feel they can add value. Also include your management team if it makes sense. In good times, this approach will allow you to move quickly to unlock value by exercising their diverse network, skills and guidance. In tough times, such as when you are looking for capital if you have missed targets or need to pivot,

the strength of this relationship can make or break the company.

2. *Establish a regular catch-up and effective reporting.* In addition to board meetings, setting a regular catch-up cadence (monthly) with your syndicate lead can be an effective way to start off the post-investment relationship and ensure you are leveraging the knowledge pool. A simple monthly email update can also be distributed via the syndicate lead or directly and may have specific requests for assistance.
3. *Manage up*. Get to know your investors and *ask them for help.* Investor introductions, mentoring, mergers and acquisitions advice, example documents, recruitment, strategy workshops, interim executive roles, guidance on challenging workplace issues and policies are some issues they may be able to help with.

GIVING BACK

The startup journey is hard enough to begin with. If your company has what it takes to raise capital from an angel group, maximise your opportunity by leveraging their collective knowledge, networks and guidance.

Angels are successful entrepreneurs and business people who are grateful for their success and want to give back. Let them so that you can become an angel, too.

14

HOW VENTURE CAPITAL FIRMS INVEST

MAIN SEQUENCE VENTURES

Phil Morle, *Partner*

Bill Bartee, *Partner*

Understanding how each venture capital firm (VC) invests is critical to successfully raising capital. Although some principles are common across all VCs, some are unique to different firms. Ask a VC directly how they invest. Understand what principles they adopt across the firm. What do they believe? Where have the partners come from? What have they been successful doing in the past?

We will explore some common principles and then suggest some questions that you might ask a VC to understand their decision making, and we will answer those questions from the perspective of our fund, Main Sequence Ventures.

COMMON PRINCIPLES

VC ECONOMICS

As in any relationship, first put yourself in the shoes of the other party. What does a VC need to do? How does the VC's business model work? Who is the VC's customer?

As well as serving their portfolio companies, VCs also serve their Limited Partners (LPs). 'Limited Partners' are the investors in the fund. These investors finance the fund as an asset class in their portfolio that will be riskier than others but has the chance for a much greater return on investment. Most VCs try to return 3x to their LPs.

Attaining such a high return on investment is already hard, and the realities of venture capital make it even harder. We will explore a $200 million fund that wants to make 3x return for investors.

Brace yourself. This is going to get ugly.

Roughly $40 million of the $200 million, over the life of the fund (10–12 years), goes to management fees to run the fund and pay all the expenses. This leaves $160 million to invest and return $600 million.

A common set of assumptions in the venture capital world is that 30 percent of the portfolio will be worth $0, 30 percent will return the capital that was invested, 30 percent will make a modest multiple (say, 3x) and 10 percent will make a good return (say, 10x). Table 1 shows what this scenario looks like.

TABLE 1. Venture capital returns on investment

Investment Name	Investment Amount	Return Multiple	Return $
Investment 1	$10,000,000	0	$0
Investment 2	$10,000,000	0	$0
Investment 3	$10,000,000	0	$0
Investment 4	$10,000,000	0	$0
Investment 5	$10,000,000	0	$0
Investment 6	$10,000,000	1	$10,000,000
Investment 7	$10,000,000	1	$10,000,000
Investment 8	$10,000,000	1	$10,000,000
Investment 9	$10,000,000	1	$10,000,000
Investment 10	$10,000,000	1	$10,000,000
Investment 11	$10,000,000	3	$30,000,000
Investment 12	$10,000,000	3	$30,000,000
Investment 13	$10,000,000	3	$30,000,000
Investment 14	$10,000,000	3	$30,000,000
Investment 15	$10,000,000	3	$30,000,000
Investment 16	$10,000,000	10	$100,000,000
Management fees	$40,000,000		
Total	$200,000,000		$300,000,000

As you can see, this fund does not return 3x to its LPs. To do that, the 16th investment would need to make 40x return.

VCs that make healthy returns tend to do so because one company in their portfolio knocks it out of the park.

Why does this matter to you?

If you have no intention or plan that might gain 10x (or more!) the value of your company, a VC cannot invest in your company. Investing in a portfolio that plans to grow incrementally is a sure road to failure for a VC fund.

This idea leads to the first question for you: is a VC the right path for you? Plenty of great businesses do not display the 10x characteristic, and there are other ways to fund a business. Go into this situation with your eyes open. A VC path is a growth pathway. It has to be best for your business to grow like crazy, and that is the story that the VC needs to hear.

WHAT VCs LOOK FOR

All VCs look for certain common factors that will help to ensure a company's success.

ACUTE PROBLEM

Is there an acute problem to be solved, and do you have evidence that it exists? VCs will speak to your customers just as you do and ask them about the jobs they are trying to get done and the pains that they face. VCs will be expecting customers to talk about the problems that your business is solving. They want those problems to be acute, recurring, recent and emotional.

UNIQUE SOLUTION

Is your company solving the problem in a unique way? How many other people are doing it? How does your company stand out? How is it defensible? What will you do next when the value of the current solution is exhausted? Peter Thiel asks this another way: 'What is your monopoly?'

UNDERSTANDING THE CUSTOMER

When a VC asks you about customers, do you understand some fascinating details about them that will help you to solve their problems? Do you know how to reach them systematically to scale your company?

LARGE MARKET

Is the market large enough eventually for you to deliver the 10x business?

This is sometimes the most damaging question a VC pathway can force upon a founder because it causes companies to skip straight to this global domination stage. Companies still need a path to get there that makes sense. Be careful to articulate this path as a journey you are on that you want to take, and then describe a market that you are attacking, dominating and winning right now that is manageable with the resources you have.

All of the above principles are universal, but after addressing them, you need to go deeper to understand each VC.

UNDERSTANDING EACH VC YOU SPEAK TO

Each VC has its own beliefs about how it will succeed. Some use software to make decisions algorithmically; others are more intuitive and conviction driven. It helps a lot if you understand how the fund you are speaking to thinks.

In the next sections, we will walk you through some questions that you can ask and that VCs would like you to ask.

WHAT ARE YOUR BIG THEMES? DO YOU HAVE A THESIS THAT YOU INVEST AROUND?

VC funds are increasingly focused on specific themes, partially to make themselves stand out from other funds but mostly because they believe that their thesis will deliver a stronger return to their LPs. Some funds focus on a certain vertical market, like software as a service (SaaS) platforms or medtech. Others, like ours, are driven by a thesis about how the world is changing and what kind of products will be needed in the future.

Our fund, for example, is focused on companies led by deep tech founders who are building new industries using research or science. Within that niche, there are subthemes that emerge from us interacting with the companies around us. How are the business models in agriculture changing? What happens when health care is patient-led? How do we re-educate people in the age of rapid change and disruption?

VCs enjoy having these conversations with you because it helps them to refine their thesis.

For most VCs, it will be constantly evolving. Find out what sectors each VC does and does not invest in. You can waste a lot of time trying to get a meeting and pitch to a VC who does not invest in your sector.

WHAT STAGES OF COMPANY GROWTH DO YOU INVEST IN? WHAT DO THOSE STAGES LOOK LIKE IN METRICS?

Seed-stage investors like to get involved at a point when they can help you remove risk and increase impact. They understand that the risk is greater, but they are looking for a higher multiple if it all works well. The later the stage, the less of a return that the investor will expect, but the greater the expectation that you have removed the risk. Be clear what stage(s) the VC you are meeting with invests in. Some invest in the seed stage and the Series A stage only, while others invest in Series C and up. Find out early on if you are a match for the stage preferred by the VC you are exploring.

Our fund likes to invest early if we can and then follow on with the companies that continue to hit their milestones.

Ask investors how they measure qualifications for each stage.

WHAT DO YOU LOOK FOR IN FOUNDERS?

A common saying amongst investors is, 'Ideas always change, people rarely do'. Most VCs will look for particular qualities in the founding team.

Here are some of the qualities our firm seeks:

- We look for people with an 'unreasonable belief' in their idea. These people sound a bit crazy at first, but they insist that they can bring their company to life at a global scale.
- We like the 'unreasonable belief' in their idea to be combined with the 'GSD' (Getting Stuff Done) gene because startups are all about execution.
- We look at the team and hope to see the 'guardian of the flame' for the initial idea: the person (or people) that understand how the solution will work and how to take it all the way to its full potential.

WHAT IS YOUR DECISION-MAKING PROCESS?

How does each fund get to a decision? Who decides? What criteria are reviewed? These questions will help you to know what and whom to focus on. The decision-making process at Main Sequence Ventures is as follows:

- Initially qualify an opportunity against the fund's theme and stage focus.
- Identify a partner in the fund to sponsor a deal. In our fund, this means that the partner must be excited about the opportunity. They will empathise with the founders to understand and champion the deal.
- Start qualified opportunities with a 'no' and then work through a common set of questions towards a 'yes'. Usually we do not get there, but this discipline forces us to be optimistic and expansive about an opportunity rather than clipping its wings while we focus on risk.
- The sponsoring partner needs to recruit a second partner. Because we know we will be working with these companies for the next 10 years, we view this step as more than making a decision today and potentially stepping into a big stream of work. Much of our deal flow falls at this step. If you knew this information about our fund, you would want to make sure you spend time communicating with both partners.
- When we take an opportunity to the rest of the Investment Committee, we allow ourselves to 'disagree and commit' to an idea that we may not all see. This is because we understand that some of the biggest successes have been the hardest to see at this early stage.

If all partners need to agree, how can you influence them all?

WHAT ROLE DO YOU PLAY AFTER INVESTING?

A great fit with an investor is when that investor can materially contribute to the success of the company. VCs look for this and, if they do not feel that they can help you, they are unlikely to do the deal. Ask the VC what their superpowers are across the firm, and then work with them with some proactive ideas about what you might be able to do together. Here are more questions you can ask:

- What role do they play in the next capital raise?
- What role do they play as you grow the team?
- Can they get you access to customers?
- Do they expect a board seat? What is their style as a director? What is important to them?
- Have they worked with successful technology companies before from seed to multiple hundreds of dollars of revenue? Do they understand the growth path?

WHO ARE YOUR LPs?

The LPs in a fund are generally investors further up the food chain of company and industry building. It is worth asking who they are in this fund, or at least what type of LP they are to explore if there is anything that they can do for you as your company grows.

WHAT ARE YOUR TIMELINES?

Raising money can take time, and it is important to make no assumptions on timescales. Most VCs are extremely busy; most of the time spent in your relationship with them will be the time it takes to get the deal creation process under way. Therefore, it is important to build a relationship with VCs over time so that you are not trying to force a review of your company into a busy schedule when the VC is not really paying attention.

In our case, we like to give a clear ‘no’ within days if we can if that is what we are thinking. Working through a deal usually takes 2–3 months.

CONCLUSION

Be proactive with VCs. They want you to help them make the deal come to life. Participate in the process, and be quick with your responses. VCs are more than money, so understand what that is for each VC that you speak to and make sure there is a good fit with your company.

15

NURTURING ‘DEEP TECH’ STARTUPS

CICADA INNOVATIONS

Petra Andrén, *Chief Executive Officer*

The proliferation of technology across modern society has highlighted a need to differentiate between commonly available technologies and those that are highly unique, proprietary, intellectual property (IP)-protected and hard to replicate. Enter the relatively new term ‘deep technology’.

Deep technology, or ‘deep tech’, goes beyond simply innovating an existing business model, enhancing the delivery of a standardised technology or reinventing a customer experience. Instead, these technologies create revolutionary solutions to advance scientific and technological frontiers spanning industries as diverse as agriculture, medicine, energy or transportation—and beyond.

They effect serious, widespread and lasting change because they are founded in pure engineering innovation and scientific advances that have the power to create their own markets or completely disrupt entire industries. They address some of the largest societal and environmental challenges shaping the way we solve today’s most pressing global issues.

After the past decade of digital innovation, it is my strong belief that deep tech companies will drive the next wave of industrial and informational revolution.

So where does Australia fit in?

AUSTRALIA’S EVOLVING ROLE

Australia has the potential to play a pivotal role in the evolution of deep tech. Australia was one of the strongest-performing economies in the Organisation for Economic Co-operation and Development (OECD) over the last decade. It has many of the necessary ingredients for deep tech companies to thrive: Government policies such as the research and development (R&D) tax rebate, world-leading research and facilities and a recent inflow of venture capital supported by Australian superannuation funds.

Australia ranks in the top 10 internationally both in terms of number of researchers per capita and the proportion of highly cited publications produced. And our universities produce some of the best research in the world. In prominent world rankings, six of Australia’s Go8 Universities—the Group of Eight world-leading research-intensive universities—are consistently ranked in the world’s top 100. Each year the Go8 also spends some $6 billion on research, including $2 billion spent on medical and health services research.

But as we transition from a capital-intensive, resources-based economy to a more diverse, services-oriented country with a population that increasingly lives longer, many challenges remain for business innovation.

For example, Australia ranks lowest in the OECD for collaboration between research and industry sectors. According to findings by Innovation and Science Australia, under 5 percent of 'innovation-active businesses' actively collaborate with universities and higher education institutions (Office of the Chief Economist, *Australian Innovation System Report,* 2016). When it comes to commercialising IP, much of the focus has been on the 'research' side of the R&D equation and not enough on getting products to market. As a result, Australia also ranks near the bottom of the OECD rankings for 33 major world economies for commercialisation of research (Glyn Davis, 'Poor research-industry collaboration; Time for blame or economic reality at work?', *The Conversation,* 9 November 2015).

This input versus output imbalance creates an opportunity to unlock the potential behind this research.

With the Government's introduction of the National Innovation and Science Agenda two years ago, it is becoming easier to access and commercialise research that historically was locked up in our publicly funded research institutes. Programs focusing on IP commercialisation, such as the New South Wales Health Medical Device Commercialisation Training Program (MDCTP) and the GrowLab program supported by Meat and Livestock Donor Company (MDC) focusing on deep technologies in agtech, provide important vehicles to ensure that IP from publicly financed research reaches global markets. Since 2014, the 50 graduates of MDCTP have launched 12 companies and raised nearly A$20 million to commercialise their ideas.

Helping to shift Australia's deep technologies up a level requires examination of the vastly different circumstances required for deep tech versus digital innovation to flourish.

So, what are the unique characteristics of deep technologies that require specific consideration?

LONGER TIME TO MARKET

Unlike consumer tech, fintech and software startups developing apps and marketplaces, deep tech companies have a far longer time to market given the technology-intensive nature of their businesses. They typically also require larger capital investments than traditional consumer technologies to get them to global markets.

For example, rather than focus on customer acquisition milestones, deep tech startups embrace technology-oriented milestones that become key inflection points to further investments. This is one of the reasons why these companies often remain at pre-revenue stage for several years.

In the medical space, for example, it is not unusual for a company to spend up to a decade in R&D mode without taking a single product to market. For robotics companies, to use a different example, a prototype with minimal features can easily cost up to a million dollars in development.

This situation means that deep tech companies must get creative with their business models to generate revenue while simultaneously remaining laser-focused on the development of their core application. This approach could mean identifying and going for the 'low-hanging fruit' that could generate sales to produce much-needed cash flow and ensure the long-term survival of the business while further R&D continues.

As an example, highly regulated medical businesses may sometimes consider cosmetic, veterinary or animal applications for their technologies (where the regulatory hurdles are usually lower) while continuing work on their cancer treatment therapies for humans. Companies may also consider out-licensing technology for selected applications as a way of funding operations as they pursue their main line of business. Both strategies significantly shorten time to market and revenue.

In the earlier stages of a deep tech business, therefore, thinking outside the box and pursuing creative business models to generate cash flow is vital.

ACCESS TO FUNDING

Deep technology businesses also often struggle to access funding because of their relatively long investment horizons. However, having the right capital available from the start is essential to the long-term viability of a deep tech venture—particularly given the above-mentioned issues regarding a longer time frame to market.

Therefore, one of the most important ingredients to sustain a deep tech company is access to something called ‘patient capital’. Patient capital is provided even before the core product is fully developed and ready to be launched. It is ideally sourced from investors who have technical domain expertise of their own and can understand and assess complex technologies and the unique progress that will trigger additional funding milestones. Patient capital is needed given the longer time to market and the capital-intensive nature of deep tech companies due to their expensive infrastructure and the significant costs associated with filing and maintaining IP protection.

However, early-stage investors should have more than just ‘patient’ money to offer. Investors who have relevant domain expertise with a clear understanding of tech and IP strategy bring a lot more to the table than simple funds, and they can be an asset in helping these businesses become a success. For this reason, corporate venture capital is playing an increasingly important role in the sector.

Large industry players can offer not just funding but also the ability to conduct field trials to gain better customer insights and access to global markets as well as expertise in areas such as manufacturing, marketing and commercialisation through established networks. Several multinational tech companies, such as Bosch, Google and Microsoft, now have dedicated funds looking to invest in disruptive and innovative deep tech ideas. Although not based in Australia, these funds are starting to look to Australia for deal flow.

Also, several startup ‘accelerator’, or better-named ‘commercialisation’ programs, in Australia focus on deep tech companies, such as the CSIRO’s ‘ON’ program aimed at commercialising research from CSIRO and partner research institutions. However, few offer support beyond the incipient three- to six-month accelerator phase, which invariably often means that most only reach a proof of concept stage at best. Further support is needed for deep tech companies that are likely to remain in the vulnerable pre-revenue and R&D phases for much longer than this. These businesses often benefit from long-term nurturing, post the accelerator program phase, where the aim is to turn them into high-growth ventures with global impact.

One of the primary incubators, if not the only incubator, offering this type of long-term support in Australia is the Sydney-based deep tech incubator Cicada Innovations. Cicada Innovations addresses this issue by providing successful graduates from their various deep tech accelerator programs with an incubation period of five years or more. During this period, companies will reside in Cicada’s state-of-the-art facilities, accessing a curated community of deep tech innovators and entrepreneurs at different stages of development. They will also have access to talent to scale through Cicada’s four shareholder universities (Australian National University, the University of Sydney, University of Technology Sydney, and the University of New South Wales) as well as various types of local and overseas funding.

In Cicada’s experience, Australian venture capital funds such as Brandon Capital, GBS Ventures and One Ventures specialise in providing later-stage funding for advanced technology startups primarily in the medical space. However, there is often a great need for funding in the preclinical stage for life sciences and in prototype funding for early-stage complex hardware and advanced material technologies. This gap tends to be more often sourced from overseas investors because overseas investors (currently) have greater expertise and risk appetite for hardware plays requiring advanced manufacturing capability than our local investors do.

With that said, the very limited funding available for deep tech in Australia is possibly about to change dramatically. CSIRO recently announced a $200 million Innovation Fund (Main Sequence Ventures). The British-based business called IP Group has committed at least $200 million over a 10-year period to fund early-stage deep tech startups from Go8 research-intensive universities. Areas covered include digital medicine, new medical therapies and quantum computing.

THE NEED FOR GRANTS

For deep tech startups, being able to access and identify relevant grant opportunities at pre-revenue and scale-up stages is key.

Grants offer a non-dilutive form of funding that is crucial to founders who cannot access other capital at the early stages, so founders are likely to require several dilutive equity-funding rounds before their deep tech company goes to market. Grants also enable companies to derisk their technology and reach proof of concept, and at that point, it becomes easier to attract angel investors and other types of seed capital.

In Australia, Government grants exist at the state and federal levels to support a range of startup and scale-up companies.

At the state level, the state where a company is incorporated will often determine the grants it can apply for. However, some states also offer grants for interstate companies that are willing to either relocate parts of their business or enter into collaboration agreements with state-based companies and/or research institution.

Industry focus and levels of funding can also vary at the state level. In New South Wales, for example, the Medical Devices Fund invests in the development and commercialisation of medical devices and related technologies. But it will not award any grants to companies located outside of New South Wales.

At the federal level, an Accelerating Commercialisation Grant is provided by the Government under the Entrepreneurs' Programme. This Programme gives businesses access to expert advice and matched funding of up to $1 million to cover eligible commercialisation costs to help them to take novel products, processes and services to market. However, companies need to match the funding, which limits the eligibility of many companies.

A similar policy measure includes R&D tax incentives that encourage angel investments modelled on the Seed Enterprise Investment Scheme/Enterprise Investment Scheme in the U.K. Australia's R&D tax incentive also plays an important role in supporting deep tech companies through significant tax offsets for eligible R&D activities. This is not a competitive grant, but rather a Government entitlement as long as the R&D project is deemed eligible.

IP STRATEGY IS CRUCIAL

Considerations around IP for deep tech companies are twofold. In the first instance, deep tech companies must understand how crucial they are to begin with. Deep tech companies are typically those built on pure engineering or advanced scientific solutions that cannot easily be replicated, have been developed over a long period of time and required considerable funds and knowledge to develop.

Obtaining IP protection in the form of patents is crucial because it can minimise competition and act as a defensive mechanism against infringement claims from others. With competition fierce and many tech companies boasting unlimited financial resources, years of research can also be undone in an instant if a product can simply be copied when it gets to market. In this sense, IP protection is essential in not just attracting but also in *maintaining* key partnerships and helping much-needed funding continue to flow.

But, on the other hand, any IP strategy must be tailored to its specific technology, company and industry and may require special attention to timing.

Patents are *expensive* to file and maintain, require a lot of *time* and resources, and result in the *public disclosure* of sensitive information. So, filing a patent can have certain drawbacks that must be assessed as part of the startup's overall IP strategy. When discussing patents, the focus is often on utility patents, but design patents should also be considered as part of a well-rounded IP strategy. In general, a *utility patent* protects the way a product is used and works, while a *design patent* protects the way the product looks.

In addition, timing is a particularly crucial component of IP strategy, especially at the point in which the product is ready to move towards commercialisation. And it is also not a one-off process. As a deep tech startup continues to develop its product or line of products, it is important to consider each new feature for possible patent protection. Startups that file patents early may find that, once the patent has been issued, the product has evolved and moved far beyond what was initially contained in the original patent application. The product may end up being underprotected or not even covered by the patent at all!

UNIQUE INFRASTRUCTURE NEEDS

Companies in the deep tech space need more than a fast Internet connection, a sales office and a few ping-pong tables in the office to succeed. They require expensive and specialised infrastructure, such as clean rooms, laboratories, prototyping spaces and specialised equipment to develop their complex products. They need access to state-of-the-art facilities at affordable cost, particularly in the early stages of the business life cycle.

Depending on the specific location of the business, corporate partners or specialised tech incubators can sometimes offer access to these types of facilities and equipment.

Unfortunately, since the introduction of the Federal Government's 'ideas boom' as part of the National Innovation & Science Agenda, Australia has been very focused on providing infrastructure in the form of shared office spaces for fintech and other consumer startup and digital technologies.

But the Government now seems to be slowly shifting its focus as it recognises the need for more hardware, 'TechShops', and 'Fab Labs' (workspaces like those at the Massachusetts Institute of Technology) to allow for easy access to equipment that can fast-track the development and prototyping of revolutionary products. For companies developing intensive hardware products, deep technology incubators like Cicada Innovations offer specialised facilities and access to equipment onsite and through its shareholder universities. These advantages make Cicada one of the most attractive options for those lucky enough to be accepted into such a technology incubator.

NEED FOR HIGHLY SKILLED LABOUR

One of the pressing issues facing the Australian technology and innovation space is the chronic shortage of talent. This situation has been exacerbated by several factors.

Recent restrictions to the 457 Skilled Visa scheme has made it challenging for startups to attract overseas talent. It has therefore become far more imperative to create linkages to Science, Technology, Engineering, and Mathematics (STEM) talent from local universities to plug this gap. Access to STEM talent at local universities will be a key driving force in transforming validated technology and IP into scalable, commercialised businesses. Building relationships with research institutes that can be leveraged as brain trusts to fuel the growth of R&D work will also be critical when startups reach scale-up phase.

Additionally, deep tech startups and scale-ups that use internship programs to identify and later employ talent will arguably be ahead of the game. Australia's future PhD-qualified workforce, for example, must have more exposure to real-world work opportunities. Gratefully, some products are under way that will help break down barriers between universities and industry and make it easier for startups to access PhD talent before students graduate. This situation is a positive for both the PhD candidate and the startup, which can tap into PhDs' research and talent and potentially bring them into their fold.

Finally, share schemes have been an invaluable instrument in helping startups remain attractive for top talent and stay competitive as employees accept working for equity instead of for a high salary. For startups with more equity than cash or revenue in the company's vulnerable early financial stages, not having an ESS in place can significantly impede their ability to attract talented employees. I am looking forward to watching as we improve the ESS here in Australia.

The future is looking very bright indeed!

PART II

SCALEUP

16

STARTUP IS GREAT—BUT IT'S JUST THE BEGINNING! FOCUS ON SCALEUP

AUSTRALIAN CENTRE FOR BUSINESS GROWTH, UNIVERSITY OF SOUTH AUSTRALIA'S BUSINESS SCHOOL

Dr. Jana B. Matthews, *Professor, Director*

An employee of a three-year-old, fast-growth company in Australia recently asked the chief executive officer (CEO), 'When are we going to get out of startup?' The CEO responded, 'I hope we never get out of startup!' That same CEO had been telling me how he 'could not wait' for his toddler to grow up so they could go fishing. And here he was, wanting to perpetuate his company's 'babyhood' forever!

Starting a company is a lot like having a baby. There is a gestation period, then infancy, and then a lot of work to get the company in position to scale, grow and go global. Your baby will go through stages of growth as he or she becomes a child, a teenager, and finally an adult, and so will your startup company. If the CEO is a good parent, he or she will work hard to get the company ready for the next stage of growth. But if the CEO does not understand what to do, that CEO can stifle the development of the company and unwittingly become a serious bottleneck to growth.

Startup is hard, and so is scaleup—especially if you do not know what you need to do. According to the Kauffman Foundation, more high-potential startups are getting funding than ever before, yet fewer are scaling (The Economic Impact of High-Growth Startups. *Entrepreneurship Policy Digest,* June 2016). Too few promising startups know how to go from startup to scaleup!

BIG PICTURE

Australia has 2.2 million companies. They have the following characteristics:

- Greater than 60 percent are sole proprietors with no employees (1.3 million).
- Less than 1 percent are large companies with more than 200 employees (4,000).
- 27 percent are microbusinesses with 1–4 employees (about 600,000).
- 9 percent are small companies with 5–19 employees (about 200,000).
- 2 percent are medium-sized companies with 20–199 employees (51,000).

According to Mark Cully, Chief Economist, Department of Industry, Innovation and Science in the Australian Government, the 37 percent of the companies that are microbusinesses and small businesses account for 44.3 percent of the jobs, and the less than 1 percent of companies that are large account for 32.4 percent of the jobs. Medium-sized companies, which are only 2 percent of all companies, account for

23.3 percent of the jobs (ABS cat. no. 8165.0, table 13, and ABS cat. no. 8155.0, table 05, June 2016). Cully noted that

> '… most mid-sized businesses stay mid-sized. Post the Global Financial Crisis around two in three persisted as mid-sized between 2010 and 2014. Turning to those that did make a transition … businesses in this group were about 10 times more likely to shrink back to small than they were to grow to become a large business. If those who exited business altogether are counted, the ratio of shrinkers to growers increases to roughly 20:1' (Stuck in the middle? Mid-sized enterprises in the Australian economy, September 2017, p. 5. Analysis undertaken by the Office of the Chief Economist using the Business Longitudinal Data Analysis Environment [BLADE]. For background on BLADE, see https://industry.gov.au/Office-of-the Chief-Economist/Data).

So, why are so many companies in the U.S., and in Australia, having problems scaling? Some argue that companies need more access to more money. But money is just an enabler that makes it possible for a company to do the following:

- Hire a CEO and a senior management team.
- Hire people who understand which customers to reach and how to market.
- Develop new websites and marketing collateral.
- License in new technology.
- Hire people to develop new products.
- Develop manufacturing capacity to make the product.
- Make the supply chain more efficient, and so on.

Money, in and of itself, can do none of this. If you want to grow, the CEO needs to know how to 'use money' to hire people and develop products, develop a winning strategy and market in ways that provide a competitive advantage.

Until the founder has defined a mission and can articulate *why* the company exists, has identified the values that will define how the company does business, and can articulate a vision of where he or she wants to take the company, a business is unlikely to become a growth company. Yes, it might grow—if it has a product that people rush to buy, but it will not be a growth company until it has the bones and muscles to support the development and delivery of a succession of products that customers want, need and value.

How do you become a growth company? You put building blocks in place that will enable you to build for the future. You understand the 12 roles you need to play during growth, become a leader instead of a doer, get better at selecting and managing people, keep everyone customer focused, develop a growth strategy and execute on a growth plan.

The founder needs to understand that the company's mission, values and vision will determine which people—with what kinds of knowledge, skills and values—should be hired, which markets to target and which channels to use to take the product or service to market. But choosing the right growth strategy, understanding how to select, lead, manage and delegate to an executive team, and managing the personal and psychological ups and downs of growth are also important. The bottom line is that more money, per se, will not ensure a successful scaleup. In fact, the company will not become a growth company unless the founder/entrepreneur is able to develop into an entrepreneurial CEO—or hire someone else to play that role. The metamorphosis from an entrepreneur to an entrepreneurial CEO is not easy, but that is what your company needs in order to grow.

Three years ago, the first class of 10 companies graduated from the Australian Centre for Business Growth's Lead Program. Since then, those 10 companies have grown their aggregate revenue 149 percent and profit 419 percent. They created 415 new full-time equivalent jobs and are now exporting into 15 new countries.

How did they manage to grow that rapidly and consistently? They learned what to expect during the journey of growth and what to do when, why, how and in what order.

When Mark Cully studied Australian companies, here is what he found:

- Only 10 percent of the companies had a written strategic plan. 100 percent of the companies in our Program leave with a written three-year plan.
- 50 percent of the companies did not monitor any aspect of their performance. If they tracked any metric, it was revenue, but less than a quarter track 'innovation', and just over half measure 'quality'. Companies in our Program leave with a set of metrics they track, measure and report on consistently.
- Only 10–20 percent embark on high risk–high reward ventures. CEOs in our Program have learned how to assess and mitigate risks, so they are now taking more risks and are growing.

UNDERSTANDING THE JOURNEY OF GROWTH

It is dangerous to think, 'I have now learned what to do during startup and just need to continue doing the things that made me successful!' Driver's Ed may teach you the basics of driving, but it certainly does not prepare you to be a racecar driver!

If a driver enters a race without knowing how to drive a high-performance sports car, the odds are that he or she will crash. Even if the driver is able to get through the race alive, those who know how to get maximum performance out of their cars will win. Your job, as a parent, a driver or a CEO, is to make the right decisions quickly and do what is necessary for the baby, car or company to win and endure. Because your child, car or company cannot tell you what they need, you must learn what to do, when, and in what order so that you can meet those needs and facilitate acceleration—and growth.

Startup is a giant beta test while you try to figure out which product or service, with which features and benefits, to offer which customers, in which markets. You need to experiment with a lot of different messages, sent through direct, social and indirect channels as you try to cut through the noise and reach the people who are willing to buy what you are selling. Hopefully, you followed lean startup principles when you began, but in scaleup you need a different framework. Scaleup requires you to behave and think in new ways, which is hard. You need to take a holistic approach to leading and managing growth, to think of your company as a system of interacting parts, and to understand how decisions in one part of the business affect the whole organisation. You need to develop new competencies, frameworks and decision rules to sort and sift through large amounts of information, at increasing rates of speed. These new tools and frameworks will ensure that you and those to whom you have delegated can respond *quickly* to risks that threaten or opportunities that support your growth strategy.

STAGES OF GROWTH AND THE ROLES OF THE CEO

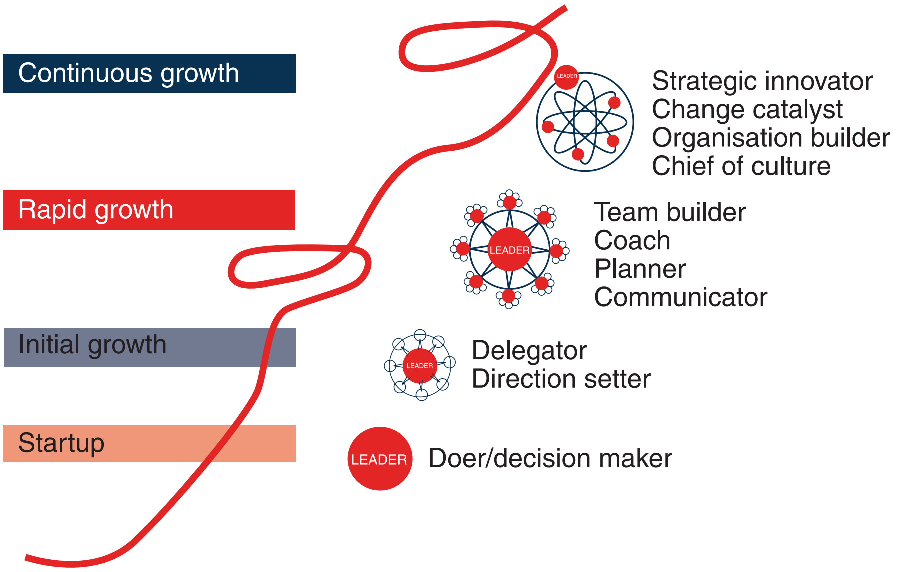
The journey of growth has four stages, according to Catlin and Matthews (*Leading at the Speed of Growth: Journey from Entrepreneur to CEO,* John Wiley & Sons, 2001). Each stage requires different kinds of data analyses, decisions, roles and behaviors from the CEO (Figure 1).

STARTUP

In the Startup stage, the CEO is the big red dot, making all the decisions, telling people what to do; in short, serving as the determining factor regarding what the company is—and becomes.

This stage is very seductive because CEOs are the centre of everything. Everyone asks them for directions and they make all the decisions—probably quicker and better than anyone else because they have the mental picture of what they want their company to become. All customers want to talk with the CEO because he or she sold them the product or service. At this stage, the CEO's identity is closely connected with the company's—and the company's identity is very dependent on them, what they do, who they hire, what kind of customers they secure and what kind of customer service is provided.

FIGURE 1. The roles of the CEO during growth



Many CEOs get stuck in Startup because they think the job of the leader is to make all the decisions and hire people who do what they tell them to do. They do not realise that this kind of behaviour actually makes them the bottleneck to growth.

INITIAL GROWTH

If a company is developing multiple products and starting to gain some traction, has customers and is generating revenue, it is ready to move to the stage called Initial Growth. At this stage, the CEO needs to begin to set the company's direction and learn how to delegate.

The Startup stage was full of experimentation, but once the CEO and key employees can figure out which customers want which products, which channels work, and how to place and price the company's products or services, the company should begin to have predictable, recurring revenue and be picking up speed.

By the time a company makes it to Initial Growth, the CEO should have identified the biggest opportunity for success. That realisation does not come easily; it takes a lot of hard work and lots of mistakes before finding the company's 'sweet spot'. But when you find it, the CEO can begin to set the direction and chart the course.

The second role the CEO needs to play in Initial Growth is Delegator. You need to ask yourself, 'What is it that only I can do?', and then learn to delegate everything else to other people. Delegation is not a 'yes' or 'no'. You need to learn the Five Levels of Delegation, and the protocols to follow to make sure the people to whom you are delegating understand the task, time frame and level of authority being delegated to them.

RAPID GROWTH

Some companies have a steady growth trajectory, while others are jettisoned into the Rapid Growth stage. The role of the CEO in Rapid Growth is radically different than the roles played in Startup and Initial Growth. Rather than being the person who knows the most and makes all the decisions, the CEO's job is to find the very smartest and most qualified people in various functional areas (e.g., finance, marketing, sales, operations) and then coach them to high performance, make sure they work together as a team, lead them through the planning process, and make sure there is clear communication throughout the organisation.

Planning becomes critically important at this stage. Once you have determined the biggest opportunities for success, the strategic plan becomes a mechanism to chart the course to the future and the operational plan becomes the company's work plan, guiding where people spend time, money and energy and providing a way to measure progress on a quarterly basis.

Finally, the CEO needs to be a great communicator and make sure the team members, individually and collectively, are passing along the messages throughout the organisation. All employees should know 'where we're going and what our goals are' and be learning from the wins and losses.

CONTINUOUS GROWTH

The fourth stage is Continuous Growth. If you have done a good job selecting great people on your executive team, if you have modelled good communication and taught your team to delegate and to work together executing the plan, then you can move into the new roles that are required in Continuous Growth.

In Continuous Growth, the CEO plays the 'outside-in' role of Strategic Innovator, looking for changes in markets, in customers' demands, in technology, in competitors, and identifying opportunities for growth outside the company. But the CEO also needs to prepare the company for changes that are coming, and thus must learn how to be a 'Change Catalyst'.

The third role the CEO plays is the Organisation Builder & Rebuilder. As various members of the executive team leave for health reasons, a new job, or family issues (or because they cannot keep up), the CEO needs to add people with skills and expertise the company will need for the future, not just replace the people who just left. Employee departures are opportunities to reassess the organisation, merge departments, create new units, promote from within and recruit people with new sets of capabilities.

The fourth role is the Chief of Culture. After developing and communicating a set of company values to undergird the culture, there will be times when CEOs will have to deal with people who are not acting in accordance with the values and are negatively affecting the culture.

Growth is not a straight line from the bottom left to the top right. It comprises many zigs and zags, two steps forward and one backward, one step sideways, but generally forward over time. But if the CEO has not put the right processes and systems in place, built a strong infrastructure, hired the right people or built a strong executive team, the company can literally 'hit the wall' during growth.

The problems that cause you to 'hit the wall' come in all sizes and shapes: internal (e.g., embezzlement; partners falling out; key salespeople leaving, followed by their customers); personal (e.g., a spouse leaving, family illness or death, a house fire, identity theft); and external (e.g., a natural disaster, an election, a change in public policy).

If the company has a plan and a strong team, it can get through the turbulence associated with 'hitting the wall' and back onto the growth curve fairly quickly. But if it does not, the company can go into the 'death spiral', a drop in revenue that will likely result in layoffs, negative publicity, fewer salespeople making fewer sales, declining levels of customer service, and unhappy customers, bankers and investors.

It is critically important that the CEO play the appropriate roles during each stage of growth. Just as parents need to change the roles they play as the child grows up, CEOs must change their roles as the company grows up. Playing the right roles at the right stage will accelerate growth. Playing the wrong roles, being lax or refusing to change roles can stunt the company's growth.

WHAT YOU NEED TO KNOW TO SCALE

In essence, the things that you did in the past that got you through startup are very different from what you need to focus on in the future to enable you to scaleup. Specifically, you need to move from:

- focusing on perfecting the product or service—to marketing and selling more of it to customers
- doing everything and making all the decisions yourself—to recruiting and delegating to employees who will make decisions almost as good, and sometimes even better, than you would
- selling to anyone who wants to buy your product—to identifying and doubling down on your 'ideal' customers (who are willing to pay a price that enables you to be profitable)
- marketing to individual customers—to understanding which channels enable you to reach large numbers of ideal customers
- doing whatever is necessary to get the product out the door—to putting in systems that will enable you to be more efficient and effective
- the 'revolving door' of hiring 'bodies for slots'—to developing processes including job definition, recruitment, screening, interviews, reference checks, offers, orientation, delegation, training and development, performance review and promotion or termination
- opportunistic moves—to the thoughtful development of a mission, values, vision, a three-year strategic plan and a one-year operational plan
- quick, reactive pivots—to execution on a proactive plan
- worrying about how to meet payroll—to having good financial systems, which will project revenue, enable you to manage expenses and be more profitable (hence, bankable)
- running as fast and hard as possible—to recognising that growing a company is less of a sprint and more of a marathon
- brute force—to developing the strength of mind and body that will enable you to lead your company to successful growth.

As one of our CEOs said, 'I thought you needed to be a rocket scientist to grow a company, but now I understand it's about knowing what to do, when, and in what order—and having the courage and discipline to execute. Now that I know what to do, I can grow my company!'

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FROM STARTUP TO SCALEUP

NATIONAL AUSTRALIA BANK

Owen Hereford, *Business Development & Strategy*

> *'First mover advantage doesn't go to the first company that launches, it goes to the first company that scales'.*
>
> Reid Hoffman, LinkedIn founder

So, you have a viable product, a rapidly growing user base and a small team of employees. You have successfully raised seed capital, differentiated your value offering from competitors, secured external financing and have a healthy level of founder and employee ownership. What happens now?

This is a pivotal 'push-on or plateau' moment for early-stage growth companies. As discussed in previous chapters, the number of startups and availability of funding for early-stage companies are growing rapidly in Australia. Of greater concern now is the deficit in the availability of funding for later-stage startups looking to scale and expand, which is currently being filled by overseas firms—or not at all.

A *scaleup* is a company with 10 or more employees and average annualised growth in turnover (or employment) greater than 20 percent a year over a continuous three-year period. Scaleups are looking to increase market share, develop new products, grow the team and enter new markets.

The emphasis on innovation and entrepreneurship by policymakers, tertiary institutions and the private sector—and the globalisation of capital and distribution channels—has made it easier than ever to launch a company in Australia. These factors have led to the cultivation of a mass increase in the number of startups—and *successful* startups—domestically.

But we have critically lacked the same drive in encouraging later-stage startups to grow. The rate of scaleup growth in Australia is significantly slower than startup growth. Australian startups are less likely to make it to Series A and later funding rounds than those in Europe and North America. As the startup process has simplified, barriers to scaleup have persisted.

In this chapter, we discuss the financing needs of scaleups and inhibitors to scaling up, as well as the current condition of the Australian scaleup industry.

WHAT CAUSES SCALEUPS TO PLATEAU?

The following list describes some reasons why scaleups fail to reach their potential:

- *Inability to access capital:* Although more venture capital funds are available in Australia than ever before and we see a greater appetite for risk by Australian investors, there is still plenty of scope for the Australian VC market to continue to grow sustainably. Furthermore, accessibility to offshore capital also appears to be on the rise, with more global investors willing to invest in early-stage, riskier opportunities than previously.

Despite this scenario, it appears that this increased amount of capital in the domestic market is disproportionately going to early-stage companies. The evidence shows that later-stage startups are having to bootstrap to scale or source capital overseas to raise the comparatively larger volumes that they require.

- *Inability to access* the right *capital:* In addition to an insufficiency of traditional venture capital, the entry of innovative finance platforms in Australia is notably slow. Alternative financing vehicles for early-stage companies, such as equity crowdfunding, marketplace lending, venture debt and revenue-based financing, are steadily gaining traction in comparable overseas markets. Comparably, take-up of these technologies has been significantly slower in the Australian market. Intuitively, startups with a diversified capital structure and access to a variety of financing sources and types of funding are far more likely to secure late-stage funding and succeed in scaling.
- *Limitations in leadership capability:* We often see early-stage entrepreneurs with great ideas, ambition and technical knowledge but an absence of expertise in the management and administration of a larger company. It is vital, then, for high-growth business founders to continuously develop their commercial acumen through mentorship, further education and training to ensure the sustainability of the startup and to scale.

  Another significant barrier to scale is the ability of founders to hire talent with the right capabilities. When startups begin to scale, new functions emerge in product management, marketing, sales, finance, human resources, information technology and administrative and operational support. The inability to find and hire *strong* leaders with the right skills to manage these vital functions—particularly within the constrained time frame of a fast-growing business—can greatly impede the startup's ability to scale and may even induce the failure of the still-young business.
- *Partnering with the wrong investors:* The vital second function of any investor, beyond suppling capital, is the ability to provide business expertise and strategic and operational advice. Undoubtedly, some entrepreneurs would prefer to receive a cheque from investors and have limited further engagement. Similarly, some institutional investors prefer a laissez-faire partnership with their portfolio companies, only to engage when their return on investment is being realised through a sale or initial public offering (IPO).

  However, the 'softer' benefits of an investor partnership cannot be underestimated. The ability to scale effectively is contingent on choosing investors whose strategic involvement and intellectual capital is going to be *equally as valuable* as their financial capital, and whose core values and expectations for the business are aligned closely with those of the founders. Doing so will help mitigate potential conflicts in the management and strategic direction of the business.
- *Lack of consideration for late-stage funding rounds early on:* During business inception, entrepreneurs are preoccupied with acquiring seed funding and getting their product to market. Consideration around later funding rounds and future expansion may not have even occurred to them until much later in the game.

  Later-stage investors will have priorities around expansion, strategy and exit that may diverge significantly from those of early-stage investors. Simultaneously attracting growth funding from new investors while protecting the interests of existing stockholders is no easy feat. Consequently, the impetus is on entrepreneurs to carefully consider and plan for these potentially conflicting priorities early on. Two key considerations for early-stage entrepreneurs to avoid this trap are:

  1. rejecting unfavourable terms from early-stage investors that limit a startup's ability to acquire funding later

2. forming close relationships with experienced entrepreneurs and industry experts early on to provide strategic advice and mentorship in navigating unfair term sheets and tyrant investors.

- *Inability to scale internationally:* Australian startups have a notable tendency to launch and scale successfully in the domestic market but lack the global scalability of comparable jurisdictions. This situation could be attributable to the strategies employed by Australian startups to venture internationally. Specifically, some build and grow locally and then attempt to enter global markets later (SEEK and Carsales), and others move operations overseas from the beginning (Canva and Safesite). Although both of these strategies have success stories, they also carry severe impediments to growth. The 'Australia first' strategy allows global competitors to establish themselves, diminishing the startup's first-mover advantage in the international market. The 'Global Day 1' strategy sacrifices Australian talent, capital and revenues to economies with bigger domestic markets and better access to international markets.

VENTURE FUNDING AND SCALEUPS

Seed funding can be acquired from friends and family, accelerators and incubators, and angels without necessarily needing to solicit institutional investment from venture capitalists, large hedge funds and corporations. This situation makes Series B and later funding rounds an entirely different ballgame than a seed round. It requires far greater time and effort of founders, as well as more business knowledge and financial expertise. Also, given the large size of growth-stage funding rounds, the investor's decision-making and due diligence processes will be significantly more rigorous and involved. A Series B funding round is focused on continuing to scale the company once there is an established business model and market traction. These rounds are most commonly raised from venture capitalists, although the size of the corporate venture capital (CVC) market is growing in Australia. Funding is used to increase market share, grow the team and potentially expand the service offering or enter an international market. Two fundamental objectives should be achieved after acquiring Series B funding:

1. Companies should now break even or have a net profit.
2. Companies should now have an established business with sales and marketing teams and administration functions and systems in place.

All further venture funding rounds pre-exit (Series C, D, E and onwards) are used to further scale the company, develop new products, make acquisitions, increase market share, expand internationally and prepare the company for exit. These funding rounds historically come from large VC funds, private equity firms, hedge funds and investment banks.

Contrary to popular opinion, the most dangerous period for entrepreneurs is not obtaining funding as a startup but actually when scaling the business. In particular, it is challenging to manage cash flow whilst the business is getting established and contend with lumpy sales, increasing resources and difficulties in forecasting future cash flows. Scaleups should consider diversifying their financing for growth as well as using unsecured and secured debt options, grants and management of cash flows (e.g., negotiating with suppliers regarding payment terms), even for employees who may take stock options in lieu of some cash. When scaling quickly, many entrepreneurs think solely about raising risk-sharing equity investment from venture capitalists or angel investors. It is equally important to consider diversifying this financing.

CONSIDERATIONS IN LATE-STAGE FINANCING

In early-stage funding rounds, the considerations for investors and entrepreneurs when contemplating a partnership can be distilled into two core factors: the investor's valuation of the startup (which informs the amount they are willing to invest) and the strategic benefits the investor can provide. Late-stage funding rounds require far greater thought around liquidity, governance and ownership considerations than earlier rounds, from both the investor's and the entrepreneur's perspective, because now vastly more players are in the game.

- *Liquidity considerations:* Greater emphasis is placed on the ease of exit and liquidity of the business in late-stage private financing rounds. Investors in late-stage funding rounds will often require protections against downside outcomes in the event of IPO or acquisition.

  The primary concern of investors in follow-on rounds is the consequent sale of the scaleup without an increase in its valuation, a 'flat exit'. Such an exit provides no return on investment to the follow-on round investors but significant returns to early-stage investors and managers. Consequently, later-stage investors often require an approval rights specification in the term sheet that prohibits the sale of the startup unless a required return on investment is achieved for follow-on round investors.
- *Governance considerations:* Management needs to give more consideration around the governance features of the agreement because large institutional investors often induce a shift from a founder-controlled board to an investor-controlled board. There is an important distinction between passive and active venture capitalists and a whole spectrum of funds in between. Active venture capitalists play a more proactive role in the management of the company and assume one (or more) seats on the board of directors, whereas passive venture capitalists will forfeit board seats and take a lower ownership stake in the scaleup.

  Although we have referred to this distinction at the fund level, in reality large VCs have multiple limited partners who typically specialise in different industry segments. Although it requires a unanimous (or majority) partner decision to invest in a portfolio company, one partner will often be the lead engagement contact. Consequently, the level of proactivity employed by individual partners can vary greatly across a fund and is an important consideration for entrepreneurs to be aware of when investigating investors.
- *Ownership considerations:* A key consideration for management seeking late-stage investment is how best to divide ownership of the company amongst founders, employees, existing investors and new investors. Specifically, entrepreneurs need to decide whether to issue new shares (primary market transactions) or to purchase shares from existing stockholders (secondary market transactions).

  Issuing new shares provides more liquidity for the company to fund expansion but effectively dilutes existing shareholder wealth and ownership. To mitigate this factor, the scaleup may issue preferred stock that gives new investors a right to preferential payment in the event of liquidation. Purchasing shares from existing stockholders uses growth capital to purchase existing shares, providing an exit strategy for current shareholders. This stock is typically purchased at a discount because it is not preferential, giving new investors the same economic rights as early-stage investors even though they bear more risk. Consequently, effective strategies for financing expansion often employ a combination of primary and secondary market transactions.

BETTER FINANCING FOR THE SCALEUP SECTOR

If Australia is to transform into a globally competitive, innovation economy, focus must be brought to bear on increasing the proportion of firms that scale with the same rigour we have demonstrated in the early-stage startup sector.

Some of this growth will happen organically as the venture capitalist market rapidly increases in Australia and accessibility to overseas funding increases. We have only just started to see the potential of CVC in Australia, with NAB Ventures and Telstra Ventures, for example, being players in this area. Further opportunities will be realised through CVC as its role continues to expand and contribute to a significant part of the startup ecosystem. Additionally, the entry and increasing traction of alternative financing platforms, such as equity crowdfunding and venture debt, will continue as these financing vehicles become familiar and normalised amongst Australian investors and entrepreneurs. These sources of financing have the potential to become an important source of capital for growing business, as they have in other developed economies.

The benefits of a successful scaleup extend beyond high returns for founders and investor, supporting scaleups to reap positive social externalities. High-growth firms comprise less than 9 percent of total Australian companies but contribute more than 46 percent of annual employment growth. In the same way that policy agents created incentives to enable entrepreneurship and promote innovation and risk-taking for early-stage companies, Government should increase its focus on developing grant schemes and funding frameworks for high-growth, late-stage companies. These initiatives should be accompanied by new incentives for investors to preference businesses seeking later-stage funding to more evenly distribute growing venture capital across the startup ecosystem.

Finally, the evidence both overseas and domestically shows that serial entrepreneurs iteratively cycle through the startup ecosystem. The targeted focus on scaleups by the public and private sectors will be returned in multiples as founders and early employees from successful startups go on to form their own startups and invest in others.

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FUNDAMENTALS OF FINANCIALS

KPMG ENTERPRISE

Michael Hine, *Partner in Charge, Tasmania*

Fleur Telford, *Director – Technology Lead*

Kaajal Prasad, *Director – Tax & Advisory Services*

Aristidis Semertzidis, *Associate Director – Digital Assets*

Whether we like it or not, the numbers really do tell the story. Therefore, it is important that you count all your beans and balance your books diligently. This chapter will provide you with the fundamentals of the following topics:

- record keeping
- budgets
- financial statements and what the Balance Sheet and Statement of Income actually tell you
- how to decide if you need an external advisor
- whether or not you need an audit
- what to consider when evaluating technology options
- risk management as part of your strategic plan
- considerations and obligations when taking on employees.

RECORD KEEPING

The fundamentals of good accounting and tax compliance begin with meticulous record keeping. In Australia, the three types of record-keeping requirements are:

- *Australian Taxation Office (ATO):* Records must be maintained for a minimum of five years from the date after the completion of the transaction or acts to which they relate.
- *Australian Securities & Investments Commission (ASIC):* Companies must maintain financial records for at least seven years.
- *Corporations law:* All companies operating in Australia must have a registered office in Australia and must set up and maintain a register of members in Australia.

The record-keeping requirements that apply to your business will be partly dependent on the type of trading structure you implement. For example, a trading discretionary trust is not subject to the record-keeping requirements of ASIC. However, all operating businesses, regardless of their trading structure, are subject to the ATO's requirements. It is important to remember that the ultimate responsibility for maintaining records is with the taxpayer, whether or not you have an external accountant or tax agent.

BUDGETS

Most new business owners are aware of the importance/necessity of preparing a business plan to capture what becomes their strategic goals and objectives. A financial budget helps to determine whether the activities and transactions required on a day-to-day basis fit in with the overall goals and objectives that the business owner sets out to achieve, and whether the expected levels of activity can be achieved and sustained within certain cash and other constraints. A good, useful budget usually comprises the following elements:

- links to strategic goals as set out in the business plan or strategy document
- expected timelines, particularly in relation to achievement of specific goals and obligations
- regular comparisons of budgeted figures against actual figures
- identification of key drivers to enable reforecasting if actual figures do not quite agree to budgeted tolerance levels.

FINANCIAL STATEMENTS

Most small to medium enterprises (SMEs) are not required to prepare and/or submit a formal set of financial statements, generally called Special Purpose Financial Statements (SPFS), unless they are required by third parties, such as banks and other lenders.

However, many business owners seek comfort in obtaining a set of SPFS for their own purposes, as a succinct report on the financial performance and position of their business activities for a particular period (usually at the end of a financial year).

SPFS are subject to generally accepted accounting principles (GAAP) and the Australian Accounting Standards, to ensure consistent and standardised methods for recording and reporting transactions and balances. SPFS usually consist of a Balance Sheet (or Statement of Financial Position), a Statement of Income (or Statement of Financial Performance), and Notes to the SPFS to provide further details of balances, where necessary.

For completeness, large businesses and some medium enterprises may be required to prepare, and have audited, a set of General Purpose Financial Statements (GPFS), particularly if they are subject to the requirements of corporations' law and have several stakeholders who are reliant on them. On the other hand, SPFS are prepared for the private business owners only, and there are no other statutory obligations to present these documents to other parties.

BALANCE SHEET

The Balance Sheet provides a snapshot of the financial health, or other circumstances, of a business at any given moment in time. In very basic terms, it lists the following:

- *The assets that the business owns:* These include bank account balances, the value of inventory, amounts receivable from customers and plant, equipment and motor vehicles.
- *The liabilities that the business owes:* These include amounts due to suppliers, loans due to banks and other third parties, employee-related payables and taxes payable.
- *The equity, or net worth, in the business:* This usually consists of retained profits, capital contributions and share capital, and it should be equal to the business's assets less its liabilities.

STATEMENT OF INCOME

The Statement of Income (formally known as the Profit & Loss) is a summary of the business's income and expenditure over a specified time. It is a key indicator of the financial performance of the business—is the business making a profit?

Depending on the type of business you are running (e.g., retail, manufacturing, service, wholesale), and the structure of your business (e.g., company, trust, unit trust, sole trader, partnership), the Statement of Income will follow a generally accepted format. Regardless of the type of structure you are running your business in, the Statement of Income will show you the income you have earned, expenses directly incurred in earning this income, indirect expenses incurred in earning this income and your profit before tax.

STATEMENT OF CASH FLOWS

Whilst not part of a standard set of financial statements, the Statement of Cash Flows provides valuable information in relation to your net cash inflows and outflows from operating, investing and financing activities. The Statement of Cash Flows helps to reconcile the profit (or loss) that was made over a specified time with the funding activities that the business undertook over that same period. In essence, the Statement of Cash Flows bridges the gap between profit (per the Statement of Income) and the bank account balance (per the Balance Sheet).

IN-HOUSE ACCOUNTANT VERSUS EXTERNAL ADVISOR

No strict rules indicate when you should employ the services of an external advisor. Most SMEs will at least have a tax agent in place to assist with the obligations associated with the ATO—such as income tax returns, activity statements for goods and services tax (GST), pay as you go (PAYG) withholding and PAYG instalments, and tax-related registrations. Tax agents also provide the added benefit of being granted concessional lodgment and payment dates for their clients.

For most small businesses, the combination of a bookkeeper and a tax agent is usually sufficient when the business is in its infancy. Most modern, cloud-based accounting systems allow you to generate your own financial statements with a few clicks of your mouse, and these statements are usually sufficient to provide to your tax agent for preparation of your tax return and activity statements.

The addition of an accountant/advisor to your pool of professional advisors may provide the following added benefits:

- guidance in relation to the commercial aspects of your business as a whole, particularly in relation to your intentions and objectives for that business
- review of your accounting system to ensure optimal set-up and use
- identification of opportunities that may improve your financial performance and/or position
- access to a pool of advisors and experts, including lawyers, bankers, insurance brokers, and so on
- thought leadership and insights in your industry.

In reality, many SME owners juggle the business operations and balancing the books themselves. Appointment of the right team of advisors helps to minimise the distractions to the owner and the business whilst obtaining the most appropriate advice in an efficient, timely manner.

DO I NEED AN AUDIT?

For most small to medium businesses, the answer to this question is usually ‘no’.

Currently, three circumstances generally require an audit of financial statements:

1. *An audit pursuant to ASIC—for ‘large’ corporations:* A corporation (being a company, along with any other entities it controls) is large if it meets two of the following criteria in any given financial year: (1) consolidated revenue of $25 million or more, (2) consolidated gross assets of $12.5 million or more, and/or (3) 50 or more employees. Many large, privately owned Australian businesses may be eligible for relief from a statutory audit if they meet certain criteria in accordance with corporations’ law.
2. *An audit required by the ATO for specific reporting requirements:* Currently, there are no audit requirements for small to medium entities. Large multinational groups of entities, called Significant Global Entities, are required to submit audited GPFS.
3. *An audit required by third parties:* Third parties include banks and third-party lenders, potential investors who may require an audit and/or due diligence as well as potential purchasers if you are looking to sell. Such audits are usually limited in scope and are not subject to full testing of balances, as an ASIC audit would entail.

TECHNOLOGY

The evolution of technology, particularly mobile and cloud technology, has greatly affected the way that businesses of all sizes are run. Business activities are being undertaken at any time, in real time, with a significant increase in reach and scale, including globally.

In the world of business finances and accounting and tax compliance, this evolution has meant that traditional accounting and tax software providers have had to invest significantly in modernising their products to meet the demands of the instantaneous transaction capability that consumers expect. However, using a cloud accounting package is only the tip of the iceberg when it comes to modern business technology practices.

RUNNING YOUR BUSINESS 'IN THE CLOUD'

Cloud accounting systems, mobile phone apps and integration are fast becoming the norm for SMEs. Cloud accounting systems provide real-time results of financial performance and position by relying on constant refreshing of live data feeds that almost instantaneously update your accounting ledger. Reports can be generated with a few clicks of the mouse, and all of this can be done by the technology while you focus on running your business.

Mobile phone apps only make things easier—your accounting system and all the reports it can generate are always by your side. It is not uncommon these days to approve invoices and payments whilst sitting at the beach sipping a cocktail.

However, a cloud accounting package on its own does not maximise efficiency, optimise business performance or minimise the time you spend 'on the books'. Several other systems or apps, when properly integrated with your accounting system, can drive efficiencies and provide you with valuable insights:

- *Point of sale systems:* Instantly update the sales, cost of sales and margins associated with each transaction.
- *Inventory management systems:* Instantly track and update stock that is associated with a sale or purchase and even automatically reorder a stock item for you if it is running low.
- *Timesheet/rostering systems:* Ensure that your payroll is correct, provide an audit trail for employees' working hours and get help in allocating sufficient staff based on expected demand.
- *Key performance indicators reporting tools:* Provide benchmark and traffic-light reporting to show how you are tracking against budget.
- *Customer Relationship Management systems:* Manage reward and discount systems, customer and supplier contacts and coordinate marketing and communications activities.
- *Marketing and branding systems:* Create branded flyers, brochures, invitations and the like by using professional graphic design systems.

Many companies provide cloud technology systems, and choosing the most appropriate systems for your business requires investing time up-front and seeking the right advice. The key to getting the most out of the tools is to ensure that you speak with your advisor about the most appropriate options for your business and then ensure that these options are integrated properly as part of your business's technology ecosystem.

RISK MANAGEMENT

Risk management is a strategic area of business that is often overlooked or not formalised by SME owners. Risk management should form a critical part of your strategic plan because, in its most basic form, it sets the foundation for the extent to which you will push to make your business successful.

The core areas of risk management are:

- Commercial risk
    - For example, market position, competitor analysis, adaptability to changes in market conditions.

- Financial risk
  - For example, borrowing capacity, 'give up' threshold, performance against budget.
- Information technology (IT) risk
  - For example, adaptability to technological advancements, data security, efficiency measures, choosing the right systems to aid delivery.
- Operational risk
  - For example, understanding customer base and reliance levels, market and client awareness, staff skill level, engaged and appropriately rewarded staff.
- Reputation risk
  - For example, brand association, marketing activities, client service assessments.

These areas of risk management should be aligned with the strategic intent for your business and should reflect the risks that come towards the strategy, the risks that come from the strategy and the risks of the strategy itself. Many business owners fail to consider that the strategy itself may not actually lead the business to its desired position.

Risk management is a fluid and ongoing process and requires all owners and employees of the business to be aligned in their approach to achieving the strategy.

CONSIDERATIONS AND OBLIGATIONS WHEN TAKING ON EMPLOYEES

Hiring or contracting people to work on your idea and business is one of the most responsibility-laden steps a business can take, and it is important to be aware of all the statutory obligations. The following section is a brief summary of what you need to be aware of and where to find more detailed information.

Most of the following steps are not optional. All statutory obligations must be fulfilled. Under Australian law, directors of the company employing people are held personally responsible for PAYG withholding amounts and the superannuation guarantee charge (SGC).

PAY AS YOU GO WITHHOLDING

During set-up of a business, it is necessary to register for PAYG withholding with the ATO if you are planning to either pay yourself or others in the operation of the business. PAYG withholding enables employees to meet their tax obligations at the end of the financial year, and the ATO is notified of their employment in your business through the lodgment of tax file number declaration forms.

If the business is utilising the services of contractors, it is important to determine if they are in fact contractors under tax legislation. The ATO has a decision tool to assist with this task.

A business is also obligated to withhold PAYG payments from businesses that do not quote their Australian Business Number, and payments made to directors of the company. (Seek professional advice if you are a director making payments to yourself or other directors, to ascertain your obligations in this regard.)

SUPERANNUATION GUARANTEE CHARGE

The SGC is currently a payment of 9.5 percent of the gross amount of the salary or wages paid to each eligible employee that is paid in addition to it and is paid into a superannuation fund of the employee's choosing. It is important to set up a default fund for employees who do not have a fund; there is a range of low-fee industry funds that are suitable.

It is necessary to use a payroll system that has 'SuperStream' functionality because it is the way businesses must pay employee SGC to super funds. SuperStream transmits money and information consistently across the super system between employers, super funds, service providers and the ATO.

PAYROLL TAX

Payroll tax is a state-based tax and is only required once a payroll has reached a certain level of gross payments (salaries, wages and superannuation payments combined). The threshold varies across Australia: the lowest threshold is $600,000 in South Australia, and the highest is $2 million in the Australian Capital Territory (ACT). If your business is not geographically dependent and expects to have a large number of employees, it is worth doing the calculation regarding payroll tax because a $3 million payroll (37 employees on an average of $73,000) will cost the business $150,000 in payroll tax in South Australia per year but only $68,500 in the ACT.

INSURANCES

Workers' compensation insurance is compulsory and based on an estimation of the wages your business expects to pay for the coming 12 months. The calculation for the premium is based upon the risk category of the type of job being performed and can become expensive in some industry sectors. Two other insurances required are *public liability* (protection against financial risk due to negligence) and *professional indemnity* (to cover the cost of litigation due to breaches of contract or making an error in the delivery of a service). If you sell, supply or deliver goods, it is advisable to take out *product liability insurance* as well to cover liability in the event your products cause injury or death, property damage or a recognised mental health injury.

SALARY PACKAGING

To retain staff, you may wish to consider offering salary packaging arrangements where employees are able to sacrifice part of their salary so that some items or services are able to be paid from their pretax salary. Depending upon your business, you may be able to offer the salary packaging of computers, cars and, most commonly, superannuation. Be sure to seek advice on the fringe-benefit tax implications on the salary packaging items you deem appropriate to offer.

EMPLOYEE SHARE SCHEMES

Employee Share Schemes (ESSs) are a good mechanism for locking in key staff by offering them shares in the company to share in the growth their work is contributing to. An ESS can also offer shares for sale to eligible staff for either cash or through a loan from the company. This is an alternative way to raise small amounts of capital that has the double benefit of creating greater loyalty. Speak to your advisor regarding both ESSs and salary packaging to ensure they are set up correctly.

HUMAN RESOURCES POLICIES

To be sure you are complying with employment-related legislation as outlined in the Fair Work Act 2009 and subsequent regulations and amendments, it is advisable to acquire a human resources policy manual from a reputable source and adapt it to your business. It will cover both legislative requirements as well as general policies (such as a code of conduct and an IT usage policy) that are important for the harmonious operation of your business. The manual should be made available to employees when they commence and be referred to in times of dispute. Having a manual is especially important in regards to the Small Business Fair Dismissal Code to ensure limiting the risk of unlawful dismissal when terminating employees.

Overall, it is important to remember that hiring staff comes with a high level of administration and legislative responsibility that cannot be neglected. The obligations to the ATO are bound by the company director's personal responsibility, and it is important to notify the ATO early if the company is suffering difficulties in meeting its PAYG or SGC obligations. The ATO is usually willing to arrange payment plans if you are proactive about your situation. Directors of the company could be subject to large fines if you are not.

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FROM GARAGE TO GROWTH: WHAT STARTUPS AND ENTREPRENEURS NEED TO KNOW ABOUT REAL ESTATE

CBRE

Nicole Fitzgerald, *Director, Workplace Strategy, Pacific*

Real estate can be a dynamic and flexible asset for your organisation, capable of driving business performance, strengthening your brand and bringing together a community of people. Taking the time to define the strategic role that real estate will play in your business from the onset will set your organisation up for success in the long run, creating a physical and experiential platform that helps you support your most important asset: your people.

The stage of growth your company is in plays a huge role in how you think about your workplace and the level of investment you should be making in space. With that in mind, this chapter is based on the common stages organisations go through as they scale.

PHASE I: THE MOVE FROM GARAGE/HOME/COFFEE SHOP TO COWORKING

POPULATION 1 TO 3, GROWING TO 10 TO 15

As your company grows from one or two employees into a small team, so will your demand for space. Suddenly, a home office or a coffee shop is no longer a viable option. Although you could have everyone work remotely, the agility and pervasive collaboration required to build your business is best supported when you are together. But with growth uncertain and investments prioritised towards growing your business, the idea of signing a long-term lease, buying furniture and investing in equipment all seem inordinate.

HOW DO YOU PROVIDE AN EFFECTIVE WORKPLACE WHILE FOCUSING YOUR INVESTMENTS ON GROWTH?

Two ways of providing an effective workplace are using shared workspaces and coworking environments.

Shared workspaces serve as an effective entry point into office space. The 'shared workspace' model aggregates demand for space across multiple tenants and in turn offers flexible, short-term contracts in lieu of leases. By sharing space, tenants gain access to a broader variety of resources, such as meeting rooms and spaces that support a range of work-style preferences, as well as infrastructure, technology and services.

Coworking environments take shared workspace models a step further by placing a greater emphasis on community and experience. In these models, tenants are considered members, with access to a range of services, curated events and professional development opportunities. Community is truly a benefit, and by investing in experience, coworking provides a place where entrepreneurs build networks and leverage relationships with other members to catalyse business growth.

WHAT TO LOOK FOR IN A COWORKING EXPERIENCE

Experience varies broadly by coworking environment and membership level. Most coworking spaces are designed to encourage interaction and collisions, resulting in opportunities for members to network and share learnings, capabilities and resources. When looking for space, consider the primary role that an office will play for your team by asking these questions:

- *Will you be doing all or most of your work from the coworking space?* Look for environments that provide on-demand access to individual spaces and that support a range of work styles. Consider support for quiet and focused work, availability and types of collaborative spaces and potential added costs associated with accessing space not included in your membership.
- *Will you use the space primarily to collaborate as a team?* Look for membership that provides access to a private team space. Consider the flexibility of the space: look for writable surfaces, large screens that allow you to share information digitally and the ability to arrange the space in a way that works for your team.
- *Will you be connecting with customers, teammates or partners remotely?* Consider how well the environment supports virtual collaboration through videoconferencing, acoustically private meeting rooms and wireless network bandwidth.
- *Are you still building the business and could use help?* Many coworking memberships include access to discounted or free business services and professional development opportunities targeted at entrepreneurs and startups. These can range from human resources support to Web development and may be supported through staff available onsite.

PHASE II: FROM COWORKING TO YOUR OWN OFFICE

POPULATION 10 TO 15, GROWING TO 80 TO 100

Your company is growing. Fast. Your company may only have 10 or 15 people today, but you plan to grow to 80 to 100 in the next year or two. Your shared office space has worked well up to this point, but now you are entering a new phase: you need more space to grow, and you want more control over how you configure, operate and brand it. It is time for an office of your own.

STEP 1: CHOOSE A LOCATION

Although choosing a location may seem to be a straightforward decision, this is an important step in your long-term real estate strategy. Most organisations do not stray far from where they first put down roots. So, although it may be tempting to choose an office location that minimises your commute, it is important to also consider the following:

- *Attraction and retention of talent:* Consider who you are looking to attract and where they will be coming from. Commute times, particularly in talent-rich markets, can and do have an impact on the decisions people make to join a company.
- *The neighbourhood:* Often cast as the suburbs-versus-the-city conundrum, it is important to consider what is located near your company. Does the surrounding area offer the kind of amenities and services your people will want and need during the day and before or after work (cafes, fitness centres, supermarkets, etc.)? Does the brand of the area align to your own?

STEP 2: DEFINE YOUR FOOTPRINT, AND ORGANISE YOUR SPACE

Your first office represents the start of your real estate and workplace strategy. How you occupy, configure and assign space, and the types of amenities and services you provide, will establish a set of baseline expectations. Getting these right in the beginning ensures that you will be able to scale responsibly later without being in the awkward position of having to 'take things away'. Key questions to ask include the following:

- *What is the role of the office?* If you are moving from a coworking space, you have probably established quite a mobile and flexible way of working. The office will be one in a network of places where work is done—so what role should the office play in that network? Do you need to provide everyone with a desk to check their emails and do focus work, or is the office primarily a space for your teams to gather and cocreate? The answer will likely be somewhere in between and will ultimately drive most key decisions about the workplace.
- *How much space you do you need?* Determining how much space you need is not always easy, especially given the volatility most startups experience in hiring. One rule of thumb is to use a square-metre-per-person range and apply it to your three- or five-year head-count projection. (See Box 1 for common ranges by size of company.) Although it is good to build a cushion into your estimates, do not be too aggressive. A lot can change in a three-year period. The hurdles that come with faster-than-anticipated growth are far easier to clear than the costs of carrying too much space and low morale associated with empty offices. For greater flexibility and to manage risk, talk to your tenant representative about negotiating expansion or hand back rights into your lease.
- *What kind of space do you need?* The best way to determine what kind of space you need is to think about how you work and/or how you would like your people to work. Do your people work alone, or in teams? What is the average size of a team, and how regularly does the makeup of a team change? Are people's work patterns largely similar from one day to the next, or is there a high degree of variability in the work process? How do your people communicate with one another and those outside your organisation? How do you gather as a community? How do you recharge?

> **Box 1.** Defining your footprint: How much space do you need?
>
> - Most startup organisations target a range of 10–12 square metre/seat.
> - Smaller startups tend to be on the lower end of this range because they have fewer requirements for large spaces and amenities.
> - More established startups tend to fall on the higher end of this range as they hit head-count thresholds that make it more reasonable and desirable to bring conferencing, training and employee services and amenities in-house.
> - The use of experience-driven flexible space, including serviced rooms, acts as an extension of your work environment where larger or less frequently used meeting, training and event spaces are outsourced, enabling a smaller day-to-day space requirement.

Organise your space around the answers to these questions, starting from the perspective of the individual employee and working your way out:

- *Assignment of desks:* The decision to assign desks or not depends on the outcomes you are trying to achieve and the work patterns you look to adopt to be successful. Does the type of work you do suit mobile working? Is there an active flexible working policy in place? Would the ability to work alongside different people and/or teams accelerate decision making or strengthen a connected culture?

- *Collaborative space:* The amount and type of collaboration space you need will be determined by the frequency and format in which you meet, the size of your meetings and the tools you need to collaborate effectively. Most meetings tend to be small and impromptu. A greater number of smaller spaces will likely provide more utility than a smaller number of large spaces. Ensure your enclosed space is truly acoustically private. Spaces that give the illusion of privacy but do not in actuality provide privacy are of little use to anyone.
- *Variety of workspaces:* Ensure choice—individuals have different work patterns and work preferences. By providing a range of places from which work can be done, you provide employees with access to space that fits their tasks and personal work style preferences most effectively. In turn, people feel more productive and better supported by the organisation.
- *Community space:* Plan your community space to be attractive and multifunctional. No one will spend time in a windowless breakroom. Position your community space for impact, making it a place that people will gravitate to throughout the day. By making it multifunctional, your community space can serve both as a social space and as an alternative workspace.

STEP 3: FURNISH, EQUIP AND BRAND

Furniture can be a huge cost when you make the first move into your new space. It is tempting to go the IKEA route and buy inexpensive pieces, and it is just as tempting to make huge investments in high-end office lines.

The answer to this dilemma lies somewhere in between: make every dollar count, and spend on the things that matter. Here are a few do's and don'ts to keep in mind:

- **Do** invest in the things that matter most to your day-to-day work. This likely means a super-fast and reliable Wi-Fi connection, dual monitors at your workstations, larger monitors in your meeting rooms, ergonomic chairs and sit-stand desks.
- **Don't** paint your walls in your company colours and call it branding. Instead, consider how you can display your product or service or how your thinking has evolved, and/or showcase your work in progress. These efforts will convey your brand far more effectively than a bowl of branded chocolates on the table in your reception area.
- **Do** experiment with the technology products and services that are free or come at a nominal fee. The latest videoconferencing equipment will be obsolete before your lease term is up. Instead, consider the tools you use to communicate in daily life, such as text messaging, FaceTime/Skype/Google Hangouts and messenger apps such as Slack, and look for ways that they can scale to support your team.
- **Don't** buy too much 'soft seating'. Everyone likes the idea of meeting on a couch until they sit through a meeting on a couch. Comfortable seating is good and has a place in your office, but it should not replace the functional seating you need to get real work done.
- **Do** provide good coffee and at least some free snacks. Breaks are the best times to create and foster community. Do not miss that opportunity by forcing people out of the office in pursuit of a decent cup of coffee or a quick snack.
- **Do** understand that how you allocate and fit out space will speak volumes about what you value and directly influence the behaviours that occur within it. If you say you value transparency, ensure that people are visible. If you value collaboration, invest in space that supports it.

PHASE III: FROM ONE FLOOR TO TWO OR MORE

Population 100 to 250, growing to 200 to 400

By the time you hit a population of 200, your people will likely be spread across two or more floors and most will have defined roles and specialties. Gone are the days when one person wore 10 hats and when knowledge was transferred almost by osmosis.

Although growth and expansion of this kind is certainly a sign of success, it can also create new and sometimes unwelcome changes to how work gets done:

- *Silos:* As people begin to specialise and departments or business units take shape to tackle core business functions, silos can more easily form. The increased use of short-term contract employees means not everyone is as familiar with each other as before, when the company was smaller. The division of people across multiple floors or buildings can exacerbate this issue by breaking down informal communication channels.
- *Travel:* As their span of control widens, leaders in the organisation will begin to travel more regularly, leaving underutilised space and direct reports who require more intentional connection to achieve business goals.
- *Meetings:* As teams become more distributed, the number of formal meetings will likely increase to accommodate remote participants, placing greater demand on enclosed meeting rooms with audiovisual equipment.
- *Managers:* As authority is delegated to more people, the population of people managers will increase, thus increasing the demand for private space and decreasing the amount of 'white space' in calendars across the organisation.

There are a range of ways that your workplace strategy can help you combat (or conversely, exacerbate) the challenges inherent with these changes. Consider the following:

- *Density is not a bad word:* Density is what makes cities vibrant, exciting places. The same can be true of your workplace. Do not be afraid to increase your density; just do it wisely. Consider how space can be shared rather than shrunk.
- *What works for 10 people does not necessarily work for 100 (or more):* Behaviours and relationships that happened organically will now require more intention. Consider how information is shared, mentorship is supported and business goals are permeated throughout the organisation. Define clear roles for community and business champions.
- *Invest in growing your community:* As you scale, building community will not happen as naturally as it did when you were 15 people in the same room together. Helping people build and maintain networks within your organisation is a critical part of employee engagement. Allocate, provision and activate space that people are drawn to.
- *Establish clear norms and protocols, and talk about them regularly:* These tools help to reinforce community and help individuals and teams come together around a common set of goals.

PHASE IV: FROM ONE LOCATION TO MANY

Population 200 to 400 +

As your organisation continues to grow, you are likely to expand geographically. New locations are an opportunity to be closer to customers, access a bigger talent pool and expand brand presence. It is time to think of your office as a network of places, all working together as one platform for your employees. How will experience be consistent and reflect you as an organisation? And how will the sites be distinct and reflect the work being done there? How will you preserve or reignite your culture as you scale?

Depending on your business model and organisational structure, the new site may fall into one of three (or even all) categories: regional, functional or coworking:

- *Regional sites:* These sites represent the business in a specific region—think Australian headquarters. They serve as brand beacons, providing closer access to partners and customers and housing a variety of functions.

These sites require access to a diverse talent pool that supports the broad range of roles.

- *Functional sites:* These sites are home to specific business units or functions, such as research and development, sales and customer service. Where the regional site may serve as a hub, these are the spokes focused on serving a particular business area.
- *Coworking sites:* Coworking sites should continue to be an integral part of your portfolio strategy. They can be used either to grow and test new markets and/or to incubate new products/services without significant infrastructure investment. Readily available coworking sites also mean you can grow quickly, establishing a team without waiting for the new lease and build-out of space.

Although each location in your portfolio will serve its unique purpose, the overall experience should consistently reflect your values. These three strategies can help you drive a more consistent experience:

- *Service is the most flexible amenity:* You can scale it appropriately to each site and target the specific needs of the local population. By making the employee experience a central element of your strategy, you can reduce a 'haves and have-nots' experience that is common as organisations scale.
- *Keep space standards and protocols flexible:* Specific site purpose and the work done there might require some adjustment, but creating guidelines for planning and space types will help the experience feel consistent.
- *Integrate brand as the common variable across all sites:* Brand can be integrated in ways that are tangible and abstract—events, interactions, even signature snacks that are available at every office. Consider how you integrate and celebrate both company culture and local culture, working with your local teams to find balance between the two.

SUMMARY

Real estate is not the domain of mature companies alone. The smartest startups consider it an enabler of their business and a benefit to their people. When treated as a strategic tool, your workplace can enable your people, nurture your culture and promote your brand. When sidelined as an inconvenient but necessary expense, your workplace can hinder your ability to attract, retain and properly support talent.

Getting the foundational elements right early on—a location people can easily access, an environment that supports the way you want people to work, branding, services and events that reflect your culture—will serve you well as you scale.

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DIRECTORS AND OFFICERS INSURANCE: INSURING YOURSELF AND YOUR COMPANY

CLYDE & CO.

Christopher Smith, *Partner*

Directors and officers have a wide range of statutory and common law duties and obligations. They include the following:

- an obligation to exercise care and diligence
- a duty to exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose
- a duty to avoid conflicts of interest between themselves and the company
- a duty to disclose personal interests and not to improperly use their position or information
- an obligation not to trade while insolvent.

Directors and officers also face potential personal liability under a range of State and Federal statutes, including Work Health and Safety laws, employment laws and environmental protection laws. In addition, a director may have disclosure obligations, which vary depending on whether the company is private or publicly listed on the Australian Securities Exchange. The disclosure obligations on publicly listed companies and their directors are onerous. They include the continuous disclosure regime, duties of disclosure with respect to the issue of prospectuses and Product Disclosure Statements for financial services, as well as liability for misleading information and documents.

It is in this context that difficult decisions and judgment calls will need to be made by a company's directors and officers. Sometimes, decisions are made under pressure, often involving large sums of money. Even when directors make carefully considered decisions, errors can still be made. It is not always possible to please every stakeholder, and some interests may be adversely affected by a decision. A claim may be brought against a director or an officer by:

- the company itself
- shareholders
- regulators, such as the Australian Securities & Investments Commission, the Australian Prudential Regulation Authority and the Work Health and Safety authorities

- employees
- creditors
- customers
- competitors
- administrators or liquidators of the company (on behalf of unsecured creditors) or receivers (on behalf of secured creditors), if the company is insolvent.

If a director or officer is found to have breached a duty or obligation, he or she may have a liability to pay compensation (damages), a fine or a penalty. This amount is in addition to bearing their own legal defence costs and the legal costs of the regulator or the aggrieved party that brought the claim.

DIRECTORS AND OFFICERS INSURANCE

Directors and officers (D&O) insurance protects individuals who manage a company from claims made against them, which arise from decisions they make when running the company. D&O insurance only covers directors and officers against liability that they incur in their capacity as directors or officers. D&O insurance can provide corporate decision makers with protection and peace of mind. The existence of adequate D&O insurance will have the additional benefit of attracting and retaining high-quality candidates for board positions, particularly when the company may be seeking non-executive directors.

HOW A D&O INSURANCE POLICY WORKS

Although D&O insurance is, as the name suggests, primarily intended to protect the directors and officers of the company, the insurance policy is usually obtained and paid for by the company itself. For this reason, the company is usually described as the Policyholder.

WHO IS COVERED?

D&O insurance policies will usually identify the individuals it covers as 'Insured Persons' by listing their job title or role. A D&O insurance policy will invariably cover all past and present directors of the company and its executive officers (the chief executive officer, chief financial officer, chief operations officer and company secretary). A D&O insurance policy will also frequently cover those who are involved in the management of the company, and sometimes the definition of Insured Person may extend to employees. Every insurance policy wording is different, and a review of available policies will show that there is a sliding scale between individuals who are covered and those who are not. The definition of Insured Person should therefore be checked carefully, because it is a means by which the scope of coverage can be limited by the insurer.

INSURING CLAUSES

D&O insurance policies usually include three insuring clauses:

- *Side A Cover:* This clause provides cover for directors or officers when the company has not indemnified the director (e.g., if the company is insolvent) or is not permitted by law to do so (e.g., the *Corporations Act* prohibits a company from indemnifying its directors for liabilities to the company itself). Under this clause, the D&O policy provides direct cover to the individual directors and officers for liabilities and legal costs that they have incurred.
- *Side B Cover:* This clause reimburses the company when it has indemnified the director or officer, most usually under the director's deed of indemnity. The D&O policy covers the company for its liability to indemnify its directors and officers when they have incurred liabilities and legal costs in relation to a claim. This clause is often referred to as 'the company reimbursement clause'.
- *Side C Cover:* This clause is the only insuring clause that provides cover for the company for any liability that it has in its own right, as distinct from the liability of its directors and officers. The cover it provides is limited to claims made against a company as a result of the offer, sale or purchase of its

shares listed on the stock market. It is usually purchased by a publicly listed company to insure against shareholder class actions and securities market conduct breaches. Not every company requires such cover, and for this reason it is usually an optional component of a D&O insurance policy. If a company requires additional protection, many insurers offer a management liability policy that provides cover for the company in its own right in addition to cover for its directors and executives. This product is intended for smaller, unlisted businesses and is not discussed in this chapter.

LIMIT OF INDEMNITY AND EXCESS

The limit of indemnity will vary in each D&O insurance policy. Deciding on an appropriate level of cover will depend on several factors, but the type of business and the associated risks to which the directors may be exposed will be key factors. Insurance brokers will provide guidance, including on limits of indemnity purchased by comparable companies.

Sometimes a D&O policy will have *sub-limits*, which are capped limits within the limit of indemnity for some components of the cover, such as Work Health and Safety claims or defence costs in relation to specific types of claims.

A D&O policy that provides cover under Sides A, B or C will usually have one overall, or aggregate, limit of indemnity for all claims, regardless of which insuring clause is triggered. Because there is, in effect, one pool of insurance money, a D&O policy that includes Side C cover can put at risk the cover available for directors. For example, significant defence costs incurred by the company in defending a class action paid under Side C will erode and potentially exhaust the limit available to the directors under Side A. For this reason, a company will often purchase one D&O policy providing Side A and Side B cover for the directors and officers and obtain a separate policy providing Side C cover. In this way, the limit of indemnity available for the benefit of the directors is preserved.

An *excess*, also referred to as the *deductible or retention*, is an amount an insured individual must contribute towards a claim. In most cases, no excess applies to the Side A insuring clause that covers directors and officers. An excess is usually applicable to Sides B and C, which provide cover to the company.

PERIOD OF COVER

D&O insurance usually runs for 12 months and can commence on any date, but for convenience, many companies align their insurance with the financial year. Most D&O insurance cover is provided on what is technically termed a 'claims made and notified' basis, which means that (1) the claim against the director has to be made, and (2) the insurer has to be notified of the claim, during the policy period. With some exceptions, D&O policies will not cover a director or officer for claims arising from factual circumstances that were likely to give rise to a claim, and that they knew about or ought reasonably to have known about, prior to the commencement of the policy.

Many D&O policies refer to a retroactive date, which is usually the date on which the insurer first issued a policy to the company. As a general rule, the insurer will not cover liability arising from any acts, errors or omissions that took place prior to that date.

CLAIM

The definition of 'Claim' is important in defining the scope of cover offered under the D&O policy. It is in the definition of Claim that the requirement of capacity, discussed earlier, becomes relevant. A D&O policy almost invariably defines a Claim by reference to a wrongful act committed by an Insured Person in his or her insured capacity.

The definition of Claim will include demands for compensation and non-pecuniary relief and the commencement of legal proceedings, including civil actions and criminal prosecutions. Most D&O policies include cover for formal investigations, but this is an area where insurers can limit or broaden the available cover through the definition of 'Investigation'. A wide range of investigations and enquiries can be brought against directors and officers by regulators, liquidators and other officials. This issue should be given close consideration.

LOSS

The definition of 'Loss' in a D&O policy is very important. It will describe the financial loss that will be paid by the insurer. The definition will conventionally cover awards of damages, compensation, judgments, settlements and defence costs as well as the legal costs of the claimant. Many D&O policies provide cover for civil pecuniary penalties and fines payable by a director. The definition of Claim will usually exclude liability to pay taxes and punitive, exemplary and aggravated damages. The definition can vary between policies issued by different insurers and, as with the definition of Insured Person, can be a means by which the scope of coverage can be narrowed or widened.

WHAT IS USUALLY EXCLUDED FROM COVER?

A D&O insurance policy will contain exclusions that restrict coverage. Some must be included by law. Others are included because the risk is typically covered by another type of insurance policy. Additional exclusions may be added to the policy by *endorsement*, which is an amendment or addition to the policy that changes its standard policy terms. Some of the most commonly encountered exclusions are as follows.

PRIOR CIRCUMSTANCES

Commonly found in all liability insurance policies, this exclusion will exclude cover for claims arising from an act or omission that took place prior to the commencement of the policy, which the director or officer knew or ought reasonably to have known was likely to give rise to a claim.

FRAUD OR DISHONESTY EXCLUSION

All D&O insurance policies will exclude cover for loss resulting from deliberately fraudulent or dishonest acts, improper use of information and improper use of position. This exclusion will usually extend to exclude loss caused by any wilful breach of duty or statute, or conduct carried out with a reckless disregard for the consequences. This exclusion is often referred to as the 'conduct' exclusion.

The exclusion will usually state that it only operates once there has been a final adjudication by a Court or tribunal or written admission by the director or officer concerning the fraudulent or dishonest conduct. In this way, the insurer is still permitted to advance defence costs (see the section on Extensions) so that directors or officers can pay for lawyers to defend themselves against the allegations.

PROFESSIONAL SERVICES EXCLUSION

A *professional services exclusion* will exclude cover for acts and omissions committed by directors in the performance of professional services. The precise wording will vary in each policy, and there is often a fine line between acts carried out in the capacity of director and those carried out in a professional capacity. If the company is carrying out professional services, advice should be sought about potential gaps in cover between the D&O policy and the professional indemnity policy.

PROSPECTUS EXCLUSION

A *prospectus exclusion* excludes cover for claims arising from allegations of misstatement or misrepresentation in a prospectus or similar public disclosure document.

MAJOR SHAREHOLDER EXCLUSION

A *major shareholder exclusion* excludes cover for claims brought by parties holding a specified level of equity (usually 15 percent or more) in the company.

INSOLVENCY EXCLUSION

An *insolvency exclusion* excludes claims arising from the company's insolvency or inability to pay its debts as and when they fall due. This exclusion is often added by endorsement if the insurer has concerns about the ongoing financial position of the company.

EXTENSIONS

Several extensions may be found in a D&O policy. They are called *extensions* because they extend cover beyond that provided in the Side A, B and C insuring clauses. They provide additional protection by catering for situations that do not trigger cover under those insuring clauses. Although some extensions are now found so frequently in D&O policies as to be considered standard, a range of optional extensions is usually available to be selected to suit the requirements of the company and its directors.

The most commonly found extension is the provision for the advancement of defence costs. The vast majority of D&O policies contain a provision whereby the insurer can pay defence costs as they are incurred during the course of the defence of a claim or investigation. Should an exclusion operate to deny cover, for example, in the event of the criminal conviction of a director, the defence costs advanced by the insurer will become repayable by the director. Other common extensions include the following:

- *Cover for outside directorships:* This provides cover for directors sitting on the boards of external companies (which are not subsidiaries of the Policyholder) at the direction of the Policyholder.
- *Continuity cover:* This is, in effect, a waiver of any late notification of a claim provided that the Policyholder has held uninterrupted cover with the insurer since a specified date (known as a Continuity Date) and the claim could have been notified after that date. By forgiving the late notification, it creates an incentive for a company to remain loyal to its insurer.
- *Run-off cover for retired directors:* See the section called 'What Happens if a Director Leaves the Company?'
- *Extended discovery period:* This is a further period after expiry of the policy during which the insurer agrees to accept notification of claims.
- *New subsidiaries:* This extends cover to subsidiaries acquired by the company during the period of the policy.
- *Extensions that meet the needs of specific industries:* These include situations such as a pollution extension for mining companies.

Cover under extensions may have sub-limits of indemnity.

WHAT HAPPENS IF A DIRECTOR LEAVES THE COMPANY?

A claim may be made against a director after he or she has left the company, sometimes many years later. The director may have moved to another company or retired. Alternatively, the company may have been taken over by, or merged with, another company. Such changes in control must be notified to the insurer and will affect the company's D&O cover, typically bringing it to an end. Although the insurance policy may have expired, the director may still have liability for acts or omissions carried out in that capacity while he or she was employed with the company.

Because of the claims made and notified requirements of a D&O policy (as referred to earlier), the company must have a policy in force at the time the claim is made against the director or officer for cover to be available. For this reason, it is important for the director to check that the D&O insurance policy includes 'run-off cover', which provides cover for the director after he or she ceases to hold office. Some policies include this as a standard feature of the coverage offered; in others, it is an optional extension. Sometimes it can be added to the policy by way of endorsement before expiry. Run-off cover is also available to be purchased by the director in a separate stand-alone policy. The duration of the run-off cover should be at least seven years.

SEVERABILITY

D&O policies cover many individuals as Insured Persons, and in some cases the conduct of one director will have an impact on other directors. For example, if a director is accused of misconduct or misrepresentations to the insurer, this may affect the ability of an 'innocent' director to obtain cover under the same policy.

Most D&O policies contain 'severability and non-imputation' clauses, which provide that the wrongful acts of one director are not imputed to another. In some cases, the proposal to the insurer and the insurance contract will be separate for each insured person, and there will be no imputation of acts or omissions from one insured person to another. Many policies limit those with knowledge of the company to a small number of executive directors and officers. Each insurance policy is different and should be checked carefully.

THE RESIDUAL RISK

A director should be aware that some risks cannot be transferred to the company or covered by D&O insurance. These risks include the following:

- damage to personal and business reputation
- personal financial losses resulting from a downturn in business or income
- liability for fraud, wilful misconduct and criminal conduct (and for defence costs incurred if the conduct is proved)
- liability for fines and penalties for criminal offences, and certain civil pecuniary penalties (cover may be available depending on the particular policy).

SOME PRACTICAL ASPECTS

It is important that directors obtain a copy of the complete D&O insurance policy, which will consist of the schedule, the wording and any endorsements. Directors should not rely on a summary provided by the company or the insurance broker.

The D&O insurance policy may prohibit disclosure of anything in the policy to third parties, including the limit of liability. Directors should carefully review the confidentiality provisions and be careful not to breach them.

Throughout the process of obtaining D&O cover, either for the first time or on renewal, advice should be obtained from a specialist insurance broker. Consideration should especially be given to whether there is continuity in cover, and whether there may be 'gaps' between policies.

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ALTERNATIVE WAYS TO FINANCE YOUR FAST-GROWING COMPANY

PARTNERS FOR GROWTH AUSTRALIA

Karthi Sepulohniam, *Director*

Jason Georgatos, *Managing Director*

Equity can be a great option to fund early commercialisation of a growth company. But as your company progresses, a combination of debt and equity can work in concert to provide an optimum mix of capital from a cost and flexibility perspective. As an alternative to equity funding, growth debt particularly makes sense for companies with a proven offering, customers and growing revenue. Many high-growth companies in the U.S.—including Google, Uber, Facebook and YouTube—have used growth debt at different stages of their growth. In Australia, companies that have taken debt financing to fund early expansion include Prospa, Koala Mattress, Sunnylife, Mon Purse, GlamCorner and Yellowfin.

DEBT CAPITAL FOR GROWTH COMPANIES

Growth companies typically turn to debt financing for one of three reasons:

1. to increase their cash position when seeking to extend runway
2. to support growth initiatives with cheaper capital, such as when the company is close to cash flow breakeven but does not want to raise additional equity
3. to enhance equity returns, or wholly substitute for equity financing.

TYPES OF DEBT CAPITAL

In Australia, there is a gap for growth debt financing because traditional lenders (such as the 'Big Four' banks) do not typically provide loans to fast-growing companies unless the borrower has strong asset backing or if the founders are willing to provide personal guarantees. However, alternative financiers like Partners for Growth (PFG) have entered the market to fill this gap and provide A$1 million to A$20 million in growth debt capital. Some common structures used by alternative debt financiers include debt with warrants (also known as 'venture debt'), revenue-based financing and royalty loans. Each of these is explored in turn in the following sections.

DEBT WITH WARRANTS ('VENTURE DEBT')

Venture debt is a form of debt capital for companies that do not meet the requirements for traditional debt financing, or that want greater flexibility. In the U.S., venture debt has been an essential part of the entrepreneur's toolkit for over 30 years; however, it has only taken off in Australia in more recent times. Venture debt is usually considered as complementary to equity financing but can rarely replace true risk capital (equity).

Venture debt is typically structured as a three- to four-year loan with monthly interest and principal repayments. Most venture debt providers also require *warrants* (options issued by the borrower) for company shares as part of the overall funding package.

Typically, venture debt is senior debt that is secured by a company's *enterprise value* (defined as a company's total economic value) or by specific assets, such as accounts receivable. Venture debt lenders typically do not require personal guarantees or directors' guarantees as security. Instead, lenders and borrowers in Australia usually enter into a general security agreement (GSA). The GSA covers all the assets of the borrowing company and allows the parties to the loan agreement to avoid listing out every single asset that is being used as security.

Venture debt in Australia is often best suited for companies that are already generating revenue of scale. Commercialisation risks for the lender can be mitigated when companies begin to generate a few million dollars in sales and the venture lender can look to underwrite growth risk. Some types of companies are better positioned for debt financing than others. For example, lenders often prefer companies with recurring revenue models rather than companies with irregular or 'lumpy' revenue models. Similarly, companies with long-term enterprise contracts are considered less risky borrowers than companies with an e-commerce model with high churn. In the U.S., a form of early-stage venture debt is often used by pre-revenue technology companies that have backing from top-tier venture capital funds. The aforementioned startup companies are able to borrow money, even though they are pre-revenue, with the expectation that a future venture capital equity round will repay the debt. At this time, early-stage venture debt is not widely available in Australia because its utility for borrowers and lenders is predicated on a large and diverse venture capital ecosystem of a scale that you will find in the U.S. or the U.K. Australian companies that raise venture capital in the U.S. or U.K. and move operations overseas might be able to obtain early-stage venture debt in certain cases.

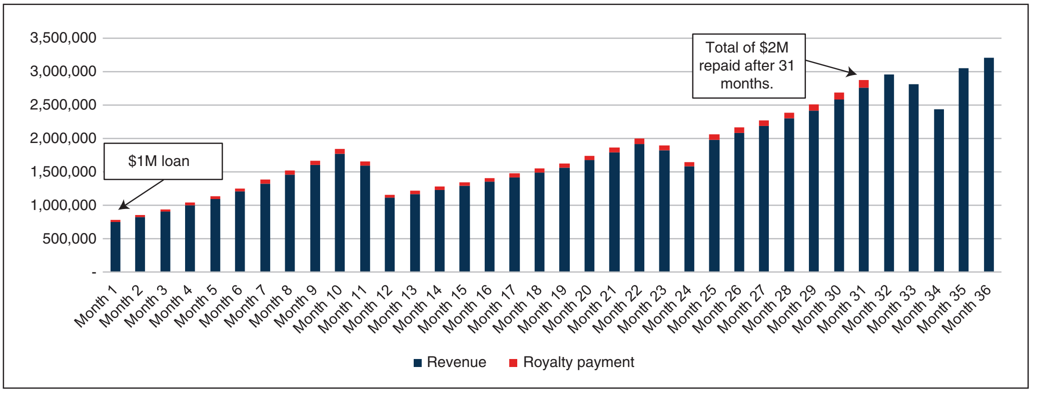
ROYALTY LOANS

A *royalty loan* is a debt instrument where repayment is based on a fixed percentage of future revenue streams, until the lender has received a pre-agreed multiple ('repayment cap') of the original loan amount. The repayment cap is generally in the range of 2x to 4x. The total amount that the borrower must repay to the lender over a set time frame (generally three to five years) will include the principal amount of the loan as well as an additional payment, which adds up to the cap. Unlike traditional loans, where repayment amounts are fixed, royalty loans payments are tied to incoming cash and usually calculated on a percentage of monthly revenue. This royalty percentage varies but is generally in the 2–8 percent range. This structure offers companies a degree of flexibility because repayments are lower in months where sales are low, while in months where sales are high, the loan is repaid faster.

For example, assume that you take a $1 million loan and agree to repay it over a three-year period. During that time, you will repay a fixed percentage of your monthly revenue—say, 4 percent—each month. If the repayment cap is set at 2x of the loan amount, you would have paid $2 million in total over the period of the loan, as shown in Figure 1. This $2 million would comprise $1 million in effective interest payments and $1 million in principal payments. A warrant for the lender can also be part of a royalty loan transaction.

Once used primarily by energy and biotech firms, royalty loans are increasingly used by growth companies, including software and Internet businesses. Royalty loans work particularly well for businesses that are

FIGURE 1. Example of repayment of a royalty loan



generating consistent revenue with decent gross margins. For this reason, software as a service (SaaS) businesses have been the largest recipients of royalty loans in the U.S. In Australia, royalty loans can be harder to find. PFG can provide them in certain situations, and we have seen several family offices and private investors structure royalty deals for growth companies in Australia.

RECURRING REVENUE-BASED LOANS

Recurring revenue-based loans are a relatively new form of debt financing but have been used successfully by several Australian SaaS companies to fund growth. SaaS businesses are ideal candidates for recurring revenue-based financing due to the predictability of monthly revenue and high gross margin nature of the SaaS business model. The most common structure for a recurring revenue-based loan is a line of credit tied to a multiple of monthly recurring revenue (MRR). For example, if a SaaS business is generating A$500,000 per month in recurring revenue, applying a 2x to 3x multiple of MRR will result in a line of credit of A$1.0 to 1.5 million.

When structuring recurring revenue-based loans, lenders will focus on key SaaS metrics, such as customer retention rates (churn), customer acquisition costs and lifetime values as key underwriting factors. Recurring revenue loans also typically have a warrant component, which provides the lender an opportunity to participate in potential equity upside.

GETTING READY TO RAISE DEBT

Once a company decides to raise debt, it is essential to prepare the right information package ahead of engaging with potential lenders. Lenders typically require a recent management presentation, historical financial results, financial forecasts, a sales pipeline and customer data (Table 1). Taken together, the information from these materials will inform the lender's assessment of the quantum, structure, risk and pricing of the debt facility.

TYPICAL DEBT TERMS

Similar to what you would see in an equity financing, there are many components to a debt financing. The main terms we will discuss below are facility maturity, facility type, interest rate and pricing, warrant coverage and covenants.

- *Facility maturity:* Typical facility maturity periods for growth debt are three to four years, although some lenders can structure facilities as short as 12 months and as long as five years. In general, the longer the facility maturity, the higher the perceived risk.
- *Facility type:* The two most common types of growth debt facilities that lenders offer are term loans and revolving lines of credit. *Term loans* can be structured with straight line amortisation or have an interest-only period of 6–12 months, after which the facility is repaid over 24–30 months. *Revolving lines of credit* act very much like a credit card, whereby the company can borrow and pay

TABLE 1. Information required by lenders when raising debt

Category	Information Required
Recent management presentation	Business overview
	Value proposition and market opportunity
	Discussion and analysis of recent financial performance
	Key performance indicators (KPIs) tracked by the company
	Team and investor information
Historical financial results	Historical monthly financial statements comprising profit-and-loss statements, balance sheets and cash-flow statements
	Information on growth rates, profit margins, working capital and capital expenditure
Financial forecasts	Forecast financial model with monthly profit-and-loss statements, balance sheets and cash-flow statements
	Clearly outlined assumptions of projected growth rates, margin trends, capital expenditures and cash uses
Sales pipeline	Information on the company's sales cycle
	Potential revenue by prospective customers
	Outline of sales funnel showing sales stage and probability of winning each opportunity
Customer data	Concentration of total revenue by top 10 or 20 customers organized by geography and industry
	Customer renewals and retention rates
	Contract terms, including commitment length and payment terms

down debt over a set period. Borrowers may prefer one type of facility over the other, depending on the situation. Term loans provide the ability to access a fixed amount of capital up-front that will be repaid over time. Lines of credit (such as a recurring revenue loan or a debtors facility) provide working capital or the ability to increase liquidity in between periods of invoicing and receiving cash from customers.

- *Interest rate and pricing:* Interest rates for growth debt are generally higher than traditional bank loans given the higher perceived risk of the borrowers. Remember that most growth companies do not fit into the credit box of traditional lenders. Typical interest rates in Australia for growth debt are 10–15 percent. Lenders also usually charge a one-off commitment fee of 2–3 percent of the facility amount, payable up-front.
- *Warrant coverage:* Where lenders require warrants as part of the overall funding package, they will usually seek warrant coverage of 10–30 percent of the facility amount. For example, a 10 percent warrant coverage would require the borrower to issue a warrant for $500,000 worth of shares for a $5 million loan. Usually the lender will try to get an informed view on what the business can be worth in the future and then back solve for quantum of warrants needed on that particular deal. Depending on the lender's view of the equity upside, the warrants required can often be 70–90 percent less dilutive than raising equity.

- *Covenants:* Most lenders will require the borrower to comply with financial covenants, which are tested on a monthly or quarterly basis. Financial covenants not only provide the lender with an ability to monitor the company's performance on a regular basis but also provide the ability to anticipate more serious performance issues earlier.

WHEN IS THE RIGHT TIME TO RAISE DEBT?

This question is best considered in context, for companies wishing to use debt and equity in partnership, or debt as a stand-alone option. A company's creditworthiness is highest immediately after raising a new round of equity. As such, if you are considering debt capital to complement to your equity fundraising, you should consider engaging with a lender once you have a few equity terms sheets on hand, or even sooner. Typically, the debt financing will be synced up to close simultaneously or soon after the equity fundraising is complete. Raising debt to shore up the balance sheet when the company is cash rich from an equity raising may seem contradictory, but often the debt can be structured with a 'draw period' so that the loan can be drawn at a later time when additional runway is required. If you are considering raising debt as a sole financing option, the best time to engage with lenders is when there is still sufficient liquidity and operating runway in the company. Trying to raise debt when cash is low and runway is minimal will prove to be challenging and will also reduce your bargaining leverage. If the company has a credible pathway to profitability, that will also help lenders get comfortable, even if the business is currently losing money.

HOW DO EQUITY INVESTORS VIEW DEBT CAPITAL?

In PFG's experience, investors generally view debt capital favourably and appreciate the role this type of funding plays in reducing the equity cost of financing their portfolio companies. There are many reasons for this. For example, debt can simply signal increased liquidity, or it may be viewed as 'insurance' and provide comfort that there is additional capital to manage through performance setbacks. Debt capital can also signal to investors that there is momentum behind the company, and it shows that the company is working to grow revenue and cash flows. Regardless of their views about debt funding, experienced investors also recognise that debt comes with compromises. If you have too much debt on your balance sheet, new equity investors may question the use of fresh equity to repay debt. Some investors may also question standard debt requirements like financial covenants and performance milestones, especially if the company is early stage. Overall, debt financing, when used judiciously, leverages the equity of existing shareholders, which can increase returns.

WHAT ARE THE KEY CONSIDERATIONS WHEN SELECTING A DEBT PROVIDER?

The key criteria that we would argue as the most important to seek in a debt provider are transparency and predictability. Fast-growing companies operate in a dynamic environment and face multiple challenges on their way to becoming mature businesses. Therefore, it is important to select a debt partner that has demonstrated the ability to work with growth companies in both good and bad times. The following are some key questions to bear in mind when talking with debt providers:

- Do they have an established institutional track record as a debt provider?
- What has been their approach to managing through off-plan performance?
- Do they have relationships with your investors or Board of Directors?
- What is the feedback from companies that have previously worked with the debt provider?

FINAL THOUGHTS

Debt finance can be a great tool to obtain the capital a growth company needs while reducing dilution and maximising the potential financial returns of existing founders and shareholders. More high-growth businesses should consider debt as part of their capital structure. However, as discussed earlier, debt finance is a much better fit when companies have a high degree of visibility into revenue forecasts, have proven product/market fit and have achieved scale (generally more than $5 million in annual revenue).

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DEVELOPING AND REFINING YOUR BUSINESS MODEL AS YOU SCALE

UPGUARD

Hamish Hawthorn, *Chief Operating Officer*

A business model is what lies at the core of any company. It is the mechanism for both delivering value to customers as well as the instrument for generating revenue. This chapter discusses the way entrepreneurs should think about their company's business model as the business evolves—particularly as you move out of the startup phase and into the scaling up of a business.

Our understanding of business models has significantly advanced in recent years. Alex Osterwalder and Yves Pigneur produced a seminal work on business model design in 2010 (*Business model generation: A handbook for visionaries, game changers, and challengers.* Hoboken, NJ: Wiley). This work, together with the work of Steve Blank (https://steveblank.com) and the lean startup movement (*The Lean Startup: How Today's Entrepreneurs Use Continuous Innovation to Create Radically Successful Businesses.* New York, NY: Crown Publishing Group, 2011), has provided a range of tools and processes for us to develop our company's business model to be a key driver of competitive advantage in the market. Given that a company's business model is so integral to the success of the business, the evolution of our understanding of our value proposition, the customers we are targeting and the mechanism for generating revenue from our customers will inform the progression of our evolving business model.

All companies go through the stage of searching for the right business model. When a company starts up, there are many more assumptions about the business than there are facts. The startup phase of all companies is all about taking the assumptions and either validating them with facts (evidence, data, feedback), or dispelling them and continuing the search for the truth. This process both informs the resultant business model and confirms the repeatability of the business model. The key for entrepreneurs is to be able to identify when their company is transitioning from the 'search' stage into the 'execution' stage and to adjust and adapt their business model to suit. Initial business models are often burdened by compromises introduced to both generate early revenue and maximise customer engagement—concessions that embed inefficiencies in a company's initial business model.

WHY SHOULD WE PLACE SO MUCH FOCUS ON BUSINESS MODELS?

Although this chapter is not about a detailed explanation or definition of business models, it is worth considering a couple of parameters. A business model describes how your company creates, delivers and captures value, so understanding the importance of data-driven decision making is critical to effective business model design. At its core, a business model is an abstraction of a company's strategy, and part of business model evolution is to ensure that the alignment between the two continues as a company progresses through its life cycle. Tools like the Business Model Canvas provide methods and frameworks for entrepreneurs to 'design' a company's business model (*Business model generation: A handbook for visionaries, game changers, and challengers*, pp. 44–55). The business model articulates the way you sell your product or service to your customers (e.g., selling directly or through a channel), and defines the relationship you want to have with your customers (e.g., transactional or intimate, repetitive or one-off). These aspects guide the way a company's value proposition is delivered to the target customer and ultimately informs the way you generate revenue. When looking at the cost structure of the business, the Business Model Canvas suggests that we break the business into key partners, activities and resources required to ultimately deliver the value proposition to the customer.

During the startup stage, we are testing and searching for the answers to our assumptions, which can be highly influenced by our initial customers. Finding a customer who cares enough to buy your product or service is a significant milestone, and entrepreneurs will naturally overweight the influence of these early customers in the development of a company's initial business model. This tendency is completely expected for startup founders—the joy at finding someone who is willing to be your first customer is not something to be underestimated! However, recognising the influence and impact of these early customers is important in the context of business model review and evolution. Early customers are critical in providing feedback to the product development process and essential in validating the value proposition. A close and intimate relationship with initial customers also tends to steer us towards a much more direct connection with the customer, ideal for learning and testing; however, it can obscure the advantages that a channel strategy/partners can provide. During these early stages, we are also much less willing to turn away paying customers, and this issue can have a strong influence on the way a business model develops, resulting in a customer-driven focus. It tends to result in concessions on the robustness of our business model from a cost perspective.

Having said all this, until we find product/market fit and have zeroed in on the ultimate target markets and customer segments, there can be limited value in over-optimising our business model in areas such as distribution and supply chain and costs of goods. This early stage is all about testing and learning so that we have signs that the model is working and our playbook for selling to customers and generating revenue is repeatable.

BUSINESS MODELS ARE NOT STATIC

Once we start observing robustness in our business model during the early stages of a company's development, it is tempting to set it aside and consider it complete. However, as the business grows and you transition to scale, additional stressors on your business model can occur. Being aware of these signs and responding to these factors is critical in smoothing the growth of a company. For example, the business model may appear to be repeatable, but inefficiencies or structural issues with the model could be impeding scale. It could be that the initial market or customer segment focused on during the startup phase is too small to feed the scaling business. The market can turn out to be too fragmented or dispersed to service with the company's current business model. Often, the solution is as simple as recognising that efficiencies expected to result from the scaling business are not able to be realised with the current business model. All these signs indicate that the business model needs revisiting.

Although companies entering the growth stage of their life cycle can focus on refining and optimising the business model, this stage is also an opportunity to go back to the drawing board and reflect on the metrics a company is tracking to validate business model efficiency. The essential question we need to ask is, ‘Is my business model still fit for purpose?’

THE IMPORTANCE OF DATA-DRIVEN DECISIONS FOR BUSINESS MODEL EVOLUTION

Although an entrepreneur can approach the challenge of modifying and improving a company’s business model in many ways, the basis of any change should come from a deep understanding of the fundamental metrics that drive the business and a high level of confidence in the data that are available to inform decision making. Additionally, clear goals and expectations from changing the business model should be agreed upon before getting too involved in the process. Is the goal simply to increase revenue, or is it to enable the expansion into new markets to address more customers? Is it more about increasing margins through optimising the supply chain and how you work with partners? All are valid objectives; however, being clear on what the goals are is what matters.

From the perspective of metrics, each company will be different (and will rely on different combinations of data to drive decision making), but some fundamentals are common to most companies. It is critical to get a good handle on data such as the following:

- sales cycle
- average selling price to your customers
- customer churn numbers
- cost of generating marketing leads
- conversion metrics of raw customer leads through the marketing/sales funnel.

Jason Lemkin’s SaaStr blog (https://www.saastr.com) is an excellent resource for diving deeper into the world of metrics for businesses based on subscription/software as a service (SaaS). Another great source of comparison data is the KBCM Technology Group Private SaaS Company Survey (https://www.key.com/corporate/industry-expertise/library-saas-resources-confirm.jsp). Many great resources for companies in other industries and with different business models are available.

With a clear goal and confidence in the data, diving into the components of your business model will reveal the areas where you can improve and optimise. For example, if the ultimate goal is to reduce customer churn as you start moving into broader markets, interrogating the way your customer relationships were established with your first few customers is critical. When ensuring that parts of your business model evolve (e.g., when moving from direct selling to a partner-focused distribution strategy), you do not inadvertently discard the components of your relationships with your customers that made them love your product or service to start with.

Having a high-touch relationship and intimacy is critical with your early customers to ensure that you maximise what you learn from them and to accelerate the confirmation of your value proposition. It is also the key to getting valuable and honest feedback. However, this type of customer relationship strategy rarely scales with the business, so seeking methods to retain the benefits of customer engagement and feedback without incurring the continuing costs and complexity will deliver significant benefits. Tracking customer engagement and providing opportunities for input into continued product development to activate the benefits of cocreation are effective strategies to continue the benefits. This approach can be done without the crippling costs and complexity that can increase with company scale.

USING YOUR EVOLVING BUSINESS MODEL AS A SOURCE OF COMPETITIVE ADVANTAGE

When we see the success of products and companies like Airbnb, Nespresso, Dell or Netflix, we see that their competitive advantage is firmly rooted in their innovative business models. Although many companies seek to maintain a competitive advantage from technological and product innovation, we increasingly see the best companies utilise business model design as a path to sustained competitive advantage. Consider Netflix—in 10 years it has gone from delivering DVDs by mail to becoming the dominant streaming service, with nearly 50 million customers. Over this time, its evolving business model has beaten off their major competitors at each stage of the company's scaleup. Blockbuster, cable TV, video streaming services, content creators—all have been left behind as Netflix has used business model innovation to maintain its advantage in the market.

Entrepreneurs who focus on the use of business models as a source of competitive advantage continue to be a hallmark of the way great companies are able to burst away from the competition. To embed this approach into your strategic planning, effective techniques start with scanning the competitive environment in which you operate. Observing how homogeneous the business models appear in your industry is a way to identify aspects of your business model to seek differentiation and advantage. Consider Nespresso's business model. Much of the success of this business was derived from the change in focus on the capturing of value: from generating revenue from the sale of the physical coffee machine to capturing value by selling the consumable coffee pods. By allowing multiple equipment manufacturers to produce Nespresso coffee machines, competition drove down price and increased the availability of machines for consumers, who were then locked into purchasing the high-margin pods from Nespresso. Salesforce and other pioneers of the SaaS revolution are also great examples of the success to be achieved from modifying business model components in mature, well-established industries to gain significant competitive advantage.

Another technique for creating competitive advantage from business model evolution is to look to business models that exist in other industries, customer segments or markets. The most prominent example of this approach is the way the sharing economy business model has been the catalyst for companies in sectors such as ride sharing (Uber, Lyft, Didi Chuxing), vacation accommodation (Airbnb, HomeAway) and financial services (LendingClub, Prosper). All of these businesses have significantly disrupted mature, competitive markets dominated by large, established corporations by leveraging business models developed in different industries. The peer-to-peer/sharing economy business models trace their roots back to the beginning of the open source software revolution. Transplanting these business models in mature industries such as vacation accommodation, transport and money lending has allowed startups to launch and scale to become the dominant players in these markets—dislodging, and in some cases greatly diminishing, the mature incumbents. Companies will continue to have opportunities to leverage components of, and entire business models from, other industries to gain a competitive advantage as they scale.

CONCLUSION

We have shown the centrality of a company's business model to a company's success. The business model drives the mechanics of delivering value to customers, and it is fundamental to how a company captures enduring value from its customers. It is also critical that entrepreneurs recognise that business models are not fixed forever and that for a company to succeed, the business model needs to adapt and evolve as the company moves through the different stages of growth. When a company first starts selling to customers, early customers often inform and shape the initial business model. Thus, as you build your business and move into new markets and customer segments, it is highly likely that the business model will need to evolve to suit these new customers. We are fortunate that tools, models and precedents are available to guide business model development—either driving the evolution as the data signals change or even allowing an entrepreneur to completely redesign a company's business model. Each revision of a business model is another opportunity to test and experiment with the business; every tweak to a business model component can increase efficiency for the company.

The key to keeping control of this process is recognising the importance of metrics and data to assist and drive the decision-making process—as the business grows, you must ensure that the metrics being collected are granting the correct insights into the business. Finally, recognise that the company's business model is ultimately an abstraction of the company's strategy. Therefore, taking the time to ensure that the two are in alignment can go a long way to ensure the success of the business and smooth the transition from the startup phase and into the period of sustained growth we strive for when building a fantastic business.

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VALUATION AND IP MANAGEMENT

GLASSHOUSE ADVISORY

David Hughes, *Director – Strategy*

Emmanuel Mastio, *Industry Professor of Sustainable Innovation, University of Technology Sydney*

Too often, entrepreneurs only focus on value when raising funds, planning an initial public offering or considering a trade sale. However, in the course of 'business as usual', there can be a tendency to ignore the rigours of value analysis.

An understanding of what drives value in a business is a powerful tool for an entrepreneur. It can act as a framework for developing the business and testing strategic options. It also provides a platform to explore underlying factors that drive and sustain competitive advantage, and to develop effective protection, investment and acquisition, and licensing strategies for the business, including intellectual property (IP) protection.

CHALLENGES IN CONDUCTING EFFECTIVE VALUE ANALYSIS

In the knowledge economy, a large proportion of the value of startups and established companies is contributed by intellectual assets such as software, tech IP, data and brands. These assets have distinctive economic characteristics that can result in their value not being obvious. These characteristics include the following:

- *Multiple use:* Intellectual assets can be used by multiple parties at the same time (unlike tangible assets such as plant and equipment).
- *Sustainable value:* They are not diminished by use, but the underlying legal rights can expire and the assets can become obsolete.
- *Legal protection:* The extent of legal protection can be complex.
- *Relationship between cost and value:* Generally, a linear relationship does not exist between the cost of developing intellectual assets and their value.
- *Variability of value:* Value can vary considerably under different ownership.

The value of many early-stage companies is highly dependent on a core technology, together with the capabilities of the founders. In these circumstances, in addition to valuing the enterprise, it can be informative to gauge the value of the core asset under a range of commercialisation scenarios.

VALUATION METHODOLOGIES

Common methods of enterprise valuation include earnings multiples and discounted cash flow.

Estimating value by applying a multiple to a profit measure (such as earnings before interest, taxes, depreciation and amortisation) is appealing because of its simplicity, but there are drawbacks. Estimating maintainable earnings can disguise the sales curve of companies that are still in a growth phase, and identifying suitable multiples can be difficult for private companies with distinctive asset and risk profiles.

The discounted cash flow method (DCF) is underpinned by finance theory and reflects that the amount a rational investor will pay for a business (or asset) is the cash flow that it is expected to generate, discounted by the cost of capital. Critics argue that difficulty in estimating the cash flows of early-stage companies compromises DCF valuations. However, the counterargument is that the need to discretely analyse key value drivers—rather than bundling them into a single multiple—is a positive feature, and that each of the assumptions within a DCF valuation is important to business planning.

This 'unpacking' of the value drivers provides insight into a business that may otherwise be overlooked or ignored. It also provides a basis to communicate value to others. For entrepreneurs, this approach can be invaluable when seeking external investment.

THE CONTEXT OF VALUE

To provide context for the valuation, management should assimilate the best available information regarding factors such as:

- size of target market
- growth trends and competitive forces
- time to market and development hurdles (if not already launched)
- relative price
- peak market penetration
- costs
- sales curve (forecast)
- useful economic life of current generation technology
- development and commercial risk.

Collection of information regarding market attractiveness, product differentiation, price, costs and risk should be regarded as commercial common sense rather than as an unwelcome chore. Obviously, the resources of a company influence the extent of information that can be collected. Modest levels of information and qualitative assumptions are better than ignoring parameters that are relevant to the economic performance of an organisation. Not all valuations need to be in-depth; in many instances, indicative valuations are an adequate basis for decision making.

THE IMPACT OF COMPETITIVE ADVANTAGE

The value of intangible assets is multifaceted. It requires an integrated assessment of the market landscape together with functional, legal and economic characteristics of the subject assets.

Many corporate strategy theories relate to the importance of a business establishing and maintaining a competitive advantage. The basis underpinning a competitive advantage is often based on the intellectual capital of the business (whether that be registrable IP rights such as patents, trade marks and designs, or other rights such as copyright, know-how or confidential information). A thorough understanding of the IP rights and their effectiveness in providing a real competitive advantage (rather than just a perceived one) is a critical factor in understanding asset value and in sustaining competitive advantage.

The rigour of insightful DCF modelling forces entrepreneurs to clearly identify their competitive advantage, assess its impact on market performance and estimate the financial impact. This process can be extremely helpful in refining marketing and operating strategy.

Examples of questions entrepreneurs can use to gauge the extent of technology-related differentiation are:

- How is the technology superior to alternatives?

- How well are the differentiating tech features protected?
- What are the financial implications of the differentiation in terms of incremental revenue or reduced costs?
- When one considers the strength of legal protection and the rate of technical innovation, how long can the differentiation reasonably be expected to be maintained?

Questions that must be differentiated for companies relying on branded differentiation include the following:

- How is the brand positioned relative to its peers in terms of perceived quality, image and affinity?
- How has the brand identity been established, and how is it expected to be maintained?
- How well protected is the brand by trade marks, copyright and registered designs?
- What is the impact of the brand on price and volume premiums?

Regarding the value contribution of intangible assets, only about 15 percent of the value of Nasdaq-listed companies is contributed by net tangible assets. The bulk of corporate value is therefore generated by intangible assets such as technology, data and brands. The Australian Securities Exchange is currently less tech-centric; despite this, 50 percent of enterprise value is attributed to intangible assets.

'Value mapping' can also be used to identify how the assets of an organisation are deployed to create a differentiated market position and generate cash flows. Valuations can be used to quantify the value of the business as a whole and the underlying assets.

IP RATINGS

Often, the purpose of a valuation exercise is to understand and communicate the relative strength of IP assets to management or investors. An effective method is through an IP Rating that includes an assessment of the asset's earning capability and risk profile, without placing a dollar value on the asset. The rating includes different dimensions that are often expressed in a scale from E− (failing) to A+ (blockbuster).

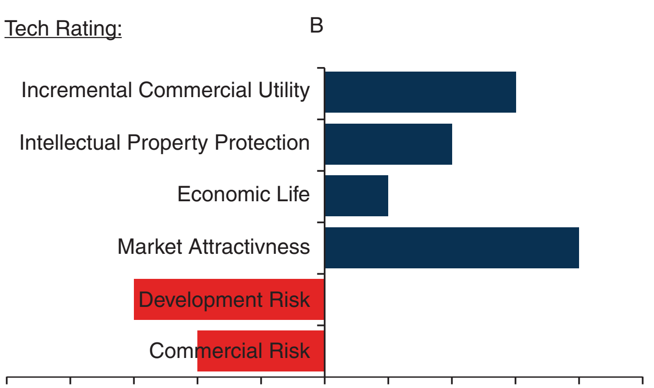
An example of an IP Tech Rating is shown in Figure 1. The profile of the rating and commentary of each dimension provide insight into its value potential. An advantage of this approach is that indicative ratings may be based on a high-level assessment, whereas a formal rating incorporates broader and deeper analysis.

The dimensions of the rating are outlined in Table 1. They provide a foundation for valuing the subject technology and/or IP.

VALUE-BASED IP STRATEGY

To maximise the value of IP, it is important to consider the underlying ideas in the context

FIGURE 1. Intellectual Property Tech Rating example



Rating	*Description*
A+	Blockbuster tech
A	Extremely strong tech
B+	Strong tech
B	Moderate strength
C+	Above average
C	Average
C–	Below average
D	Moderately weak
D–	Weak tech
E	Extremely weak tech
E–	Failing tech

TABLE 1. Intellectual property rating dimensions

Incremental commercial utility:	This gauges the functional and commercial benefits of the subject asset relative to alternative technologies. It is informed by a review of the patent landscape, a review of available literature and functional and cost comparisons with competing technologies.
Intellectual property protection:	The extent to which the important commercial characteristics of the technology are protected by patent claims and/or trade secrets will be based on a patent attorney review.
Economic life:	The expected period in which the technology could be exploited takes account of the remaining development hurdles, patent life and the rate of change in technology.
Market attractiveness:	A gauge of market size, growth trends and competitive forces.
Development risk:	The cumulative probability of the related product or process successfully reaching the market, reflecting the probability of failure at each development and regulatory hurdle.
Commercial risk:	This incorporates post-commercialisation risks, including market risk, patent risk, new product risk and risk of obsolescence.

of a technical, legal and financial framework. Too often, the IP strategy of an organisation becomes confined to technical issues (e.g., my idea is a blockbuster technical development and therefore needs to be protected by patents) and/or legal issues (e.g., my idea is only an incremental development and therefore is not worth protecting). Viewing ideas through these confined lenses can cause opportunities to be missed or money wasted, which may significantly affect value creation.

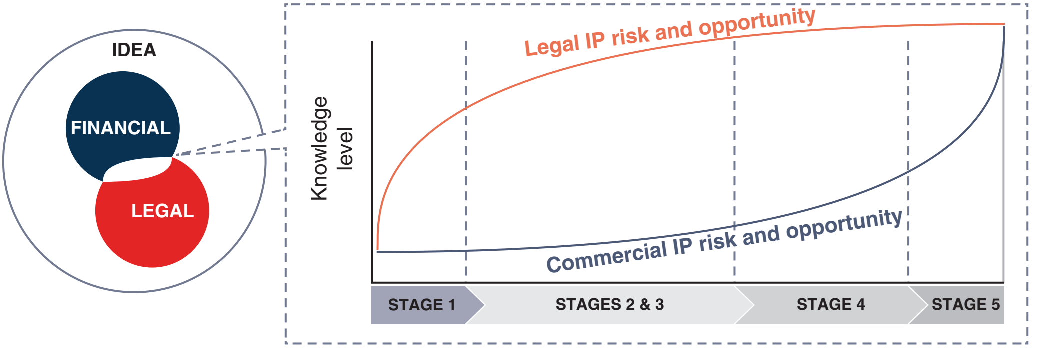
Aligning the technical, legal and financial lenses brings the necessary clarity to strategic decision making. The Tech Rating system outlined in Figure 1 provides a simple visual guide that brings these different dimensions together. The blockbuster idea will not be as attractive to patent if its economic life is very short. The incremental idea is much more attractive if there is low commercial and development risk.

Maintaining alignment of the IP rights over time is also very important. Because of legal requirements, patent protection needs to be applied for early in the product life cycle. As an innovation develops, the commercial embodiment of the innovation and the patent protection may become disconnected to a point that the patents do not actually cover the valuable aspects of the innovation in its commercial form. This problem is accentuated because the scope of the patent often requires restriction during examination to overcome prior art. This disconnection may be catastrophic to the resulting value of the asset.

To avoid this misalignment between the IP protection and the valuable aspects of the asset, it is necessary to introduce a regular review process to the innovation process. Those reviews should always look at the correlation between technical features, IP assessment and commercial viability. The review process can be based on the criteria of the Tech Rating which, by its design, works across the technical, legal and financial dimensions.

Ideally, an exploration of the value drivers that will result in a high correlation and a strong Tech Rating should be considered during the early development stages of the intellectual asset. The Idea Diagnostic™, a structured methodology developed by Glasshouse Advisory, is designed to analyse and develop ideas in order to

FIGURE 2. Idea Diagnostic: Curves represent the knowledge progression of an idea's legal (red) and commercial (blue) relevance through the Idea Diagnostic stages



IP = intellectual property

bring alignment (or at least knowledge) of the technical, legal and financial aspects. The knowledge gained through the Idea Diagnostic provides insight into the legal and commercial IP risks and opportunities.

The methodology (illustrated in Figure 2) includes the following:

- *Stage 1:* Develop a functional analysis of the idea to understand its key characteristics within a functional hierarchy. This analysis is designed to deconstruct an idea so that it provides a deeper understanding of the problem being solved and enables it to be better assessed in terms of its IP.
- *Stage 2:* Map the idea within the patent landscape to establish patent infringement risk. Whilst such initial investigations may not be exhaustive, they provide initial guidance on freedom to operate, which is an important criterion in IP strategy formation and investment decisions.
- *Stage 3:* Explore inventive aspects of the idea with reference to its main useful function and the IP landscape. This task is best done with a patent attorney, who can identify aspects of the idea that can be legally protected.
- *Stage 4:* Identify key characteristics that are commercially relevant. This step is done in the context of the business and inventive aspects, thereby bringing alignment to the legal and business dimensions.
- *Stage 5:* Establish a preliminary Tech Rating of the idea's earning capabilities based on market attractiveness, differentiation and competitive environment. This information then provides the framework and a simple visual guide to understand the strength of the idea and can provide a relative measure to assess a portfolio of ideas.

The methodology provides learnings at each stage and may be iterative with stages revisited based on new learnings. Any stage may also trigger a decision to stop the process based on its findings. Using such a structured approach enables a fuller understanding of the idea and can assist in guiding investment strategy (such as whether to commit to further research and/or patent spend) by identifying risk and opportunities in the legal and business environment. It also improves the quality of IP protection by identifying protectable features of the idea and potential unique selling points, so that any legal protection aligns in the commercial context.

ROYALTY DETERMINATION

The legal protection enjoyed by IP, together with economic characteristics, enables earnings to be generated from licensing. This approach is a low-investment way of extending the use of IP into new regions or applications while leveraging the capabilities of licensees.

When considering a licensing strategy, it is necessary to understand and articulate the earnings potential of the subject IP. Royalty rates and franchise fees are the flip side of the value coin. Instead of quantifying the dollar value of an asset, they express its economic potential with reference to a measure of sales. Royalties are a profit-sharing mechanism between IP owners and licensees. For well-established trade marks and strong patents, revenue-based royalties are most common. However, the most appropriate royalty mechanism reflects the commercial circumstances of a transaction. For instance, if the subject IP is not a primary revenue driver for the licensee, a single up-front fee or a fixed periodic fee is likely to be used rather than a revenue-based royalty.

Unsophisticated licensors sometimes rely on rules of thumb or gut feel to determine royalty rates, which often leaves money on the table.

Decisions regarding the value of IP, and associated royalty rates, have far-reaching commercial consequences. As a result, these assets are no longer the exclusive domain of IP practitioners: boards, investors, deal makers and tax authorities are increasingly influenced by their perceptions of the value of IP. It is the responsibility of IP owners to develop IP systems that allow them to effectively manage the value of these assets and, when appropriate, to communicate the value to other stakeholders.

CONCLUSION

The rigour of insightful DCF valuation modelling forces entrepreneurs to clearly identify their competitive advantage, assess its impact on market performance and estimate the financial impact. This information, in turn, gives a deep understanding of the value drivers of the assets and provides a framework to manage IP effectively. This framework provides the integrated capability to view IP through its legal, functional and economic characteristics and can be embedded in the entire innovation process. It allows more effective decision making at all stages. Furthermore, few investors have the integrated capability to evaluate the legal, functional and economic characteristics of these complex assets, so communicating with reference to the dimensions that make up these characteristics provides a powerful platform to demonstrate business value.

24

GROWING PAINS: NAVIGATING THE LEGAL SPEED BUMPS

GILBERT + TOBIN

Deborah Johns, *Partner, Corporate Advisory*

Muhunthan Kanagaratnam, *Partner, Tax*

Tim Gole, *Partner, Technology + Digital*

John Lee, *Partner, Intellectual Property*

Entrepreneurs are time- and cash-poor, no more so than when it comes to legal matters. An ever-growing number of increasingly sophisticated resources are available to help them through the early startup period, including free or low-cost legal advice, documents to cover a startup's basic needs and numerous websites, blogs, articles and the like to help interpret those materials. As companies grow, though, the pitfalls of the do-it-yourself approach mount. This chapter looks at some of the more common issues that arise as companies grow.

LET'S DO THIS…

One issue that plagues growing companies is corporate governance. Founders often make decisions in an informal and ad hoc way. In principle, nothing is wrong with this approach when the company is small and has no external shareholders. However, as companies grow, it is essential that important decisions be made via minuted board meetings or circular resolutions and that directors understand what decisions they can make and what decisions are reserved to shareholders under the Corporations Act or the company's constitution.

It is common to be performing due diligence on a company and learn that important matters either have not been approved or have been approved but by the wrong body (particularly the board, when shareholder approval is what was required). This situation can be particularly problematic when the transaction in question involved alterations of share capital (such as a share split), and even more so when subsequent transactions have relied on the earlier, improperly approved share capital change. The solution to these issues may require revisiting all the subsequent transactions, getting consent from counterparties (or their estate!) to amend sale documentation and performing extensive work with the Australian Securities & Investments Commission (ASIC) to update corporate records and ensure that the subsequent transactions are all enforceable. To the extent that equity has been offered on the basis of the earlier, improperly approved share capital change, claims of misleading and deceptive conduct may need to be dealt with as well.

The following two sections on ordinary and special resolutions by no means provide an exhaustive list of things that require shareholder approval. Note that the company's constitution or shareholders agreement may include additional matters.

ORDINARY RESOLUTIONS

Ordinary resolutions of shareholders should include the following:

- Certain director appointments and potentially removals.
- Approval of a person acquiring interests in more than 20 percent of the shares in a listed company or an unlisted company with more than 50 members. (Note that a person can acquire interests in more than 20 percent of such a company's shares by other means, such as in a takeover bid.)
- Certain capital reductions and buybacks.

SPECIAL RESOLUTIONS

Special resolutions of shareholders should include the following:

- Various share capital transactions, including approval of an issue of preference shares, cancelling or varying rights attaching to a class of shares (if the company's constitution does not set out a different procedure), converting ordinary shares into preference shares or vice versa, and certain capital reductions and buybacks.
- Authorising the giving of financial assistance to a person regarding an acquisition of the company's shares. This situation arises most commonly for growth companies because they will often agree to pay the legal fees of an investor or where the company makes loans to employees to buy shares.
- Various winding-up scenarios.
- Change of company type, name or place of registration.
- Amending, repealing or replacing the constitution of the company.
- Shareholder approval of a scheme of arrangement between a company and its members or creditors. This situation is often used as an alternative to a takeover (i.e., tender) offer in a control transaction. Note that a majority in number of shareholders present and voting at the scheme meeting who together hold at least 75 percent of the votes cast on the scheme resolution must approve the scheme resolution.

I'LL GIVE YOU A STAKE IN THE COMPANY...

TAX ISSUES

Equity incentives are an important tool for rewarding employees in high-growth companies. One of the biggest mistakes we see, however, is that companies do not get around to completing the necessary paperwork to complete the grant of the option or shares (for example, for board resolutions, updating registers, contractual terms) until long after the promise is made. Usually the paperwork is done on the eve of a funding round or other major event, which forces the company to tidy up loose ends but also sets an increased value for the company. Questions then arise as to when the equity was granted, and this situation can cause significant tax issues for the otherwise lucky grantee.

In an ideal world, a company has several tools at its disposal to get equity into the hands of employees, but the key concept is the discount at which the equity is issued, which triggers tax consequences. When employees pay less than market value for shares (or options) from their employer, they are taxed. An employee will be taxed on the 'discount' at which the equity is issued—in other words, the difference between the market value of the equity (as at the 'taxing point', as described in the next paragraph) and the amount the employee paid for it.

Employee share schemes (ESS) can be set up so that employees pay this tax at one of two 'taxing points':

- *Up-front tax*: Employees pay tax on issuance.
- *Deferred tax:* Employees pay tax later (normally, when there is no more real risk of losing the equity and at the time they are allowed to sell it).

Deferred tax is a two-edged sword. Employees get to 'kick the can down the road' and worry about tax later. The problem is, the company might be worth much more at the later time (the taxing time), and this is the time at which the market value of the company is assessed. In this respect, being taxed up-front (when the company is worth less) might be attractive, even if it is an unfunded tax liability (meaning employees pay tax without actually receiving cash to pay the tax with).

In addition to playing with the taxing time, tax can be mitigated in a few ways. Startup concessions allow startups to value their company on a concessionary basis to work out the 'discount' amount (which disregards intangible assets, see ESS 2015/1). Other arrangements can be implemented, including loan-funded schemes (i.e., the company helps pay for the shares). These methods may have the effect of reducing or even eliminating the discount (and the associated tax).

In the situation where the promised equity is issued on the eve of a new funding round and depending on the circumstances, the recipient may be taken to be awarded the equity at the later date (when the 'tidy up' occurs), meaning the equity is issued at a different discount (possibly a bigger discount) compared to what it would have been issued at had it been done when originally contemplated. The later in the life of the company that the equity is granted, the higher the discount is likely to be to make the equity affordable, the less flexibility there is for the company to use some of the tools described earlier to reduce the discount and the less flexibility there is for the employee to elect to be taxed up-front.

Another consideration is the availability of the capital gains tax (CGT) discount on sale. If the employee were to sell his or her equity, the employee may be eligible for the CGT discount (i.e., up to 50 percent off the CGT on the sale). However, the employee needs to hold the equity for at least 12 months to be eligible, meaning delays in issuing equity may limit the availability of the CGT discount. (Note, however, that where equity is issued at a discount, the 12 months start ticking at the 'taxing point'.)

The bottom line is, failing to take care of equity grants when originally promised can limit the company's options for managing negative tax consequences for employees, thereby defeating the purpose of the grant.

DISCLOSURE ISSUES

Another group of common pitfalls with employee incentive schemes that we see as companies grow are the non-tax compliance aspects of operating an incentive scheme, particularly around disclosure (what information has to be given to employees). The general rule is that all offers of securities (including options to employees) require disclosure of certain prescribed information (such as via a prospectus or offer information statement lodged with ASIC), unless an exemption applies. It is still most common to rely on the small-scale offering exemption (offers to no more than 20 people in any 12-month-period to raise no more than $2 million, including the exercise price of the options) and the senior manager exemption. Other class order relief is also available. Although these exemptions are usually adequate for equity grants earlier in the life of a company, a company that wants to make equity available on a broader basis will have a harder time relying on them. Companies should ensure that their compliance regimes around disclosure, as well as in relation to licensing (what financial services are being provided to employees and how are they regulated), advertising and hawking (making unsolicited offers to employees), keep up with the growth of the company. Otherwise, they may find that they have breached the Corporations Act inadvertently.

OVERSEAS EMPLOYEES

A related issue arises as companies expand and start to hire employees overseas, including offering them equity in the Australian parent company. It is essential that a company seek local law advice in relation to the grant of the equity before doing so, because important tax, disclosure and other compliance issues arise in each overseas jurisdiction that are very different than the rules in relation to these compliance issues in Australia. It is often necessary to create separate plans, or at least sub-plans, for each jurisdiction in which the person hires employees to ensure that relevant local laws are complied with.

NUMBER OF SHAREHOLDERS

Finally, a company with a broad-based equity incentive scheme for employees needs to ensure that it does not go above 50 shareholders—an increasingly difficult proposition as companies grow. Having more than 50 shareholders (whether employees or not) would subject the company to the takeovers rules in Chapter 6 of the Corporations Act, which can make an early-stage company a less attractive target and complicate an exit. For example, if employees all exercised their options on the eve of completion of an exit event, so that the company went over 50 shareholders, it would be a significant breach of the Corporations Act for the acquirer to complete that transaction without complying with the takeovers rules, even if the company only had more than 50 shareholders for a split second in time before completion. Solving such a breach with ASIC can be very expensive and time-consuming for the parties involved. It is essential that any employee incentive plan that intends to cater for broad-based equity participation by employees caters for this by enabling the employees to sell the options, or to put the shares into an employee share trust (noting that this brings with it its own compliance challenges, for example, in relation to financial services licensing).

I'M STARTING TO GET SOME CUSTOMERS OVERSEAS...

WEBSITE TERMS AND CONDITIONS

Companies often do business outside of Australia without re-domiciling the company itself. Several issues immediately arise for the company going global, but one of the most common questions we get is, do the legals on my website work overseas?

Often, the company will have a set of standard terms and conditions and a privacy policy—likely copied from another website or taken from a law firm's precedent—which apply in the Australian context but do not necessarily address the legal regimes in other countries. This issue is particularly important where the website may be collecting personal information and/or storing it in the relevant jurisdiction. In theory, operating an online business exposes the company to the laws of every jurisdiction in which its website can be accessed or its goods or services can be purchased from. Obviously, it is impossible for the company to ensure compliance with the laws of every country, particularly for a startup, so often this issue is approached by defining the key target markets for the company and obtaining local legal advice on some or all of those key overseas markets.

This decision can be partly informed by whether a particular jurisdiction is known to have particularly strict laws in an area (e.g., European privacy regulation), the nature of the goods and services being provided (including, for example, whether they fall within a heavily regulated market such as financial services), as well as the volume and sensitivity of personal information being collected by the company. A final caution is that Australia's consumer protection laws are quite tough by global standards, and our privacy laws are often different than those in major markets such as the U.S. or Europe (and certainly not as restrictive as those in Europe). Therefore, you should take care when 'borrowing' terms and conditions from overseas examples.

IP PROTECTION

The other most frequently asked question for Australian companies expanding overseas is, should I bother protecting my intellectual property (IP) overseas?

Businesses that already have IP protection in Australia are not automatically protected overseas. IP rights are national only, so protection needs to be sought in each individual country where the business intends to trade. However, Australia and most of our trading partners are party to treaties that simplify the obtaining of IP rights internationally. These treaties allow companies to seek patent and trade mark protection in several countries through the filing of a single application. Businesses should consider these options when expanding overseas because they can often assist in keeping costs down.

IP protection needs to be considered as early as possible before expanding overseas. Some IP rights have strict deadlines for the expansion of protection into other countries. Businesses also need to ensure that they are ready to deal with any IP issues they might encounter in other countries that were not necessarily encountered in Australia. For example, registration of a trade mark might be rejected in another country on the basis that an identical pre-existing mark in that country is already in use. It might be that the business will need to consider whether it still wants to expand into that market, or whether it is worth rebranding in that market. Businesses should also consider whether it is worth undertaking clearance searches in certain countries, to ensure that any use of their IP will not breach any pre-existing IP. This issue is particularly important in highly litigious countries, such as the U.S., where it may be worth the additional cost to avoid any potential infringement issues.

The punchline with IP is to make decisions early. If there is even a possibility that your business will expand overseas, you should think about your IP position as soon as you start scaling. A small investment will buy you an IP option that you can revisit and, if necessary, abandon later. However, if you fail to act early, that option will be lost.

CONCLUSION

In the past few years, Australia has placed an enormous amount of focus on ensuring that companies get off to the right start. However, companies face different challenges as they start to grow. Being prepared will help to avoid the most common pitfalls that can come to light during important transactions and that are often expensive to rectify.

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BUILDING TECH IN AUSTRALIA AND EXPORTING GLOBALLY

muru-D

Mick Liubinskas, *Co-Founder*

Australia has more than enough potential to become a world leader in technology. Whether or not we take this chance will not be decided by the media, the Government or big corporations, but by the global ambition and matching execution of entrepreneurs.

Our previous disadvantage, the tyranny of distance, is mostly irrelevant in a flat-world market. We have the core resources of talent, capital and ideas, not in surplus, but enough. This opportunity is ours to take or ours to watch slip by and regret.

THE SIMULTANEOUS OPPORTUNITY AND THREAT

Today we are amidst one massive, surging wave of technology—software, software as a service, marketplaces, tools—that has exponentially lifted productivity and connection. Another wave, probably even larger than the last—artificial intelligence, robotics, augmented reality/virtual reality—is forming and will change the world so much that we will not recognise it.

This new wave will displace many jobs, but it will also create many new ones. Some countries will have a net loss and some a net gain. It is definitely a case of participate and potentially win—or spectate and probably lose.

To the end customer, these technologies may appear indistinguishable from real magic. Those who create them know that they are just carefully arranged ones and zeros. The good news about this for Australia is that these technologies can be crafted anywhere, so why not in Australia?

OUR DISADVANTAGES

AMBITION DEFICIT

Life is good in Australia, which is an advantage on almost all counts. The exception is that it reduces the number of Australians who are willing to forgo good salaries and good living for 10 years of hard work with a small chance of success. Yes, the winners win big, but it feels like a lottery that makes you work long hours and wait a long time for the result, which does not sound like fun.

What also hurts is that we have not had 50 years of successes where the spoils are shared with the employees through share options. We are only just coming out of 10 years of options complexity and, even though we have had some good, big exits, it has not been enough to establish a pattern that supports thousands of employees taking pay cuts for options (along with longer hours and less security) in exchange for options in a ‘wild dream’.

Even when we do start a company, we are often happy with an early, smaller exit. Tech industry veteran Terry Hillsberg refers to it as 'two Mercs in the driveway and the kids in private school'. The impact of this route is hopefully some more cash circulating into the ecosystem by new angel investors (although many buy some land by the beach in Byron and never come back).

Contrast that approach with that of entrepreneurs in Asia, Africa, Eastern Europe, Israel and even the middle/south U.S., where real salaries are low or falling. The possibility of success, even a small one, would be life-changing for them, their families and probably their whole city.

How do we fix this situation? Can we celebrate the underdog and the overachiever at the same time? I think so, and I hope so, too. Part of the solution is sharing stories of people who are successful and showing what they created over and above the money.

SMALL, FRAGMENTED MARKET

Australia is a small population spread out across a large country. This situation means that not many companies can achieve scale by staying at home. Consequently, some companies are unsuccessful because they do not get to a revenue point that will sustain them, some companies are just too small and some companies pursue early exits when the global market leader gobbles them up.

The technology industry is also highly spread out, without one major hub. This scenario might be okay if we had a big population, but having a small one spread out means that we are less efficient and less collaborative. Despite all the technology, innovations mainly spring from hundreds of face-to-face conversations.

Israel and New Zealand are small markets and also small geographies, but they are so small that it forces them to think global earlier. Australia seems to be less pressed to jump on a plane early, maybe because we think we are large.

Big companies in Australia are mostly banks, telcos, mining companies or branch offices of multinationals. They are not interested in exports, other than mining companies, which are highly specialised and commoditised. This focus means less exporting expertise.

SPECIALISATION

Being small and spread out, it would help if Australia could focus on something we could lead the world in. This product or service would have both brand impact and gravity to attract people in that space to Australia. We have had some good wins in enterprise software and marketplaces, but not enough to stand out. We also have a strong research base, but it is not matched by commercialisation and exporting skills.

THE ADVANTAGES

CULTURE

Australia is a multicultural melting pot that mostly copes with strong diversity. We are entering a phase (slowly but hopefully) where differences are valued, appreciated and rewarded more than similarities. This outlook should position Australia well. It also means that we have a positive connection to most of the world. Everyone seems to like us. This advantage allows us to do business globally, which many other countries cannot do.

The negative factor of our distance from other countries has also meant that many of us are comfortable with travelling. We are fine to get on a 24-hour flight to London, whereas Americans consider a six-hour flight from San Francisco to New York to be torture. We just need to be as open to the travel for business as we are for backpacking.

BUSINESS

Existing without rivers of venture capital has made Australians hardy and thrifty. Our companies are built in a desert, so when winter comes, we survive while those banking on their next big round of capital die off.

Venture capital is a long, lagging indicator of a market's success. They are 10-year funds, based on 20 years of data, that are actually risk averse. They need to pick 20 good investments from thousands of options and back them over multiple rounds through to initial public offering. That is a difficult full process to go through in Australia alone.

MARKETS

The U.S. market is still dominant and is the easiest big market for Australians to target. We have a strong and growing bridge to the U.S. built by those who have been there for decades building out some big networks, if not big companies. The market is also not just Silicon Valley. In multiple cities, we have networks of people who will help you find customers, team and capital.

Only considering the U.S. would be a mistake. Businesses can target multiple other big and growing markets. We are the only Western country to be in the close time zone to most of Asia. We also have a slight geographical advantage, although it is really only a slightly longer flight from Los Angeles than from Sydney to Tokyo or Beijing, so I think we overplay that advantage. Also, Asia is not a single country, culture or language. It is multiple markets, and it does business very differently than Australians do. Unless you have a deep personal connection (i.e., you or your parents are from the country and you speak the language), it will take many years and commitment to make it in Asia. This is a big, long-term investment we have to make if we want to participate in the fastest-growing region in the world. The Aussie networks in Asia are not quite as big or active as in North America, but they are there if you look for them.

We still have a strong connection to Europe, and I see a lot of solid groundswell, particularly in Germany, France and the U.K. Very cost-effective tech talent also exists in Eastern Europe. On the downside, you have Brexit, the distance and fragmented markets. From the community side, networks are forming for Aussies in the European Union, and I expect solid growth over the next five years.

On the emerging market side, Africa and South America have perhaps the next big growth potential; long-term investments in those markets are promising. That being said, Australia does not have any real advantages or network there, so the going will be hard and lonely for a while. But go and get it started, and others will follow.

TALENT

New tech companies are about people and our people are talented, although they have room for improvement. In general, we work pretty hard. We do not work as hard as some people, but we are also quite balanced, so maybe that is an acceptable trade-off. We have a fine educational system that produces good raw talent. Although the quality of our people is good, the quantity is not enough, especially in Science, Technology, Engineering and Mathematics (STEM). You might think by all the noise that we are obsessed by STEM in school, but it takes a generation for this approach to flow through to the workforce, so we have to keep it up for 20 years. We need to be aggressively retraining people in droves but, even with that, there will be a shortfall. The options for growing tech companies are to bring the people in (which adds to Australia) or to set up offices where the people are (which does not add to Australia).

OFFSHORE TEAMS

Another big advantage for Australia is the change in attitude to remote teams. Even five years ago, the preference of chief executive officers and investors was to have the whole team in one building. Australian companies like BluePulse got investment on the proviso that the whole team pack up and move to Silicon Valley—which they did. Nowadays, due to the high cost and difficulty of recruiting and retaining talent in the Bay Area, it is expected that a company will have a team somewhere else. Yes, it could be Denver, Santiago, Jakarta, Kiev or Nairobi, but it could also be Gosford, New South Wales (near where I grew up, hence the plug).

Having offshore teams is also in the 'could be better' pile as an advantage. This situation is because of the high cost of living, mainly the high cost of real estate for Sydney and, to a lesser extent, Melbourne. What moves the needle to the positive is the research and development (R&D) offset, giving early-stage tech companies a big bonus for managing cash flow (which is still queen).

EXPORT SUPPORT

Another consideration is the Export Market Development Grant, or EMDG. It can support any investments you make in trying to get export customers, including research, visiting the target customers and more. Combining the R&D offset (building stuff) and the EMDG (selling stuff overseas), we have enough support from the Government to succeed in growing big, world-leading tech companies. As a reminder, it is not their responsibility to make it easy; it is our opportunity to do it even if it is hard.

STRATEGIC OPTIONS

Infinite combinations of markets, vertical markets, timing, financings, team and plans are used to build technology in Australia and sell it globally. A few patterns (described in the next sections) have been more successful than others.

GET BIG, GO GLOBAL LATER

- *What:* Have your company get big enough in Australia to be meaningful, and then use that position as a base to attack other markets.
- *Examples:* Spaceship, Carsales, Realestate.com.au, SEEK.
- *Pros:* Your company stays at home, you know the market, it is less risky and you expand on a big base.
- *Cons:* Not many businesses can get to scale in Australia. You are unlikely to be a world leader due to the time it takes.

BOOTSTRAP, SELL ONLINE

- *What:* Stay lean and sell your product online without a sales force; grow by reinvesting profits.
- *Examples:* BigCommerce, Campaign Monitor, Atlassian.
- *Pros:* Your strategy is low risk, and your company retains equity because you do not need to raise capital.
- *Cons:* The 'easy money' in this space is gone and it is very competitive; most of the time, it involves two founders, both of whom can code.

MOVE OVERSEAS, LEAVE TECH AT HOME

- *What:* If you need capital early, you often have to have your core team in the market where the money is. You may be able to have your tech team in Australia. For this strategy to work best, you have to have a founder in each location.
- *Examples:* Culture Amp, Canva, SafeSite, Accelo.
- *Pros:* You get the capital and market access.
- *Cons:* You split up the team, value is split and the founders overseas have fewer opportunities to have an impact on the local ecosystem.

RAISE LOCAL, GO GLOBAL

- *What:* The increase in Australian accelerators, angels and venture capital firms with real vision and capability to help you build a global business has gone 10x in 10 years. This factor makes building more capital-intensive businesses with global ambitions possible.
- *Examples:* Stackla, Edrolo, FluroSat.
- *Pros:* You get the capital locally (so any returns stay local); you are more supportive of the local team.
- *Cons:* You have fewer options for capital, which sometimes means less of a good deal with terms and valuation.

MOVE OVERSEAS COMPLETELY

- *What:* Despite what you might think, it is not a total loss if a company moves overseas. If that is what it needs to do to achieve its potential, the company needs to do it. There is a good chance that some of the team will come back to Australia and bring experience, networks and capital.

- *Examples:* Larry Marshall, James Tynan.
- *Pros:* You get the capital and market access.
- *Cons:* You split up the team, value is split and the founders overseas have fewer opportunities to have an impact on the local ecosystem.

TIPS FOR BUILDING TECH IN AUSTRALIA AND EXPORTING GLOBALLY

YOU CANNOT DO IT ALL REMOTELY

Yes, your business is digital, but much of business building is not. Observing customers, hiring, managing and leading employees, building relationships with suppliers and partners—they all take time, and they all take some face-to-face interactions. If you want to build a four-hour work-week lifestyle business, sure. But if you want your product to fit in with a market you are not next to, then you will find it very hard to be completely remote.

GO EARLY

The more you work on your product/market fit without visiting the market you eventually want to get into, the further away from fit you will probably be. It is the same thing as being non-agile and waiting a year before showing your product to your customers. Go early. There is little excuse. Fairly cheap flights are available to most markets; find a couch to sleep on. Eat ramen pasta or two-minute noodles. Get meetings, go to events, get out there, follow up, stay as long as you can, call customers, make sales.

STAY FOCUSED

If your company is in the stage of pre-product/market fit or even pre-scale (sub $1 million annual revenue) and you are thinking about having customers in Australia AND in a foreign market...do not do it. You are basically trying to work out two businesses at once. Remember that product/market fit includes three parts—a product, a market and it fitting. It would be really hard to get two products nailed, and it is equally hard to get one product nailed in two markets. You may say, ‘But the U.S. is pretty much the same as Australia, right?’ Wrong. My rough rule of thumb is that consumer markets will be 50–80 percent the same, so they are still 50–20 percent different. And business-to-business is 30–60 percent the same—very different. Why? Taxes, laws, channels, competition, payment methods, industry groups, geography. Nail one geography—preferably one inside a large market—and then grow.

If that means firing your Australian customers, including those who have helped you out, do it. It is better to be tough on them than to make life much harder on yourself and decrease your chances of reaching your full potential. If the Australian customers can use your product as is without any help, support or customising—great. I remember that in the early days of Pollenizer, we started using Confluence from Atlassian, and we had to pay in U.S. dollars. Why would an Aussie company pay another Aussie company in U.S. dollars? Because that was the market they cared most about.

GET HELP

Building technology is hard enough—do not try and work it all out on your own. Many Aussies are patriotic enough to take a call or grab a coffee. Reaching out will not get you all the way, and you should definitely not do everything your colleagues say, but they will help you get moving and help you avoid the dumb stuff.

DO IT

Do it because you can: you can build a tech company with customers around the world. Aim high, be disciplined, look after your people, be customer obsessed.

You can do it.

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CREATING AMAZING TEAMS

GOOGLE AUSTRALIA

Alan Noble, *Former Director of Engineering (Google Australia), Founder of Australian Ocean Lab*

Startup founders have so many things on their minds, not the least of which is how to grow their business. As a result, team development is not always top of mind. It should be, though. People problems are a leading cause of startup failures (The top 20 reasons startups fail. *CB Insights Research Briefs,* Sept. 27, 2017. https://www.cbinsights.com/research/startup-failure-reasons-top/). Growing teams is not easy, and neither is ensuring that they are effective. Amazing teams do not happen automatically.

Amazing teams happen only with good leadership and good practices. Leaders set the tone for their company and their teams. Teams invariably monitor, magnify and even mimic their leaders. Although all the company's leaders matter, the founders matter the most in this regard.

We can break down the process of creating amazing teams into three areas: culture, growth and effectiveness.

CULTURE

Founders, who may be in the business of envisioning a better world in some way, often pay scant attention to envisioning their own company. In such startups, culture develops haphazardly.

Company culture is too important to be left to chance. Culture should be articulated and communicated. What are the company's core values and its guiding principles? What type of work environment does the company strive for? What type of people does the company embrace? How should dissenting views be handled? The answers to these and related questions define the company's culture. You can think of a company's culture as its personality. Just as for people, there are friendly personalities and less friendly ones.

Of course, merely articulating one's company culture is not enough. It is remarkable how often founders say one thing and do another. You have got to *live* your culture. In other words, 'If you're going to talk the talk, you've got to walk the walk'. Leadership without authenticity is lame, just as vision without execution is hallucination.

For example, there is no point in talking about transparency if leaders themselves are opaque, nor is there any point in talking about mutual respect if leaders lack it.

Culture underpins everything else. Get it wrong, and everything else becomes so much harder.

In my experience, at the heart of any healthy company is a strong culture of mutual respect. Note, however, that mutual respect is definitely *not* about everyone being best friends. In fact, research shows that startups founded by friends actually do *less well* than those founded by colleagues or even complete strangers (Wasserman, N., 2012. Relationship dilemmas: Flocking together and playing with fire. In *The founder's dilemmas: Anticipating and avoiding the pitfalls that can sink a startup,* pp. 100–103. Princeton, NJ: Princeton University Press).

Mutual respect means that people delivering a message have a responsibility to do so respectfully. Furthermore, people receiving a message have a responsibility to assume the 'most respectful interpretation' (MRI). In other words, assume their intentions are good, even if it may sound otherwise at first.

I once ended up at a public company where the vice president of sales continually interrupted everyone and silenced dissenting peers and reports alike, even to the point of ridiculing them. The chief executive officer should have called out this behaviour, but instead turned a blind eye. The culture was toxic and, like a cancer, it spread throughout the company. It was unpleasant working with this person. I could not wait to leave the company—and I was not alone.

This situation reminds me of something that Urs Hölzle, senior vice president of Technical Infrastructure at Google, wrote a few years ago. He shared his thoughts on Google's company culture in a company-wide memo entitled, 'I don't want to work with jerks'. Eagle-eyed readers will note the inconsistency of using the disrespectful term *jerk*. This issue was duly noted at the time by Urs, who considered that a document with an attention-grabbing title was more likely to be read. And read it was—by tens of thousands of Google employees. It goes to highlight the importance of considering one's *intent,* though. Google is a great example of a company with a well-defined culture where mutual respect is paramount.

Many other ingredients make up a successful company culture, but without mutual respect, things tend to go pear shaped rather quickly.

GROWTH

Successful startups are growing businesses, and that business growth invariably demands team growth. Growth can cause a lot of headaches. I have managed engineering teams for both a fast-growing startup and a fast-growing multinational. Between 1996 and 1999, at my California startup NetMind, the company grew from three founders to 60 employees and from one to 30 engineers. At the Australian subsidiary of Google, engineering grew 8x between 2007 and 2010, before slowing down.

Here I will share some considerations for managing that growth.

GET PERSONAL

Founders should plan to interview *every single candidate* until it is no longer practical to do so. At NetMind, I personally interviewed all 30 engineers that we hired over three years (and many more that we did not hire). At Google Australia, I shared the interview 'burden' with Lars Rasmussen, who led the Google Wave team. (I use 'burden' in quotations because, actually, interviewing amazing people and gaining new insight from those conversations is quite a privilege.)

Either Lars or I personally interviewed each engineering candidate, and some (unfortunate) candidates were interviewed by both of us! I racked up almost 200 interviews at Google in just a few years. Between 2007 and 2010, Google Australia's engineering team grew from less than 20 people to over 150. Furthermore, the engineering team has continued to grow and now has more than 600 engineers. Your first hires are the most critical ones, though, and really demand the personal touch.

PARTNER

Fast growth is only possible with an amazing staffing (recruiting) team. Form a strong partnership with your staffing team, and invest time and energy to ensure that they are immersed in your company culture and fully aligned with your vision.

An empowered staffing team makes all the difference. I have therefore always considered my regular meeting with my lead recruiter (or head of technical staffing) to be one of my most important meetings. For example, Google Australia could not possibly have sustained such strong growth over so many years without an enduring partnership between engineering and technical staffing. We grew from what was primarily a sales office with a tiny engineering team to an office that is now 50 percent engineering and Google's third-largest engineering centre outside of the U.S.

Furthermore, seek opportunities to work with external partners. Universities should be at the top of the list of external partners (and not just for recruiting). At all of my startups, as well as at Google, strong university partnerships have (among other things) ensured a strong pipeline of new graduate recruits. The best thing is that one does not need to be a large multinational or a venture capital–backed startup to develop a strong university partnership. In my experience, universities are always willing to engage with prospective employers of their students. Offering their students internships is a particularly good way to start. I have found that even the smallest startup can attract amazing student talent provided that the company's vision is compelling enough.

BE PERSISTENT

The best candidates can sometimes be the most reluctant ones. (For that matter, even *I* was not sure I wanted to work for Google, and it took my recruiter almost a year to convince me.) Reluctance to switch jobs can take different forms. For example, candidates may already be quite successful where they are and need convincing that moving to another company is the right thing for them to do. Alternatively, they may secretly relish the new opportunity but lack the confidence to change jobs. Either way, take the time to understand candidates and then find ways to encourage them.

Some of the most amazing people I hired (or persuaded to transfer) were ones who were not even sure they wanted the job. Yet, they are often the ones who become superstars. They are often modest, and if they are reading this, they may still not self-identify.

SEEK DIVERSITY

In a perfect world, your team's diversity would mirror the diversity of the real world. Put another way, if X percent of your customers have a Y background, shouldn't X percent of your employees also be Ys? Doesn't that also give your business the best shot at understanding its customers? As a bonus, research also tells us that the best ideas come from diverse teams (Viki, T. Why diverse teams are more creative. *Forbes,* Dec. 6, 2016).

Unfortunately, we do not live in such a perfect world. For example, only 15 percent of computer science graduates from Australian universities are women. It should be 50 percent, but it is not. As a result, the technical teams of most tech startups are dominated by men, which is a lost opportunity. Companies that do better than the average have an advantage. Diversity naturally has other dimensions beyond the physical characteristics, such as gender or race. Businesses, large and small alike, benefit greatly from a diversity of backgrounds and a diversity of experiences.

The true value in team diversity is only unlocked when team members feel included. There is a saying, 'Diversity is about being invited to the party; inclusion is about being asked to dance'. Therefore, leaders, and founders in particular, need to be models of inclusive behaviour. A key aspect of being inclusive is listening with an open mind and embracing multiple points of view. This approach implies being open to others who are willing to disagree with you (respectfully, of course). Rather than silencing or ignore dissenting views, actively encourage such conversations.

AVOID THE PITFALLS

To quote Frank Sinatra, 'Regrets, I've had a few'. Regrets can take two forms: doing things you wish you had not done, and not doing things you wish you had done. Frankly, I do not worry too much about the latter category, though, because it readily degenerates into a navel-gazing exercise.

At NetMind, I was told by a board member to hire engineers ‘as quickly as possible’. At face value, this directive seems pretty reasonable. After all, more engineers means more resources. Furthermore, at the time, tech startup valuations were often driven by the number of engineers on the payroll. Happy times? No! I followed that advice, and even after scrutinizing every candidate I still made hiring mistakes. I have therefore learned that the exact opposite strategy is the right one. Hire people *as slowly as possible* (but no slower).

By hiring slowly, you can certainly be more stringent. If you are hiring for technical candidates, you can clearly screen very carefully for technical ability. Google and tech startups alike do this, but if you stop here, you are making a mistake. Hiring slowly means you can screen more carefully for other attributes, such as culture fit. Equally important, slowing down gives you extra time to seek out diversity and avoid ‘cookie cutter’ hiring.

Conversely, I wish I had been quicker to dismiss employees who did not fit our company culture. In my defense, I have always tended to err in giving people the benefit of the doubt. Just do not let that become the path to procrastination. My advice is to fire people who do not fit *as quickly as possible*. Note that I am not talking about *poor performers;* I am talking about *poor fitters.* Poor performers should be given every opportunity to raise their performance. So, why not give poor fitters every opportunity to raise their culture fit? Well, you should, but be forewarned with the knowledge that, in practice, it is often very hard to understand and change entrenched behaviours. After all, the entire profession of psychology is devoted to it! Raising someone’s performance is child’s play by comparison. Regardless, inappropriate behaviours cannot be tolerated; left untreated, they will poison your culture. Call out disrespectful behaviour when you see it and encourage others to do likewise. However, if such behaviour persists, employees who are disrespectful need to go.

Note that founders should not conflate disagreement with disrespect. Healthy disagreement, communicated respectively, is a *good thing.* It is sad to observe founders bouncing within an ideological echo chamber of their own creation due to their inability to include others and incorporate differing views.

EFFECTIVENESS

Now that you have articulated your culture and are successfully managing your team growth, you need to make sure that your teams are effective.

A great deal of research now shows how the effectiveness of a team depends more on how well a team works together than who is on the team.

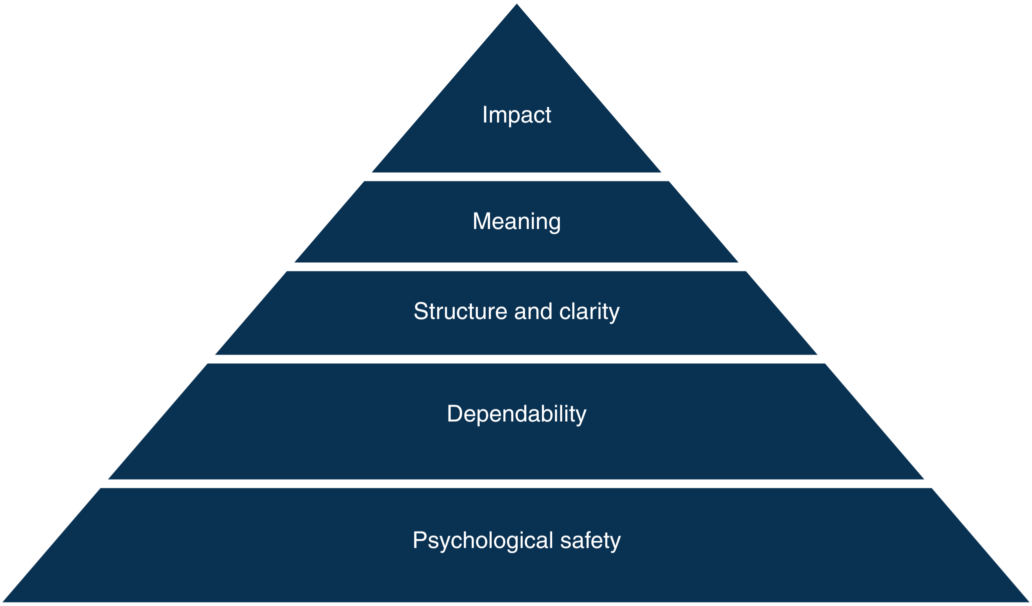
At Google, we conducted our own internal research, testing hundreds of variables to determine what makes teams most effective. Before we started the project, we imagined that creating an effective team could be solved with enough data and some kind of sophisticated algorithm. Google is a data-driven culture, after all. For example, the algorithm would specify just the right number of techies, MBAs, extroverts, introverts, etc., to build that amazing team. You may laugh, but so many of Google’s successful products and processes are data driven. For example, Google’s hiring processes are highly data driven. Why not team formation?

The algorithmic hypothesis was wrong. The most important things that differentiated teams based on effectiveness were less about *who* is on the team and more about *how* team members interact. In particular, the following five things were at the top of the list in differentiating the most highly effective teams from the rest. In order of importance, they are described in the following sections and shown in Figure 1.

PSYCHOLOGICAL SAFETY

Team members feel safe to take risks and be vulnerable in front of each other. This

FIGURE 1. The most important things that differentiated teams based on effectiveness



'psychological safety' lets team members hold a shared belief that the team is safe for interpersonal risk-taking. As a result, they enjoy a sense of confidence that the team will not embarrass or otherwise punish someone for speaking up. Safe teams are also inclusive teams.

DEPENDABILITY

Team members feel as if teammates are dependable and can really be counted on to get things done on time and in accordance with the company's values and standards.

STRUCTURE AND CLARITY

Team members have sufficient structure and clarity to guide their work. They

- know what the short- and long-term goals are
- know their own role and the role of their team members to get there
- understand the plan to get that done.

MEANING

Team members feel as if work is personally meaningful, whether it involves the people they are surrounded by or the output that they have created. Meaningfulness is deeply personal. It can be hard to pin down, and even harder to measure, though.

IMPACT

Team members feel as if their work has impact and clearly connects to what the company is trying to accomplish. At Google, we talk a great deal about our products having a positive impact in the world; indeed, it is a major recruiting message. Even so, it came in only at #5.

OTHER FACTORS INFLUENCING EFFECTIVENESS

When you read the aforementioned list, especially in isolation, it may not strike you as all that surprising. Most interesting were the myriad things that could have been high on this list but were not: things such as consensus-driven decision making, or the number of high performers on a team, or physically co-located teams versus distributed teams.

You are no doubt wondering about the role of the leader in team effectiveness. In Google's research, this role did not stand out as a *direct* predictor of team effectiveness; however, leaders were nevertheless critically important as role models. This view is supported by other research, too. Effective leaders strongly and positively influence how each of the five dynamics plays out on the team, enabling their teams to be most effective. For example, team members are much more likely to derive meaning when leaders provide clarity about the company's vision and explain how team members personally contribute to that vision. Conversely, poor leadership is frequently associated with a loss of meaningfulness (and other attributes).

CONCLUSION

In conclusion, amazing teams are the result of clearly defining your company culture, carefully managing team growth and creating the right environment that enables teams to be effective.

All the best creating your own amazing teams!

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GROWING YOUR FINTECH COMPANY INTO THE NEXT GIANT

ASHURST AUSTRALIA

Stuart Dullard, *Partner*

Tim Brookes, *Partner*

Jonathan Gordon, *Partner*

Jennifer Schlosser, *Partner*

Australia has experienced phenomenal growth and innovation in the financial services sector, with new technologies and business models known as 'FinTechs' disrupting large and established players. FinTechs bring new products, competitive pricing and more user-friendly customer experiences to a seemingly endless array of financial services. In this environment, investors of all types have been keen to invest in FinTechs to capture some of the growth and potential in the sector—often at a very early stage of the company's journey. This growth, technology and investment brings about specific opportunities and challenges in a highly regulated sector. This chapter identifies some of the common challenges and presents ways to navigate them.

1. RAISING EQUITY

Raising equity by issuing shares is often the first step for a FinTech in raising funds from investors. The process is generally straightforward. However, some common mistakes made at the early stage can come back to haunt founders and shareholders.

ARE YOU READY TO RAISE EQUITY?

Ensuring that your business is structured appropriately is critical to attracting capital. The following items should be resolved prior to seeking to raise equity:

- *Is there an entity capable of receiving equity investment?* The most common entity is a private company (i.e., proprietary limited) that is able to issue shares to a limited number of investors.
- *Does the company own the key assets?* Investors will be concerned to see that the company is the owner of the core assets of the business. These assets include intellectual property (IP), the key contracts and employment of the key staff members.
- *Are your records in good order?* Investors will want to be able to review the key documents before investing. This includes evidence of the shares on issue, any agreements to issue further shares, the constitution, ownership of IP, employment agreements and financial accounts (which generally do not need to be audited).

WHAT DO I NEED TO DO TO RAISE EQUITY?

The simplest form of equity financing is issuing ordinary shares. A common initial class of investors is friends and family or high net-worth individuals who join as 'seed investors'. Following the seed round, venture capital funds and corporate investors commonly invest as 'Series A' investors on preferential terms to the seed investors through preference shares, which carry different rights to the ordinary shares if a liquidity event occurs.

Although raising funds by issuing shares is a simple form of financing, legal advice needs to be taken to ensure that the company is able to issue shares without a prospectus in Australia (or without breaching foreign securities laws).

The documentation required for an equity raise for a proprietary company is relatively straightforward. A confidentiality agreement is essential before you share information with investors. Once they have decided to invest, a simple subscription agreement is required to set out the basic terms of the investment. Several simple legal formalities are also required, such as producing share certificates, updating the members register and notifying the Australian Securities & Investments Commission (ASIC) of the change in capital structure. The most important and complex document is the shareholders agreement.

WHY DO I NEED A SHAREHOLDERS AGREEMENT?

A shareholders agreement is essential to govern the relationship between the shareholders and the company itself. The following are key aspects of the shareholders agreement:

- *Who will run the company?* How many directors will there be? Who has the power to appoint directors? Typically, the founder has the majority shareholding and will chair the board, and investors of a certain size (e.g., those holding 20 percent of the shares) will also have the right to appoint a director. Often, a negotiated list of 'reserved matters' requires either unanimity at the board level or a supermajority (e.g., 75 percent of directors).
- *Minority shareholder protections:* To give some protection to minority shareholders without director appointment rights, some material matters will require shareholder approval (e.g., a listing on the Australian Securities Exchange or the sale of substantially all of the company's assets).

  Another important protection for shareholders is anti-dilution rights, under which the company agrees not to issue shares unless it first offers the existing shareholders the opportunity to invest before going to new shareholders.
- *Restrictions on transfer:* Typically, transferring shares will be restricted unless the selling shareholder has first offered the shares for sale to the current shareholders. Shareholders are also restricted from using their shares as security. These mechanisms aim to balance keeping the shareholder base as a known quantity and giving some ability to shareholders to sell.
- *Drag along/tag along rights:* To allow for the sale of the company, a majority of shareholders (say, 75 percent) will often have the power to force the minority shareholders (the remaining 25 percent) to sell to the chosen buyer on the same terms (known as a 'drag along' right). This gives the majority the power to exit where the buyer is seeking 100 percent of the company.

  The flip side to this right is that if a majority of shareholders (say, 60 percent) want to band together and sell to a buyer, the minority shareholders have the right to sell on the same terms so that they are not left behind with a new controlling shareholder (known as a 'tag along' right).
- *The founder:* Founders are often asked to agree to non-compete provisions or buyback arrangements if the founder leaves the business. These arrangements are to protect the investors where the founder is a 'key person' and are often sought by more sophisticated investors.
- *The all-important exit:* In addition to the drag along/tag along regime, a good shareholders agreement will have a mechanism that allows

the shareholders to vote to pursue an exit—either via an initial public offering or a sale of the company or business. If approved, then all shareholders must work together and take all necessary steps to ensure that the exit event occurs, including legal mechanisms to drag along troublesome or unresponsive shareholders.

CAN I ISSUE MY EMPLOYEES SHARES?

An employee share ownership plan is an effective tool to align the interests of the employees and the business. Some real tax advantages can be seen if the plan is correctly structured. However, pitfalls with these plans can occur whereby staff with shares leave on bad terms and can become a thorn in the side of the business.

Importantly, once the company has more than 50 shareholders, it is regulated by the complex takeover provisions in the Corporations Act, which can impede an exit event. Accordingly, advice and careful structuring need to take place to ensure that the share plan works from a tax perspective, dovetails with the shareholders agreement and does not hamper an exit event.

2. DO I NEED A LICENCE?

One key consideration that is almost always relevant to Australian FinTechs is licencing. Primarily, this concerns whether they need to hold an Australian Credit Licence (ACL), an Australian Financial Services Licence (AFSL) or even a banking licence.

WHEN DO I NEED AN ACL?

Under the credit regime, a person needs an ACL if they are engaging in a 'credit activity', which includes being a credit provider in the course of a credit business or providing credit assistance.

WHEN DO I NEED AN AFSL?

Generally, an AFSL is required if (as part of your business) you:

- provide advice on financial products to clients
- deal in a financial product
- make a market for a financial product
- operate a registered scheme
- provide a custodial or depository service
- provide traditional trustee company services.

HOW DO I GET AN ACL OR AFSL?

The most common way to get an ACL or AFSL is to apply to ASIC for your own licence. It is also possible to become a representative of another person who has an appropriate licence and, in some cases, it may be possible to outsource the licenced activities to a person with a licence.

ASIC also offers a 'sandbox' arrangement to approved FinTechs to help them trial a minimum viable product, or MVP, with a limited test base.

WHAT IS INVOLVED IN APPLYING FOR AN ACL OR AN AFSL?

Applying for a licence involves having 'Responsible Managers' (RMs). *RMs* are people who have had experience and are skilled in the precise type of credit or financial services as those you are seeking a licence for. RMs need two years' experience in the last five years in the case of a credit service, and usually five years out of the last eight years in financial services (although five experience tests are available to AFSL RMs).

Your application must include information about your RMs, your business plan, national criminal history checks and insolvency checks for any fit and proper person, membership with an ASIC-approved external dispute resolution scheme and certain other supporting information (such as financial information) in the case of an AFSL. Depending on the authorisations requested, financial conditions, such as cash holdings, may be imposed.

The licencing process can take three to six months, or even longer for an AFSL.

ARE THERE ONGOING OBLIGATIONS?

When a licence is issued, ASIC will impose licence conditions. These may be general conditions, or conditions could be specific to your business.

A common obligation is the 'key person requirement', where ASIC requires you to notify them within a short time if your key person ceases to be involved with the business. It is also usually not acceptable to have RMs in a foreign country rather than having day-to-day involvement with the business.

After a licence is issued, licensees must comply with 'general conduct' obligations. These are in section 47(1) of the *National Consumer Credit Protection Act 2009* (Cth) (for credit licensees) and in section 912A of the *Corporations Act 2001* (Cth) (for financial service licensees).

To assist licensees, ASIC has issued a series of guidance notes called 'Regulatory Guides', which describe the law in relation to a particular topic and how ASIC expects licensees to comply with the law. ASIC's Regulatory Guides are available on the ASIC website.

3. DO YOU HAVE EVERYTHING YOU NEED TO ISSUE DEBT?

Most FinTechs do not anticipate securitisation to be an accessible form of funding. Traditionally, securitisation in the Australian market has been largely driven by originators securitising asset-backed securities, such as Residential Mortgage Backed Securities. These are usually funded by large financiers such as the Big Four Australian banks, non-bank financial institutions and large private equity funds. However, with investors' growing understanding and recognition of FinTech, securitisation is now a viable option.

GETTING THE ASSETS RIGHT FROM THE START

The underlying assets (e.g., a loan receivable) are of critical importance in a securitisation. Accordingly, when starting out, it is important to ensure that the lending documents comply with all regulatory requirements. Securitisation funders will often require a legal opinion on the loan terms confirming that the relevant loan receivable is legally enforceable, complies with consumer credit and unfair terms legislation and is able to be transferred under the securitisation programme.

Securitisation funders will often also conduct due diligence on a FinTech's credit and collection policies.

In the past 12 months, we have seen an increasing number of FinTechs accessing securitisation warehouse funding in the wholesale debt market with relatively small underlying receivables pools (e.g., less than A$10 million). Often, these facilities are established with subordinated and mezzanine funding first, with senior funding introduced once the pool is a critical size.

HOW DOES SECURITISATION WORK?

Securitisation can be understood as realising the future value of assets in the present. Securitisation allows FinTechs that originate loans to pool these loan assets and sell them to investors in search of yield and to use the proceeds to grow the business.

We have recently acted on several FinTech securitisation transactions for personal loans and small-business loan providers. In these cases, the FinTech sells a pool of loans to a special purpose vehicle (SPV)—usually a trust—that has been established for the sole purpose of raising funds.

Investors contribute funds by subscribing for notes issued by the SPV (or, alternatively, investors directly lending funds to the SPV). In each case, the repayment of the notes or loans is dependent on the cash flows from the pool of assets held by the SPV. The proceeds of the notes or financier loans are used by the SPV to acquire the pool of loans from the FinTech.

During an initial period known as the 'revolving period', the SPV applies collections on the pool of receivables held by it to acquire more receivables from the FinTech originator. After the revolving period ends, the SPV funding is either refinanced (by transfer of the pool to another funding structure) or the SPV applies collections on the pool of receivables to repay the notes or funding on a pass-through amortising basis. The notes and loan funding provided to the SPV are limited recourse to the pool of receivables held by the SPV (and there usually is no recourse to the FinTech originator).

GETTING READY TO NEGOTIATE

The following points often come up in negotiations with potential FinTech financiers. Although many of these financier requests are difficult to resist in early funding stages when funding certainty and tenor of availability are critical, the implication of these points should be considered carefully in the context of future growth.

- *Security and guarantees:* FinTech financiers may ask for security or a guarantee from the FinTech or its related companies; however, in a typical securitisation an originator will not provide security or a guarantee in respect of the SPV's obligations because the deal is primarily an asset-backed deal. Where a FinTech has few assets and little credit history, however, such security or guarantee may be required in initial funding stages.
- *Change of control/key person:* FinTech financiers will often seek to include a change of control or change of key persons clause, which, if triggered, may stop the revolving period of funding. The rationale for this is that the FinTech is young and its success to date is often tied to the founders and initially equity holders. If possible, it is better to resist change of control and key person triggers to preserve flexibility for corporate growth and potential exits.
- *Right of first refusal:* FinTech financiers may ask for a right to provide future funding, provided the financier can match the terms and pricing of its competitors. This is understandable on the basis that the financier was willing to provide funding at an early stage in the FinTech's growth. However, agreeing to a right of first refusal needs to be subject to clear parameters, such as dollar limits and time periods, at which point the right falls away.
- *Refinancing risk:* FinTechs need to be aware of refinancing risk where financiers are proposing bullet repayment of debt that is shorter in tenor than the underlying pool of loans sold to the SPV. This can become especially problematic if there are restrictions in the facility that prevent the transfer of the SPV's receivables in connection with a refinancing. Such transfer restrictions should not apply after the revolving period has ended, because time will be needed to arrange for refinancing if the facility is not extended.
- *Equity asks:* FinTech financiers may seek to combine an offer to provide securitisation or debt funding with equity rights such as options and, at times, may look to have the right to appoint a representative to the board of directors. The correct balance of equity rights to give up in the context of debt funding is a point for careful negotiation, and legal advice on this matter should be obtained.

4. PROTECTING YOUR (FIN)TECH

Often, the key asset and competitive advantage that FinTechs possess is their technology. Protecting the IP in technology is crucial to the survival and growth of the business, and being able to demonstrate this protection is essential in persuading investors to fund the business.

HOW DO I PROTECT MY IP?

The good news is that a variety of IP, such as code, marketing collateral, certain databases, computer programs and more, are protected by copyright in Australia. This protection arises automatically on creation of the work—neither a copyright notice nor registration is required to ensure protection.

DO I NEED A PATENT?

A FinTech business based on a technically innovative product or service (such as a novel method of tokenisation or of ensuring trust) should consider obtaining initial advice (typically from a patent attorney) on how to identify and best protect the IP in their business. Initial advice of this kind is generally inexpensive. Obtaining patent protection can be a good idea to ensure market exclusivity for your product/service (i.e., to increase the price that can be demanded from a customer), to give you something you can licence to a bank or other collaborator to generate a revenue stream (i.e., royalties), and to have an asset that can be used to attract capital investment to grow your business. Make sure not to risk losing patent rights by publicly discussing a patent prior to registration.

DO I NEED A TRADE MARK?

A registered trade mark is recommended when a FinTech wishes to have exclusive ownership and trading rights over its brand (such as a name or a logo). To register a trade mark, it must be distinctive and not descriptive.

WHAT ABOUT MY EMPLOYEES?

Copyright works such as software code created by employees during their employment will be owned by the employer, subject to any agreement to the contrary. It is important to document this issue in employment agreements, and investors will look for this when doing due diligence before investing.

A common pitfall is when contractors or consultants are engaged. The terms of engagement must include a written assignment of IP to the FinTech; otherwise, the work will automatically be owned by the contractor.

Confidential information beyond IP also needs to be protected in employment contracts and the terms of engagement with contractors.

SHOULD I ESTABLISH A COMPANY TO OWN THE IP?

Holding IP in a separate corporation is a commonly used mechanism to isolate IP from general business risk and facilitate licencing arrangements. However, this structure has specific tax and legal enforcement complexities that require expert advice.

WHAT ABOUT PRIVACY LAWS?

FinTechs often collect masses of information about their customers and users. Information or an opinion about an identifiable individual ('personal information') is regulated by the *Privacy Act 1988* (Cth) and the Australian Privacy Principles, which impose obligations regarding the collection, use and disclosure of personal information. Obtaining appropriate customer consents up-front is critical, so this should be planned when designing your product and preparing your terms of use.

The new European Union (EU) General Data Protection Regulation (GDPR) will apply from May 2018 on and will introduce an additional layer of requirements for Australian organisations that have a connection to EU customers.

For these reasons, FinTechs need a privacy policy, strategy and process from the outset to avoid worst-case scenarios, such as being unable to use valuable data because they have been collected without proper consent.

HOW ARE DATA REGULATED IN AUSTRALIA?

Extraordinary growth in data generation has occurred in recent years. In Australia, the Government is keen to improve the availability and use of public and private-sector data and ensure that the economy does not lag behind others (e.g., the U.K. facilitates open data via its 'midata' initiative, the U.K. Competition and Markets Authority's Retail Banking Market Investigation and the Revised Payment Services Directive, also known as PSD2).

The Government has announced the introduction of a Consumer Data Right, which will first be applied to the banking sector under the forthcoming Open Banking regime. The recently released 'Open Banking in Australia – Final Report', which was a result of an investigation by the Australian Government on how Open Banking will be implemented, recommends that banks share their customer data to third parties that have been accredited under the regime, which will likely include FinTechs and other financial services companies.

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CORPORATE VENTURE CAPITAL IN AUSTRALIA

NAB VENTURES

Lucinda Hankin, *Investment Associate*

Corporate Venture Capital (Corporate VC) is a source of capital that provides emerging companies not only funding but also the opportunity to gain strategic leverage from established industry players. Corporate Venture Capital is growing in size and relevance, as illustrated in Figure 1, which shows that in the first half of 2017, Corporate VC funds invested US$13.3 billion across 798 deals globally (*CB Insights,* Corporate venture capital H1 2017 report).

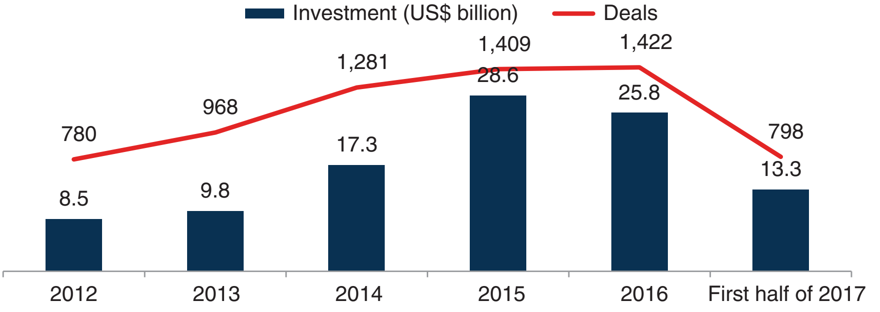
This chapter will provide a general overview of what Corporate VC is and how it works, followed by an illustrative example of the approach taken by National Australia Bank's corporate venture capital fund, NAB Ventures.

WHAT IS CORPORATE VENTURE CAPITAL?

Corporate VC is the investment of corporate funds into external companies as well as internal ideas that are spun out of the company. *CB Insights* traces the origins of Corporate VC investment back to DuPont investing in General Motors in 1914 (see the second entry in the Resources list at the end of this chapter). Its popularity and scale has since ebbed and flowed throughout the twentieth and twenty-first centuries. The objectives and structure of Corporate VC have changed significantly during this time.

There has been plenty of mixed rhetoric around the value and impact of Corporate VC over the past decade. Today, its role is expanding and varied, contributing to a significant part of the startup ecosystem. Corporate venture capital teams are investing in startups and helping their portfolio companies scale by providing strategic capability (i.e., more than money). Given the abundance of capital

FIGURE 1. Corporate venture capital deals, by number and size (US$) globally since 2012



Source: *CB Insights,* Corporate venture capital H1 2017 report.

available in today's market, highly sought-after entrepreneurs can pick and choose their investors and increasingly select only those who can provide a well-defined strategic benefit. Top institutional VCs are both co-investing and participating in rounds led by Corporate VCs. By way of example, NAB Ventures led Veem's funding round, in which top Silicon Valley VC Kleiner Perkins participated.

Within Australia, the number of Corporate VC funds has increased, as have corporate accelerators and incubators. Today, we have at least 12 Corporate VCs, compared to just two in 2010.

HOW DO CORPORATE VCs DIFFER FROM INSTITUTIONAL VCs?

Corporate and Institutional VC funds share the same objective: investing in high-growth and innovative companies. Their core differentiators are highlighted in Table 1, but note that approaches vary amongst Corporate VCs.

TABLE 1. How Corporate VCs differ from Institutional VCs

	Institutional Venture Capital	**Corporate Venture Capital**
Objectives	Institutional VCs target a financial return.	Strategic objectives are typically at the core of Corporate VC, including near-term partnership opportunities and longer-term innovations. Financial returns are often a secondary objective. This ultimately depends on the Corporate VC, but in some instances, they may just be solely driven by financial return.
Strategic Leverage	Institutional VCs can provide expertise in building companies and driving financial return.	Corporate VCs can leverage the expertise, capability and customer base of their corporate sponsor, with potential to add value in product development and distribution. Mirroring institutional VCs, Corporate VCs increasingly employ teams of experienced investment professionals who are also able to provide expertise in scaling companies.
Investment Stage	Institutional VCs tend to invest through the corporate cycle. Typically, individual mandates will dictate the preferred stage of investment.	Corporate VCs generally drive the greatest leverage at the early to mid-stages of a startup's life cycle. Corporate VCs will, however, invest in later-stage companies where it makes strategic sense.
Capital Commitment	Institutional VC funds are often structured as 10-year commitments, where initial investments are made in the first three years and follow-on investments are made thereafter.	Corporate VC funds tend to have open-ended time frames around their capital commitments, although they are affected by the strategic decisions of their corporate sponsor.

(*Continued*)

TABLE 1. How Corporate VCs differ from Institutional VCs—(*continued*)

Exit	Institutional VCs seek a financial return on exit, whether via an IPO or trade sale. Institutional VCs will be required to liquidate their holdings within a specified time. Where an IPO or trade sale has not occurred, the Institutional VC may be required to liquidate its holding on a secondary market.	Although Corporate VCs will also target a financial return, prior to exit, they will seek to ensure that strategic leverage is secured by partnership, insights or an acquisition of the company. Corporate VCs are not generally required to exit their investment within a set time.
Control	Institutional VCs will take an active or passive role depending on their investment mandate, which will dictate whether or not they seek a board seat. Institutional VCs tend to take a non-controlling, minority stake.	Corporate VCs may be actively engaged in the company and take a Board Observor or Board Director seat. A Board Observor seat gives the Corporate VC the right to attend board meetings and receive board documents. A Board Director seat will permit the Corporate VC to vote on board matters. Much like Institutional VCs, Corporate VCs tend to take a non-controlling, minority stake.
Source of Capital	Institutional VCs raise capital from third-party Limited Partners such as endowments, pension funds, Fund of Funds and family offices.	Corporate VCs are typically funded solely through the company's balance sheet. These funds can be recurring annually or be a one-time allotment. Where a dedicated fund has not been allocated, this can affect follow-on financings.
Approval Process and Timeline	Partners at institutional VCs often make decisions independently.	Corporate VCs often have defined approval processes. In some instances, they might require business unit or senior executive sign-off.

Institutional VCs = institutional venture capital firms; Corporate VCs = corporate venture capital firms; IPO = initial public offering

WHAT IS THE PURPOSE OF CORPORATE VCs?

Corporate VCs are generally mandated with both strategic and financial objectives. The purpose of a Corporate VC can vary and should be considered by any company that is thinking of taking on Corporate VC funding.

Corporate VCs allow established corporates to engage within the startup, entrepreneur and VC ecosystem. The startups they invest in provide access to market insights, disruptive technologies and emerging products and services. If structured effectively, Corporate VCs can drive innovation faster, cheaper and more flexibly than in-house research and development efforts. Ultimately, getting a disruptive concept to market and scale takes significant investment and risk, which can be shared and mitigated via an appropriately structured Corporate VC fund. Corporate VCs can also be used to stay across new and disruptive technologies that could potentially enhance the corporate sponsor's existing businesses.

In summary, Corporate VCs can be set up to achieve one or more of the following objectives:

I. Produce financial returns.
II. Gain exposure to new and disruptive technologies and business models.
III. Gain access to market knowledge.
IV. Deepen ties with new potential partners and innovative entrepreneurs.
V. Capture the upside when building new products and services with partners.
VI. Increase the ability to be a thought leader in that category.
VII. Establish early relationships with potential acquisition targets.
VIII. Improve the financial performance and/ or internal efficiencies of the corporate sponsor.

HOW ARE CORPORATE VCs SET UP?

Corporate VCs should be structured to take advantage of their corporate sponsor's existing resources. Corporate VCs can be set up internal or external to the organisation:

I. Internal funds sit within the organisation and generally draw down capital for investment, directly from the balance sheet. They are generally well aligned with the corporate's core strategy.
II. External funds sit outside of the organisation and may invest in areas that are not strategically aligned with their sponsor company. They can be structured in numerous ways, including as a partnership, where the corporate sponsor is the sole limited partner.

WHAT ARE CORPORATE VCs LOOKING FOR?

In a manner similar to that of Institutional VCs, Corporate VCs tend to evaluate deals based on team, technology and market opportunity. Corporate VCs will also focus on the synergistic benefit that can be gained via investing. Generally, Corporate VCs will set the investment parameters that fit their strategic objectives, and then they focus on the startup's growth potential and likelihood of success based on team, technology and market opportunity.

WHAT ARE THE BENEFITS OF TAKING CORPORATE VC FUNDING?

Scaling startup businesses is challenging, and the right investors should help their portfolio companies achieve their growth targets post investment.

Amongst other benefits, Corporate VC funding can provide the following:

I. distribution opportunities through the corporate sponsor's customer base
II. legitimacy through the product being tested by the corporate sponsor's subject matter experts
III. access to the sponsor's capability, infrastructure and people resources
IV. opportunity for deeper commercial partnership with the corporate sponsor
V. strategic advice on the startup's operations and business
VI. a potential path to exit.

THE CORPORATE VENTURE CAPITAL PROCESS

I. DEAL ORIGINATION

Corporate VC deal flow can be either inbound or outbound. Inbound deals come via cold application or the deal team's network. A VC's network is fundamental to generating strong deal flow. Within a Corporate VC, the network is extended to include introductions made by the organisation, which can be substantial where the corporate sponsor has a broader innovation and a digital agenda. Ultimately, a warm introduction via the Corporate VC's network is the ideal channel. Outbound deal flow is generated by the Corporate VC team, through which opportunities are actively identified and pursued.

II. THE FIRST MEETING

Most Corporate VCs meet with multiple startups each day, so it is important to make a strong first impression. Prior to meeting with a Corporate VC, companies should review publicly available information to identify what strategic value the startup company can create for the corporate sponsor, as well as how an investment could benefit the startup. It is helpful to provide a brief pitch deck prior to the meeting. Generally, a pitch deck should clearly articulate the problem the startup company is solving, as well as its team, product, market potential and traction (where possible). Corporate VCs will want to understand 'Why hasn't anyone done it yet?', 'Why now?' and 'What's in it for you and us?'

III. DUE DILIGENCE

Deals will undergo a due diligence process before and after signing a non-binding term sheet. Prior to signing a term sheet, Corporate VCs will typically review commercial viability, team, competitive advantage, scalability and defensibility. They will also focus on the strategic benefit that can be gained from an investment. They will often work with subject matter experts from their corporate sponsor to conduct due diligence on the company and product. Corporate VCs should guide potential investee companies through this process. After signing a term sheet, Corporate VCs will focus on more sensitive commercial and legal matters.

IV. TERM SHEET

The *term sheet* outlines the terms on which the Corporate VC will invest in a company and sets the economics and control parameters of the deal. Terms relating to economics cover pricing, share class and returns; control terms relate to board rights, voting rights and protective provisions. The Corporate VC may have unique provisions (including, in some instances, a right of first refusal to buy the startup).

V. DEAL CLOSING/COMPLETION

A Corporate VC will close the deal following satisfactory completion of due diligence, negotiation of transaction documents, agreement of co-investors (where relevant) and receipt of all required internal and external sign-offs. Investee companies should understand a Corporate VC's approval process prior to executing a term sheet, to ensure that they adequately understand a Corporate VC's timeline and potential hurdles along the way.

VI. PORTFOLIO MONITORING

A company's engagement with a venture capital firm post investment will be affected by the level of control agreed in the transaction documents. Venture capital firms will generally provide guidance and advice, and if they hold a board seat, they can retain a right to vote on board matters. The Corporate VC will ultimately be responsible for ensuring that the promised strategic benefits are achieved post investment.

VII. EXIT

Corporate VCs may be more patient than Institutional VCs because they are not beholden to a Limited Partner's 10-year time horizon. Exit options for a Corporate VC include writing off the investment, selling out via a trade sale or initial public offering or having the corporate sponsor acquire the startup.

NAB VENTURES: AN ILLUSTRATIVE EXAMPLE

NAB Ventures was launched in March 2016 in response to significant changes in technology, consumer behaviour and regulation in financial services. NAB's chief executive officer, Andrew Thorburn, created a working group to generate ideas for how NAB could continue to thrive in this dynamic environment. The end result was the creation of NAB Labs, an in-house incubator, and NAB Ventures, NAB's own Corporate VC.

NAB Ventures was established to make investments in early-stage companies pursuing scalable ideas that could have an impact on NAB's business. The fund provides NAB the opportunity to gain access to cutting-edge innovation through companies that are disrupting traditional financial services. Culturally, NAB Ventures was established to help embed a 'test and learn' mind-set within NAB, with a greater emphasis on experimentation. Although the financial rate of return is a consideration, its core focus is on the strategic benefits that can be gained by early-stage investing.

NAB Ventures' fund structure draws on both the internal and external fund models to optimise the synergistic value that can be gained with investee companies. Although it sits internally within NAB, NAB Ventures has a dedicated fund with streamlined processes that allow it to operate with the efficiency of an established venture capital firm.

NAB Ventures looks for companies with innovation at the heart of their product, service or model. Its aim is twofold. Firstly, NAB Ventures aims to increase an investee company's probability of success by enabling it to leverage NAB's customer base, reputation and institutional knowledge. Secondly, NAB Ventures seeks ways that the investee can improve NAB customers' experience. Sometimes this means investing in companies that are disruptive to NAB's existing business lines. The fund focuses on companies in FinTech and adjacent sectors, whether in Australia or overseas. It does not focus on any particular stage of venture investing, having made investments from seed stage all the way through to Series D. The first question NAB Ventures asks when considering an investment is, 'How can NAB add value to the company?'

NAB Ventures provides startups with access to the organisational capability of one of Australia's largest corporates and its 10 million customers across Australia and New Zealand, as well as the ability to test their product with a major potential customer. As an example of specific capability, NAB has the number one market share for small and medium-sized businesses in Australia as well as the number one agribusiness. Although a commercial partnership will not necessarily be tied to an investment, NAB Ventures can drive strategic leverage via testing and enhancing the product with NAB Labs or directly with a NAB business unit, via NAB's extensive distribution network or by becoming a customer and incubating and validating products.

CONCLUSION

Corporate VC has evolved into a sophisticated source of capital and capability. Companies should properly evaluate a Corporate VC prior to taking its money. Companies should focus on the following issues:

I. *Alignment:* Where the Corporate VC is not motivated by getting the highest possible returns, strategic misalignment can occur. Prior to taking Corporate VC capital, companies should evaluate the Corporate VC's objectives and motivations.

II. *Longevity:* To get the Corporate VC model right, the corporate sponsor needs to take a strategic, long-term view. This can be evidenced by the Corporate VC having a dedicated fund, with Board support and a strong track record of investing.

III. *Team:* Ensuring cultural alignment with the Corporate VC is important, because by taking an investment, an investee company is committing to a long-term partnership. This issue is particularly important where the Corporate VC needs to balance the investee company's interests with those of its corporate sponsor.

Finally, companies should be comfortable with both the investor and its terms because they could have a meaningful impact post investment. With Corporate VC growing in size, capability and sophistication, it is an opportune time to consider partnering with strategic investors.

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29

INGREDIENTS FOR A ROBUST PARTNERSHIP MODEL

STONE & CHALK

Alex Scandurra, *Chief Executive Officer*

> *Welcome to the age where corporates need to find their inner startup again and where startups want to work with corporates that have a startup mentality.*
>
> *Alex Scandurra, CEO, Stone & Chalk*

In this age of open innovation, where technology proliferates, knowledge is borderless, information sharing is instantaneous and imagination is limitless, multitudes of paradigm shifts are occurring all around us. Tradition is now mixing with the new. The status quo is being rejected, and new rules of business are being created.

This is all happening because, to be trailblazers and deliver exponential impact—as the idiom goes—we must innovate, or we will die.

We have heard all of this before, ad nauseam. But we are still talking about it. There does not seem to be a clear path on how to break through this rhetoric, shift gears and implement tangible outcomes quickly.

THE CORPORATE–STARTUP SYMBIOSIS

As we close out another decade, the burning question on our minds is this: is a corporate–startup partnership a viable solution to our future business problems, or is it just wishful thinking? Before going any further, we should clear up a few things:

- To cut straight to the chase, the answer is 'yes'. A harmonious corporate–startup partnership is a real possibility, although it comes with certain caveats and guidelines that we will describe in this chapter.
- Of course, if there were a foolproof formula, everyone would be using it.
- When we say 'startup', we mean the entrepreneurial genius of those who have a technology-based proposition (product or service) that can take on established markets quickly, iteratively and without much legacy. Startups could be in the pre-commercial launch stage or scaling rapidly (e.g., with less than three years of operating history).
- When we say 'corporate', we do not mean an entity; we mean the individuals who make up the business, which is always going to present a challenge as long as people are transient in their roles.
- The approach needs to be iterative because change is the only constant (apologies for the cliché) and because the rate of change is approaching a 'vertical curve'.

One thing is for certain. The corporate–startup symbiosis is not yet humming. We are getting dizzy in a hit-and-miss vortex. Some of us will be spewed out of it, others of us will be sucked into it, and whilst some of us will spectacularly collide, we still cannot really predict when or how any of this will happen.

Should corporates innovate from the inside out, or from the outside in? Should they partner with startups, or buy them out? Should they invest for their business (infra)structure, or for their customers? Should they hire consultants? Fire consultants? Is it better to brew over ideas or build out ideas?

As for the elusive startups, for a large part they are the ones with the phenomenal intellectual property (IP) and technology, but they often lack the know-how to get it to market and they rarely have the distribution channels and ready-made customer relationships of an established company. They do not (necessarily) want to be acquired, and in most cases they have fought hard to break away from the stifling bureaucracy that often encumbers corporates.

The corporate–startup symbiosis can in many ways be referred to as today's great oxymoron. It is like chalk and cheese, black and white, big dog/small dog. On paper, it is not a particularly logical alliance to forge. How can two entities, seemingly worlds apart, possibly form meaningful partnerships and take on category, industry and potentially market challenges together?

Yet, the possibilities of such alliances also prove to be fascinating, where the new overtakes the norm; where innovation overrules tradition; where iteration is the status quo; and where participatory leadership replaces hierarchy. The future of work never looked so different and exciting, but because we have not landed on a robust formula of how these worlds intersect, perhaps we need to go back to basics.

Perhaps the question is not how startups and corporates can work in harmony, but more important, why they should.

WHERE WILL THE COMPETITIVE ADVANTAGE OF THE FUTURE COME FROM?

Customers are being presented with an unprecedented level of choice, in an increasing number of sectors, and at an increasing velocity. It is no wonder that well-established corporations are scrambling, and often, struggling, to keep up.

As Jack Welch, former Chairman and Chief Executive Officer of General Electric, so eloquently says, 'If the rate of change on the outside exceeds the rate of change on the inside, the end is near' (retrieved from https://www.linkedin.com/pulse/rate-change-outside-exceeds-inside-end-near-jack-welch-steinke). Keeping ahead of the curve, understanding what is going on out there, informing your business with insights, and seeking kindred partners who share the same ethos is precisely where the corporate–startup symbiosis can be magical.

Several market dynamics that generally hold true globally are worth looking at:

- Technology is evolving so quickly and becoming so affordable that a small team of very smart people can have access to the same computing power as any Fortune 500 company.
- This same technology is automating repeatable processes and white-collar jobs, shining a new light on 'the future of work'.
- Increasingly, the brightest kids are creating their own startups when they leave school or university, particularly as they are exposed to this new way of working and entrepreneurial opportunities.
- There is a massive oversupply of capital globally looking for positive returns, which in many cases is settling for a 'just above inflation' rate of return.

The convergence of these dynamics is helping to spawn a renaissance-esque explosion of innovation and entrepreneurship from Sydney to London, Toronto to Buenos Aires, and beyond. Given the constraints many corporates have established over time (think legacy systems, processes, silos), they are simply unable to respond to the influx of new entrants (both big and small) that are effortlessly stealing their customers away.

Here is the choice: should corporates continue down the same path they are familiar with? Should they innovate from the 'inside-out' or partner with the best and brightest from outside of their organisation (i.e., from the 'outside in')? We can follow this through logically.

If large organisations are struggling to keep up with the pace of change (let alone innovating ahead of it) and if, on an increasing basis, the best talent is going to be found outside of the organisation (yes, even Google has a venture fund), then surely partnering with startups and scaleups will be key to success.

Winning is no longer determined by a twentieth-century model of competition, where corporates combine a commonly isolated series of business units competing externally for resources such as hiring the best talent, whilst competing internally for funding and to jump up the priority list for getting stuff done (trying to innovate from the inside-out). Increasingly the twenty-first century paradigm of success is moving to platform business models where new propositions, services and offerings to customers are a combination of what is produced internally and what is produced by third-party partners. In this new game, becoming a partner of choice—a 'go-to' partner, if you will—for the best innovators, startups, scaleups and the like is essential to winning. Winning requires as much a major cultural shift as it does a process and strategy. Corporates need to appreciate and acknowledge that they need the top innovators (startups and scaleups) just as much as the innovators need the corporate. A 'take it or leave it' approach will not make you a partner of choice. My hunch is that the tables have started to turn quite significantly. In many cases, there are multiple corporates and investors now courting the same venture. If interest rates remain low and the rate of development of new technology continues at even a similar pace (which seems extremely likely), then we may see a sellers' market (i.e., startups' market) establish itself and continue for a very long time.

If the above holds true, then logic would have it that winning today means making a shift to the twenty-first-century paradigm of innovating from the 'outside-in'.

Do not get me wrong: I am not advocating for throwing out the tools and the toolshed. I am simply trying to encourage leaders to be brutally honest about what is core (and therefore what competence should be retained internally) versus what is best designed and delivered to customers in partnership with the best that is out there.

If you can be the partner of choice for the best startups and scaleups, you stand a very good chance of attracting them ahead of your competition and we all know how valuable this can be.

For the startups, the two things they need more than anything else are customers and funding to continue to build and grow. Corporates can be both a customer and/or a channel to customers as well as a potential investor. So, in theory, it should be a perfect marriage between a corporate that needs to solve problems for itself or explore opportunities for growth and a startup who has the solutions and needs customers to grow.

Unfortunately, the policies, processes and culture of large organisations are not designed to work with relatively tiny, super-innovative, fast-moving startups. Similarly, startups typically have such small amounts of funds they can draw upon that they cannot take the time the corporates need to close a commercial deal.

Thus, it is time for that paradigm shift.

PRINCIPLES FOR A SUCCESSFUL PARTNERSHIP

MIND-SET

As I reflected on the order of these principles, I changed them around so that we could begin with the one that is arguably the most important. And that is mind-set. Is mind-set an idea, or can it be a true practice? And why does it matter?

We often refer to 'culture' at an organisational level, but organisations are actually complex—they are made up of a collective of individuals. These individuals are people, and every person has a mind-set that guides their intent at work, helps form partnerships (internal and external) and is the basis of their working ethos.

Organisations everywhere are constantly trying to change the way they are structured, often adopting concepts like 'agile' scrums, tribes, squads and more, which at some level may help shift the 'structural inertia' (until, of course, the next wave of management comes through and restructures again).

However, a change in structure alone is when we see 'cognitive inertia' seeping in, remaining or, worse, escalating. This happens because the way people think and make decisions needs to be addressed when designing how your organisation should be structured. It is not just about how people are organised—it is about how they think and the extent to which they are allowed to leverage their full potential.

Change will be short-lived once the excitement and romance of a new way of operating subsides. A sausage in a different casing is still a sausage. Updating policy and processes will be just as important, as they are the tools by which people are empowered to think, behave and therefore operate in a new way. Think of these as a three-legged stool, if one of these is missing, the stool will fall over.

How is all this relevant to partnering successfully with startups? If we want to have access to the best talent in the world, we need to help develop an alignment in the mind-set of both parties so that, collectively, we can help build the industries that will power us all into the future. Let us not forget the higher purpose here: we are helping to build the future for our children, which means both the corporate and the startup need to be successful in this partnership, so intention is all.

Deep down, it is the individuals who make a partnership: their mind-set, their commonality of spirit. Not entities. When partnering with a startup, you need to treat it fairly and with consideration of its vulnerabilities. Good organisations think of their partners' needs. In Silicon Valley, the expression is, 'Pay it forward'. I prefer to say, 'Give first'.

This concept can also be referred to as the spirit of partnership.

So do yourself a favour, before spending countless amounts of time, energy and money trying to build 'innovation' internally or go back to the same legacy suppliers, take the opportunity to stop and think about partnering with a startup, which is guaranteed to have a mind-set of growth, speed, focus: a mind-set that has endurance and courage in enacting change.

TRUST

Setting the parameters and expectations from the outset of any partnership is critical to ensure that businesses (large or small) can build trust between one another. The basic premise is that you should only seek out partners who are willing to dare and take on the world with you, and are aligned on trust, or what I often call *heartset*.

Yes, heartset goes hand in glove with mind-set. It is the reciprocity of what we say in Australia, 'Got your back, mate'—that is, we are not in this to screw each other over, but instead we recognise that to succeed in this we have dual responsibility, dual objectives, dual wins and dual failures – Partnership 101.

Sounds simple, right? Well as it turns out, apparently not.

No doubt, like many others, you most likely know of a case where a startup has spent a significant amount of time in meetings pitching and trying to sell its proposition to a large organisation, only to see that same organisation launch a similar thing later on down the track. Deplorable behaviour, and please, do not put it down to coincidence.

Why do we see this situation happen time and again? On one hand, the smaller (but no less smart) startup is holding on to some pretty awesome IP. On the other hand, large corporations are held up with brand, customers, money. But this is when we start seeing red tape, bureaucracy, organisational silos, processes, legacy systems, fierce competition and in some cases a little thing called ego and the 'not invented here' syndrome creep in. Despite best efforts by most people, these behaviours, not set on mind-set, not set on trust, get in the way.

This sort of behaviour slows down collaboration between corporates and startups and builds unnecessary defences before conversations sometimes even begin.

Trust is infinitely more valuable than bitcoin. Trust in any partnership, especially when hundreds upon thousands, even millions, of customers will benefit from your alliance, needs to be 100 percent focused with a heartset that is, equal and respectful and ignores the traditional processes of a typically structured corporate.

PREPARATION

Once you have established those parameters, it is time to understand each other's businesses and prepare for your partnership. And yes, I do mean for every meeting, every transaction, in fact, every time you are working towards a common goal.

This stage is where some partnerships between corporates and startups fall short. As the representative of the startup you need to be honest with yourself and ask yourself this question: do you know with conviction what you are truly creating and designing, or is it all innovation rhetoric? Are you able to define what your ideal future looks like, or are you stabbing in the dark?

The reason it is so important to understand your intended outcomes is because only then can you create genuine proprietary capabilities and technologies that are relevant to your customers.

Some startups and corporates will never remotely see eye-to-eye because either a corporate has not been able to articulate its business problem, or what they are trying to solve/accomplish, or the startup has a product/service that is ill defined or will not at all fit the corporate problem. I am sure you can imagine occasions where a clear match would have been possible if only the problem was better understood and/or the solution better communicated.

Partnerships need to be founded on a common ground of knowing why you are in business together in the first place. Otherwise, you will not be have a sustainable partnership; rather, you will have transactions, at best.

Here are some specific suggestions for startups:

- Founders must realise that the people you are pitching to are not there to guess what your proposition is and where potentially it may or may not be of use to their organisation. Just as large organisations need to become 'startup ready', startups also need to become 'corporate ready'. Unfortunately, I hear this feedback on a regular basis from corporates meeting with startups.
- Time is valuable for everyone, so do not waste it. Practice your pitch with a succinctly articulated unique selling proposition, remembering why it is of value to the person you are meeting with. If you cannot do this, then you are not ready to meet with customers. If you can do this, be sure you are clear about what you want—have your 'ask' ready.

Large organisations really need to iron out the following issues:

- *Take a different approach to processes, policies and procedures.* These documents are generally designed and well-tested for working with other large organisations. Yet, when reality kicks in, they are typically onerous, time-consuming and overly complex. Rather than trying to bend and twist this world, agree instead to a simple pilot with a startup. You can have a separate, low-cost, low-risk, 'fast-tracked' procurement process that is fit for purpose.

- *Know the rules of engagement.* Having a centralised versus a decentralised engagement model of engaging with startups has advantages and disadvantages. Whichever way you go, be clear before you 'open up for business' to startups. Desist on dragging out the engagement process only to then say 'no' six months later. In fact, you are doing startups a massive favour if you say no early on with some constructive feedback instead of giving false hope of securing a commercial outcome. Not only is dragging out the process cruel, but it may have caused the company to go bust because they could have spent that time with other organisations that might have become a paying customer.
- *Do your homework on what problems you are looking to solve or what opportunities you are looking to go after.* Not knowing the problems you are trying to solve will make it difficult for you to know which startups you would like to engage with further.

ALIGNMENT OF OBJECTIVES

As part of building trust, sharing the objectives between the parties can be extremely helpful. Sometimes documenting them in the pilot agreement can help remind everyone of why the project is being undertaken beyond the obvious key performance indicators (KPIs) and results that are being measured.

Rarely is performance against KPIs the only metric that is required to implement something new, so take the time to talk about this together, and try to incorporate it somehow into the agreement. Things to think about are the wider organisational objectives, extended further to the division and team's objectives.

Similarly, it is key for the startup to do the same, whether the startup is securing its first major customer or even testing the interoperability of the proposition with the organisation's systems.

CLARITY OF PROCESS AHEAD

Many startups commence their engagement with large organisations with the misguided expectation that it may only take several weeks or months to close a pilot agreement.

To minimise any misalignment of expectations, communicate the process up-front, and take the startup through how it works and how long it is likely to take. Startups are cash-strapped and cannot afford to engage in a lengthy and complex sales process. Therefore, it is important to help them understand what is likely to be in front of them so that they can make an informed decision as to whether the process will be suitable to them. Remember as a corporate you are now seeking to be the first port of call, the 'go-to' partner, so the faster and better this process works, the greater your reputation in the market. This in turn attracts more startups and your competitive advantage grows.

THE SHORT, SHARP WRAP

Businesses need to find the big 'reset to startup' button, commit and make it happen. Leadership starts at the top, and paradigm shifts require vision, determination, patience and consistency to see them through. Teach, empower and reward your people on their engagements with startups. Take the action required to make the internal changes that are necessary to become the go-to partner for startups by getting it right. Credibility and authenticity are the needed currencies in the ecosystem, and by attracting the best first, you have a good chance of outmanoeuvring your competition.

You just need to make it a priority.

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BUILDING SCALABLE TEAMS

SQUARE PEG CAPITAL

Paul Bassat, *Co-Founder and Partner*

As an investor, it is easy to make the mistake of thinking about startups in binary terms: either the company will build an amazing product and become an overnight success, or conversely, it will fail. This scenario just does not reflect reality.

You need a great product and happy customers to build a successful business. However, a fantastic product that meets a critical market need is a necessary but insufficient prerequisite for building a great company that endures. For companies that manage to find a great product/market fit, that is just the start of the journey.

REALISE THAT PEOPLE ARE THE MAJOR DRIVER OF SUCCESS OR FAILURE

In this chapter, we will home in on perhaps the most important component in the challenge of building a large business, which is finding and managing great people and developing highly scalable organisations. If the business is able to find a great product/market fit, a passionate, aligned, highly skilled team has the ability to build a really significant business. Achieving this result through multiple stages of growth is an incredibly difficult, multifaceted challenge. Through the lens of our portfolio, it is fair to say that businesses that have exceeded our expectations in their capacity to scale have achieved that position because of an outstanding team and high-quality execution.

Some of the key challenges in this area include the following:

- establishing the right foundational dynamic from day one and understanding when that may need to change
- hiring the right people into both senior and more junior positions, then retaining and developing those people at a rapid pace
- structuring the organisation in a way that drives the right behaviour, alignment in terms of targeted outcomes and efficiency
- fostering buy-in on the strategy of the organisation from top to bottom.

THE FOUNDATION OF THE BUSINESS

Backing founders who have the capacity to scale and drive the growth of the business is the most important part of a venture investor's role. Although additional senior hires will be made over time, the founders will always have an outsized impact on the organisation and need to set it up for success.

UNDERSTANDING FOUNDERS' STRENGTHS AND WEAKNESSES

In setting up the company for scale, founders and founding teams need to be students of their own strengths, weaknesses, character traits and areas of expertise.

Founding teams need clarity on their areas of responsibility and accountability so that they can efficiently delegate and coordinate teams that all drive to the same outcome.

Although some founders are able to grow with an organisation in a C-level position, this is not always the case and roles may need to change over time. Some of the most successful businesses have seen founders step back from C-level positions to focus on functionally specific roles, such as product or sales. Such changes are most often a good thing, as they allow a founder to play to their specific strengths, while maintaining a cultural influence on the organisation. This requires a high-level of EQ and self-awareness, and the determination to place the organisation above of ego. In these different roles, founders can and should remain an important part of the fabric of the organisation, so long as their commitment remains at a very high level.

ESTABLISHING ALIGNMENT OF FOUNDERS' VISION AND OPERATIONAL PLANS

Establishing alignment between founders on long-term vision, operational plans and responsibilities at the beginning of the journey is incredibly important. As the business grows and is required to respond to external influences such as customer feedback and market pressure, priorities are likely to change. Leadership teams will need to have a clear and workable management process to wrestle with how large the business can be, how success should be defined, or what the best path to get there might be.

INCREASING THE SIZE OF THE TEAM

WHY COMPANIES SHOULD BUILD TEAMS AHEAD OF TIME RATHER THAN FOR TODAY

At the early stages of a business, the team is small and usually very tightly knit. Broad areas of responsibility are common, rather than highly specific roles. This approach makes sense in the formative stages but will act as an impediment to much greater scale fairly quickly.

When you try to do everything, you often end up achieving nothing, and this becomes the first major organisational hurdle for founders scrambling to keep up with rapid growth. The small, foundational team cannot achieve large scale alone.

The path to continually generating positive outcomes at a rapid pace is through functional leverage and building teams across key disciplines. The priority of each discipline changes at different points along the journey. Early on, the priority may be building capability around product and technology as well as sales and marketing. Although these areas remain incredibly important throughout the journey, customer success and internal process become sharper pain points once the organisation is dealing with a sufficiently large customer base.

At the highest level, increasing team size can be broken into three key areas:

- hiring and determining what to look for in candidates
- going through the process of managing teams
- optimising the structure of the organisation.

HIRING AND DETERMINING WHAT TO LOOK FOR IN CANDIDATES

When it comes to hiring, there are two key questions: the first is when to hire, and the second is whom to hire.

One of the features of startups that allows such high growth rates is the ability to build a team ahead of current requirements rather than in a linear, as-required manner. Founders and senior executives need to be highly proactive in planning future team requirements as well as recruitment, rather than waiting for clear catalysts. As an example, pre-IPO businesses are well-placed to hire a C-level executive with experience in how to manage the IPO process, even a few years in advance.

An unfortunate reality of recruitment is that the timing of hires is difficult to control, and high-quality candidates are notoriously difficult to find. For this reason, you should always be on the lookout for high-quality people to hire. These serendipitous hires can end up being some of the most important hires you will make. Although you may not have a role for them immediately, in most cases it makes sense to bring such people into the company and potentially build a role around them.

Multiple methods exist for developing a pipeline of candidates and running a hiring process. Rather than discussing these elements, we will focus on what to look for in candidates, which can be broken into three key areas of equal importance:

- *Fit:* There is little more important in a new hire than a values alignment and approach to work. Founders can set an example, but organisations develop culture in a bottom-up fashion. In an early-stage business, new hires can have a radical impact on the culture of the organisation. At SEEK, we quickly learned never to underestimate the mayhem and loss of momentum caused by a poor-fit but highly skilled hire. Similarly, 'fit' should not be interpreted as 'a homogenous group of people'. A true values alignment should result in increased diversity among the team in all other measures.
- *Capability:* It goes without saying that candidates should be highly capable, but this should not necessarily be measured by experience in previous roles alone. In a rapidly evolving business, the more important measure is raw intelligence, horsepower and judgement. Can this person continuously learn, improve and scale with your business? Of course, in some cases, certain roles will require specific domain expertise or leadership experience.
- *Potential:* This point goes hand in hand with capability. Do candidates have the desire to remain on a perennially steep learning curve and expand capabilities and skills, thereby allowing them to scale with the business as its needs change? Are they hungry to progress? Or, alternatively, are they content and passionate about performing a highly specific set of tasks? Both are acceptable outcomes, but you need to have a very clear view on this point before making a hire.

MANAGING TEAMS

One of the aspects of scaling that receives the least amount of attention is internal processes. It is also one of the most common roadblocks to achieving progress inside an organisation of ever-increasing size. Poor process tends to drive poor outcomes and reduces the chance of retaining high-quality people.

Although this concept applies to all areas of the organisation, it is vital to build processes in human resources around the following:

- onboarding
- review of performance and enabling feedback
- career development and maximising retention.

Onboarding

Once a new hire has been made, everything from the offer letter through to planning the first few days, weeks and months of a role is a great opportunity to increase the pace of learning and subsequent contribution to the organisation. Many companies do this poorly and pay the price for it in a delayed period before real impact is felt and, potentially, team turnover down the track.

Review of performance and enabling feedback

Once a new hire has moved beyond the initial phase, the improvement process should kick in. Ideally, this should be an open, mutually beneficial process where multiple members of the team have the opportunity to pass on constructive feedback. Conversely, individuals should feel comfortable providing feedback to those around them. In large, hierarchical organisations, these processes tend to become political and lose their utility. It is crucial that a culture of transparency and constructive feedback continues to hold even as the organisation becomes large. The nature of these processes may change and be confined to certain teams or disciplines, but the processes are a consistently useful tool to drive awareness of individual strengths and weaknesses.

Furthermore, individuals need to understand how they are being measured by managers. Whether that is quantitative or qualitative, people tend to be more effective when they have goals and are incentivised to reach these goals. More on this topic will be covered in the section called 'The importance of incentives'. Part of holding individuals to their stated goals and key performance indicators (KPIs) is knowing when someone might no longer be appropriate for a role or, conversely, should be developed further and given more responsibility over time. It is unlikely that the senior hires you make early on will be the right people to run large, functionally specific teams, though it is certainly possible.

Career development and maximising retention

The ability of team members to learn and develop their careers is pivotal to retention and to maximising the contribution of existing hires to the growth of an organisation. Career development may come in the form of more literal development, such as courses and programs. More likely, it is allowing individuals to use their initiative in developing outcomes, driving processes or tasks, versus the unpalatable alternative of continually taking instructions before performing every task.

Secondly, given the constant evolution of roles and the expansion of responsibilities and tasks in a high-growth business, it is critical to understand the 'burn rates' of individuals and to proactively manage these. Although this understanding might come from a more formal review process, it is more likely to come from relationship building between team leaders and their reports. The high-stakes game of building a successful business can be a real struggle for many, from the founders through to the most junior members of the team. It is a constant battle against competitors, time and scarcity of capital to achieve meaningful scale and eventual financial success. Founders and managers should also put significant effort into understanding the level of engagement across the organisation and track this over time by team and individual. Team members should be able to pass on feedback anonymously where they do not feel comfortable delivering it directly. A wide array of tools is available to make this task straightforward and efficient.

OPTIMISING THE STRUCTURE OF THE ORGANISATION

The structure of an organisation changes dramatically throughout the journey of scaling. As discussed earlier, what makes sense at a very early stage makes a lot less sense for a company with $50 million in revenue and 200 people. There are natural breaking points for individuals, teams and processes, where additional structure and specificity can add leverage to a given function.

Clarity of responsibility and accountability

Teams and managers should develop very clear reporting lines and iterate on these over time. This approach is not done to entrench hierarchy for the sake of hierarchy. Instead, it is done to help drive clarity of purpose and efficient performance. Each key area of delivery should ideally have a single point of accountability. This method allows managers to define expectations and hold individuals to KPIs, but it also provides the broader team with a single point of contact and leadership for a given process or task.

Taking this approach also reduces duplication. Where you need to find a balance is in continually promoting efficient collaboration even as you seek to very clearly define roles and responsibilities and reduce duplication. For example, tasking three to four people to put together new marketing collateral without a single owner will almost certainly drive collaboration and discussion, but it will likely also lead to role overlap and inefficiency in bringing the task to completion without someone directing traffic.

The importance of incentives

As alluded to earlier, individuals tend to be more effective when they have clear goals and KPIs by which their performance can be measured. This concept also extends to financial reward.

Team members need the appropriate short-term and long-term incentives to drive balanced performance. Getting this balance right is critical to achieving sustainable growth. Short-term incentives can range from being fairly simple (usually where KPIs are more qualitative) to much more complex ones with multiple payoff scenarios (such as those for salespeople).

The ultimate long-term incentive is ownership of the business. Where a team member stands to gain from the long-term creation of value, rarely will they sacrifice this goal in the pursuit of short-term goals. Putting parameters around ownership, such as vesting of stock or options over time, is a useful way to further frame the role of an individual and focus them on longer-term outcomes.

Like many of the points discussed in this chapter, incentives cannot be static and will need to change over time to reflect the priorities set for the individual and for the business.

ORGANISATIONAL ALIGNMENT AND BUY-IN ON THE VISION

An extension of the point on alignment through measurement and financial reward is ensuring that the broader organisation shares the vision for what you are trying to achieve. This goal is fairly easy to achieve with a small team. It becomes incredibly difficult to communicate and build momentum behind when you have a much larger organisation. Achieving a shared vision is critical if high levels of motivation are to have meaningful longevity.

SETTING AND ADJUSTING THE VISION

When it comes to setting the vision, founders usually follow one of two approaches: they either take a collaborative approach to building the plan, or they set the plan and task the team with implementing it. In the case of the former, it is much more straightforward to generate buy-in with the senior team, because they have helped craft the strategy from scratch. However, where the strategy has already been set, it will be harder for the senior team to feel real ownership. In this case, it is vital to allow extensive debate and critique, as well as potential tweaking of the plan.

Changes to the vision should not be purely top-down either. Building advocacy, excitement and motivation for any change in direction should be equally well executed to generate the maximum level of buy-in across the leadership team.

COMMUNICATING TO THE ORGANISATION

Once the strategic vision is set, the challenge of communicating it to the wider organisation and building alignment becomes incrementally more difficult with increasing company size. Each organisation is different and the approach will be nuanced, but founders and senior leaders can take some common actions. First, spend time with the top senior people across the organisation in fleshing out the business plan to deliver the strategy. These individuals will then be responsible for communicating to their teams and setting KPIs based on outcomes aligned to the plan. Second, the chief executive officer or founders can communicate with the organisation as a whole to build the case for the plan, while also structuring regular updates around these objectives to refresh all teams on what the high-level goals of the organisation are.

CONCLUSION

A recurring theme in this chapter about building scalable teams is change. Change is the only real constant in a startup. Whether they are working on the dynamic between founders and senior leadership, hiring great people and developing them or ensuring that the organisation remains efficient and aligned, founders and senior leaders must constantly evolve to cope with the challenges and strains brought on by rapid company growth.

Only the highest-quality entrepreneurs can build very large businesses and navigate these difficulties. This is why understanding the capacity of the people involved is the most important area of diligence for investors. Being an entrepreneur of a high-growth, early-stage organisation is hard, but the journey can be incredibly rewarding. Immense satisfaction comes from doing something in a significantly improved way and solving a problem for consumers or businesses.

PART III

IPO

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ASX: A LAUNCH PAD TO ACCELERATE YOUR GROWTH

AUSTRALIAN SECURITIES EXCHANGE

Josh Collard, *Business Development Manager, Listings*

The history of public markets in Australia can be traced back to the gold-rush period of the 1850s, with state-based exchanges formed shortly thereafter. These exchanges continued operating until 1987, when they amalgamated to create a single national market—the Australian Stock Exchange—or ASX, as we know it today.

INNOVATION AND ENTREPRENEURIALISM ARE IN OUR DNA

Throughout its history, ASX has pioneered many initiatives and has been a world leader in its field. ASX was one of the first exchanges to close its trading floor and embrace electronic trading, and it was the first to demutualise and list on its own exchange. Only last year, it became the first exchange to announce that it would implement distributed ledger (or blockchain) technology for its next-generation equities post-trade platform.

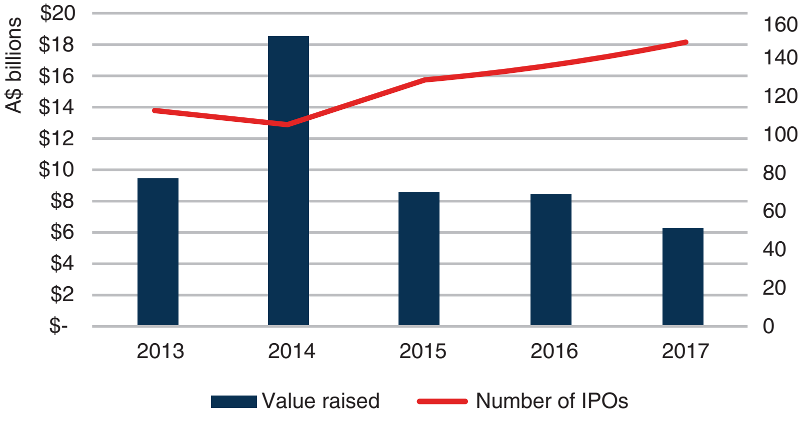
ASX has supported countless founders of enterprises seeking to raise capital to develop their businesses, from mining explorers and emerging life sciences companies to financial services firms and technology startups. Regardless of sector, all founders share the same enthusiasm for solving problems and growing their businesses. ASX takes great pride in offering founders the chance to raise growth capital on the public market, an avenue that is not always open to emerging companies elsewhere across the globe.

THE LUCKY COUNTRY

Australia punches well above its weight on many fronts globally, including capital markets. ASX is one of the world's most active capital markets, particularly when measured by the number of initial public offerings (IPOs), averaging more than 100 annually over the past five years. (Figure 1 shows the number of IPOs and value of capital raised.) Over the past five years, companies have successfully raised over A$50 billion in IPO capital, and over A$180 billion in follow-on capital (shown in Figure 2) via ASX.

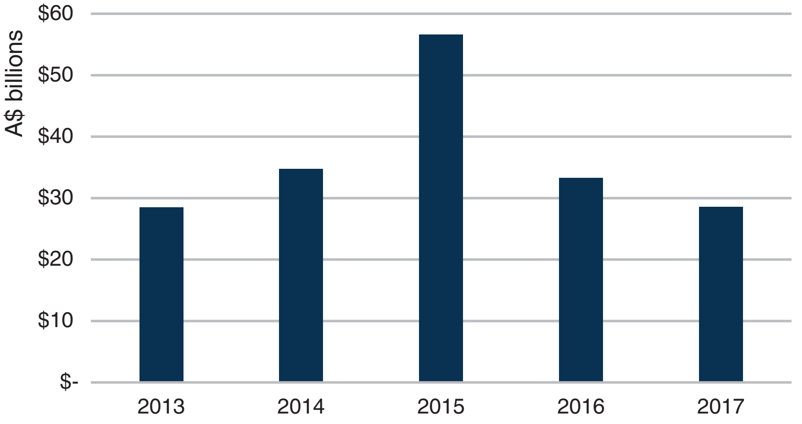
Australia also has one of the world's deepest pools of investable funds (courtesy of its compulsory superannuation system), with over A$2 trillion in deployable funds—the largest in Asia and roughly the same size as the combined market capitalisations of the 2,200 companies listed on ASX. (Figure 3 shows the investable fund assets globally as of December 2016.) These funds are forecast to grow to over A$10 trillion by the mid-2030s and represent capital that needs to find a home.

FIGURE 1. ASX initial public offering activity, 2013–2017



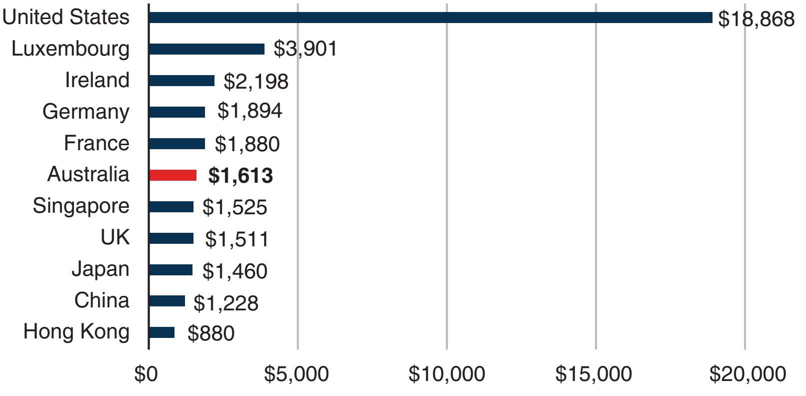
Source: ASX internal data

FIGURE 2. ASX follow-on capital raised, CY 2013–2017



Source: ASX internal data

FIGURE 3. Investment fund assets, US$ billion, December 2016



Source: Investment Company Institute, Austrade, Q4, 2016

ASX is very well connected to global markets and investors, with over 120 market participants from around the world trading on the exchange, turning over roughly A$6 billion of equities daily. Approximately 45 percent of the top 200 ASX stocks are owned by foreign investors—well-known institutional names found in any major hub across the globe.

ASX is also a highly liquid market and has positively trending trading activity. Across all 2,200 listed companies, trading velocity sits at 86 percent—meaning that 86 percent of the total market capitalisation of the exchange is traded annually, and dollar value trading volumes have increased nearly 20 percent over the past four years.

A PLATFORM FOR TECH DISRUPTORS

ASX has been successful at attracting emerging technology companies to list and raise capital over the past few years, with just under 80 technology companies listing on the exchange from 2014 to 2017, raising $A4 billion in the process. In 2015 and again in 2016, ASX ranked ahead of Nasdaq by number of technology listings. From 2014 to 2017, ASX has grown from 140 to 220 listed technology companies (shown in Figure 4). This number excludes 'technology' companies in the media and telecommunications sectors which, if included, would put the peer group at well over 300 companies, or around 15 percent of the total listed on the exchange.

Several factors have contributed to the recent growth of the ASX technology sector and will be described in the following sections.

STRONG PEER GROUP

High-profile listings both from Australia and overseas have helped to attract global investor interest, coupled with the downturn in the mining boom, which has released some higher-risk capital seeking growth opportunities in other industry sectors.

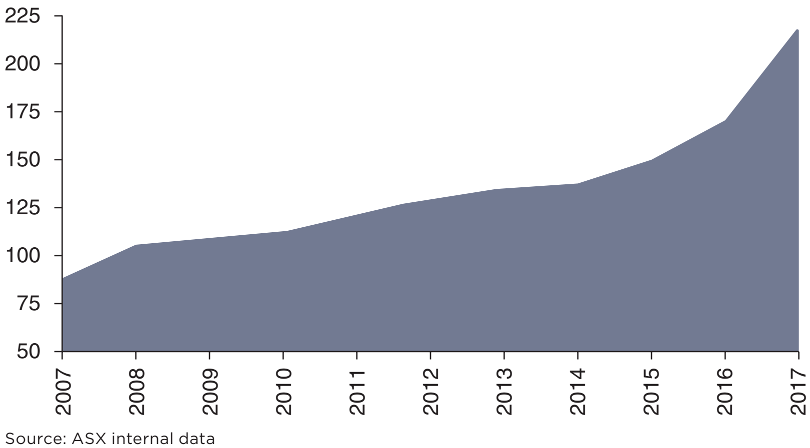
RAPIDLY GROWING SECTOR

The technology sector itself has been maturing, with lower costs, shorter development cycles and rapidly scaling business models, which has resulted in a greater number of tech companies seeking to raise capital. ASX was traditionally seen as a key listing venue for online marketplaces. However, this has evolved to include firms in other subsectors, such as Software as a Service (SaaS), fintech, and artificial intelligence.

GLOBALLY RECOGNISED EXCHANGE FOR EARLY-STAGE GROWTH COMPANIES

ASX has attracted international companies to list and raise capital in Australia. Being a globally

FIGURE 4. Total number of ASX-listed technology companies



Source: ASX internal data

recognised market that supports early-stage growth companies on a single main board has appeal to both foreign companies and investors, with now over 40 foreign technology companies calling ASX home. These companies can broadly be grouped into two categories: (1) those from large home markets that are too small for their domestic exchanges and seek an ASX listing as an alternative to another round of venture capital or private equity investment, or (2) those from a small home market with limited access to capital, peer groups or market depth, who come to ASX to resolve some of the challenges they face at home in attracting capital.

ASX continues to promote itself and the Australian market as a listing and capital-raising venue for both domestic and international technology companies, and it expects the growth in the sector to continue and expand to a wider variety of sub-sectors and geographies.

WHY ASX?

In today's connected world, capital flows relatively freely across borders, presenting founders with a wide choice of potential funding options. ASX differentiates itself in many ways.

A LONG HISTORY OF FUNDING AND LISTING EARLY-STAGE GROWTH COMPANIES

Australia is known for its abundance of natural resources, and junior explorers have been utilising ASX for more than 100 years to fund themselves to grow from explorers to producers, with investors prepared to support companies throughout their growth phases. More recently, the life sciences sector (where Australia has world-class research and development facilities) and the emerging ASX tech sector have also attracted support from early-stage investors.

MAIN BOARD LISTING

ASX is a single, main board listing venue only. This factor has many benefits, including connectivity to 100 percent of the market, a single set of rules for all listed companies and the ability to grow on the one exchange without having to move from one board to another.

Many peer exchanges have junior boards, which often have lower levels of governance and disclosure and limited connectivity to the full spectrum of investors (because investment mandates may exclude junior boards). Generally, they have lower liquidity and depth than the main board.

ROBUST REGULATORY ENVIRONMENT

ASX operates in a very robust regulatory environment and has high standards of continuous disclosure and corporate governance that are crucial to maintaining investor confidence. For example, in corporate governance, ASX has adopted a principle-based rather than a prescriptive-based approach (i.e., an 'if not, why not' disclosure regime). This approach gives all companies (including emerging companies) the flexibility to adopt and report the practices that best fit their circumstances, and in a way that gives investors the transparency to make informed investment decisions.

A DIVERSE, VIBRANT MARKET

Although ASX has traditionally been strong in financials and resources, which remain important, and core sectors, in recent times it has become an increasingly diverse and international market. ASX has experienced significant growth in technology and health-care listings, and it has successfully attracted many international listings from markets such as New Zealand, Singapore, Israel, Ireland and the United States.

A core focus of ASX is to grow these segments to give investors international exposure and a more diversified menu of companies.

EARLY ACCESS TO BENCHMARK INDICES

Companies can enter the Australian benchmark Standard & Poor's (S&P) indices at a far lower market cap compared to other global exchanges. For example, the S&P/ASX 300 index offers entry from approximately

US$260 million (shown in Figure 5), whereas other major exchanges offer entry into their main indices at valuations in the multiple billions of dollars. This path enables companies to attract mandated, institutional investment at an earlier stage via ASX than on other global exchanges, building a share register of globally recognised names much sooner.

STAND OUT IN A CROWD

ASX is a very active market, particularly for small and mid-cap companies. Those companies that might slip 'under the radar' in their home markets or on larger exchanges will find they can more easily stand out and attract the attention of investors on ASX, be they retail, high-net-worth (HNW), family offices or specialist institutional investors.

For example, it is often very challenging for companies with valuations less than US$1 billion to gain attention and traction in the U.S. public markets, so an ASX listing may be an alternative to a further private round of funding.

SPRINGBOARD TO ASIA

Australia is positioned in the world's fastest-growing region, which makes ASX an attractive proposition for companies looking to establish operations or market in Asia. Australia is a geopolitically stable country with a well-educated workforce that is in the right time zone and close to Asian markets.

WHEN SHOULD YOU LIST YOUR COMPANY?

Capital markets are not an exact science, and no easy, one-size-fits-all approach determines when a company should list. Although ASX offers early-stage companies the ability to list and raise capital in the public markets, companies should be aware that they need to be sufficiently developed to attract investors—not just to the IPO, but on an ongoing basis.

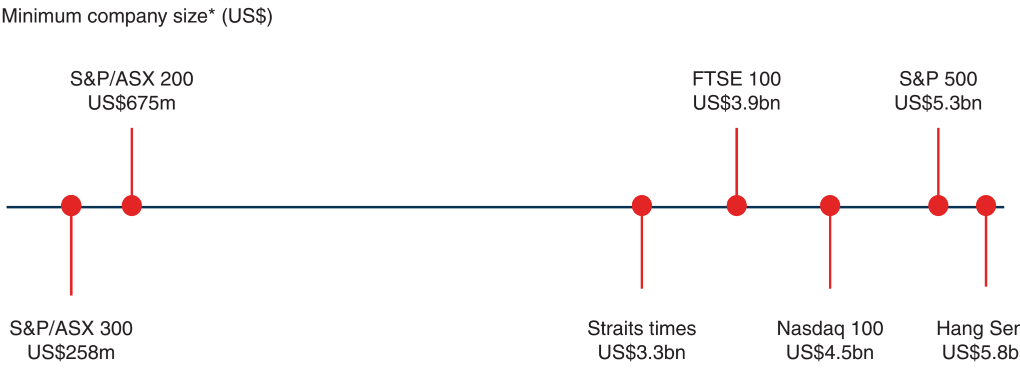
Founders also need to weigh up the pros and cons of life as a public company. Some of the benefits include those shown in Figure 6.

Other factors (Figure 7) should also be considered:

The following items should not be viewed as anchor points, and every company and sector is different, but as a general guide to a successful float, these principles apply:

- Technology companies should be generating revenue, and have good year-on-year top-line growth.
- Pharmaceutical or biotechnology companies should have achieved proof of concept for the lead asset and be in Phase II trials or later. Medical device companies should have undertaken pilot human clinical studies and have a clear pathway to regulatory approval.

FIGURE 5. Relatively early-stage access to key indices versus global peers



*Indicative values based on eligibility criteria or inclusions as at last rebalance: Exchange rates as at 31st August 2017.

FIGURE 6. Pros and cons of life as a public company

Source: ASX internal data

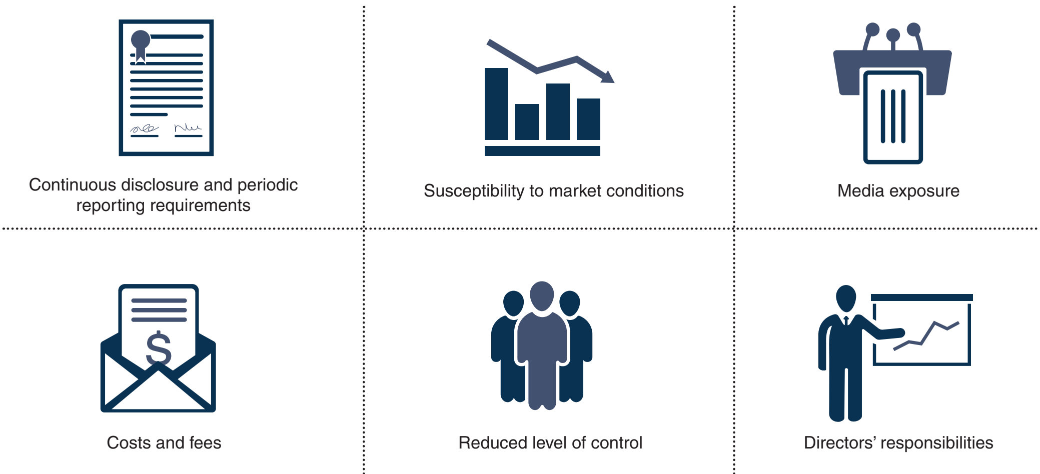
At the time of publication, a capital raising in the region of A$10–20 million would be considered a good entry-level raise on ASX. Depending on the sector, companies that are looking to raise smaller amounts will often turn to the pre-IPO market to fund themselves until they are of scale to achieve a successful public listing.

In reality, the decision of when a company is in the right stage of its life cycle to IPO should be determined in close association with quality advisors.

When marketing a company, some factors investors generally consider are:

- unique competitive advantage that is not easily replicable
- global growth prospects in an attractive market segment
- strong management and board
- track record of delivering on milestones
- ability to articulate the benefits of what the investment opportunity offers.

FIGURE 7. Other factors to consider for life as a public company



Source: ASX internal data

ASX encourages all companies considering public markets to engage the ASX Listings Team and have a conversation regarding the company, its prospects and the listings process. ASX, by virtue of sitting at the heart of Australia's financial markets, can help emerging companies navigate the process and offer introductions to reputable service providers that can assist in the IPO journey.

It is never too early to have a conversation with ASX, and it is both encouraged and welcomed for founders to do so and establish a relationship with the exchange.

YOUR JOURNEY AS A LISTED COMPANY BEGINS

Although an IPO is an incredible milestone for any founder and company, for many, particularly early-stage growth companies, it is the start of another journey and a key fundraising event.

Often, an ASX listing results in increased credibility with employees, clients and suppliers due to the ongoing disclosure obligations, improved corporate governance standards and being in the company of 2,200 other ASX-listed peers.

ASX runs a series of programs designed to connect listed entities with investors to improve investor relations, facilitate market liquidity and improve access to capital to help its listed companies maximise the benefits of a public listing. These programs are described briefly in the next sections.

ASX EQUITY RESEARCH SCHEME

ASX runs an annual program subsidising the cost of equity research for eligible companies. The aim is to support the production of high-quality, independent research for ASX-listed companies that are not already receiving coverage—often small and emerging mid-cap companies.

ASX CEO CONNECT

This program is a nationwide monthly event targeted at the large retail self-managed super fund community. It allows company management to present an overview of their business to an important sector of the Australian investment community.

ASX INTERNATIONAL CONFERENCES

This program presents a series of ASX-led international roadshows showcasing ASX-listed companies to international investors, followed by one-on-one meetings between companies and investors in each city.

MARKET ANALYTICS

ASX offers a range of company trading data via its online platform that shows various metrics, such as broker activity, ownership and volume analytics. Using this data allows companies to better understand their register, analyse trading trends and effectively communicate and engage with their investor base.

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SETTING SAIL ON YOUR IPO JOURNEY

KPMG

Cecily Conroy, *Head of Equity Capital Markets, Australia*

Going public is a huge decision for any company. It is a complex, costly and time-consuming process that places enormous demands on a company and its management team. There are many advisors to manage, meetings to attend and tasks to complete, frequently under significant time pressure. Management will be heavily involved in preparing the business for the initial public offering (IPO), yet will also need to maintain focus on the day-to-day operations and continue to deliver on the growth strategy.

REALISE THE IMPORTANCE OF EARLY PLANNING

In addition to facing the challenges just mentioned, making the transition from a private company to a publicly listed company is also likely to result in significant changes to how your business operates.

The effort can be worth it. An IPO can prove transformative, giving you access to a deep pool of capital to propel your business forward. The company will also have been placed under a microscope, giving you an opportunity to critically examine your business.

In this regard, early planning and preparation are key to achieving a successful IPO and a smooth transition to being a listed company.

KNOW YOUR OBJECTIVES FOR LISTING

A company may pursue an IPO for many reasons. Before commencing formal IPO preparations, identify your objectives for the IPO and ensure that they are reflected in your IPO strategy.

Ask yourself the following questions:

- *What are your main reasons for listing?* For example, if a main reason is to enhance the profile of the business, how will your IPO strategy help you to achieve this?
- *How much money will be raised at IPO?* Will the proceeds be used by the company or be distributed to existing shareholders, or will you use a combination of both? How will the company deploy the proceeds, and does this tie into your equity story?
- *When is the optimal time to become a listed company?* Also consider the prevailing equity market conditions and investor sentiment towards listed companies in your sector.
- *Have any other companies in your sector or with similar businesses floated?* How did they fare? Can you learn anything from their processes?

APPLY A CAPITAL MARKET LENS

It is important to look at your company through an equity capital market lens. In other words, apply the same level of scrutiny that the investment community (e.g., public market investors, research analysts, investment banks or brokers) will apply to your business while preparing for an IPO and once your company becomes a publicly listed company.

It can be helpful to meet with one or two friendly institutional investors to hear their thoughts and perspectives on your business. You should be well prepared before meeting with any investors. Avoid disclosing any specific financial information and do not leave behind any presentation materials on your business.

Ask yourself:

- *What is your equity story?* Will your business appeal to public market investors? Are there any themes that might concern investors and, if so, how can these be mitigated?
- *What are the key drivers of value?* How will the company be positioned relative to other listed comparable companies, and how can you positively differentiate it?
- *How will you give investors confidence in your ability to deliver on the growth strategy?* What key performance indicators (KPIs) will demonstrate positive momentum in the business in the lead-up to the IPO? Can these KPIs be made available to the market on a regular basis once the company is listed?
- *How will the strategic decisions you make today shape your ability to list in the future?*
- *How will you engage with the investment community before commencing formal IPO preparations?* Determine how early, with whom and what should or should not be said.

START PREPARING THE BUSINESS FOR LIFE AS A LISTED COMPANY

You should evaluate your company's readiness to commence formal IPO preparations and its ability to meet the obligations of being a listed company. Management and the company could benefit from operating with a listed company mind-set well before actually going public.

Ask yourself:

- *What changes are required to be ready to list?* Identify the items that may take a longer time to complete, such as corporate restructuring, presentation and audit of historical financials, board and management changes, governance, systems and controls.
- *Does management have the time to prepare for an IPO and continue to successfully manage the company?* The period in the lead-up to the IPO is certainly not the time for management to take its eye off the ball.
- *Have you identified the 'red flag' items that could delay your IPO timetable or affect value or investor demand?*
- *Are you tracking information (such as KPIs) that will support your equity story and give greater confidence to investors?*

You may discover early issues that need addressing before you can even start to think more deeply about an IPO.

APPOINT THE RIGHT TEAM OF ADVISORS

Companies often underestimate the effort and resources required to prepare for an IPO. An IPO requires a huge commitment from both the internal deal team as well as the external advisory team—both of whom need to work closely together. Choose an experienced team of advisors to help your company prepare for an IPO, and have a strong start to life as a listed company. Appointing the right team of advisors (in particular, selecting the right lead manager) can have a direct bearing on the success of your IPO.

Ask yourself:

- What advisors do you need to appoint to help you prepare for an IPO?
- Who is best positioned to advise your company?

- When and how should you appoint your advisors?

ADDRESS OTHER CONSIDERATIONS

Two fundamental success factors are commonly highlighted by companies who have been through the IPO process. These are:

- dedicating time to developing your equity story early on
- appointing the right lead manager to market your IPO to investors.

Many challenges and complexities are involved in each of these areas, so we will dive into each area in more detail in the next sections.

DEVELOP YOUR EQUITY STORY

Why is it important?

An *equity story* is your rationale for why investors should buy shares in your company. Some people call it an 'investment thesis', others a 'sales pitch'.

You must develop a clear, differentiated and accurate equity story that makes a compelling case for why investors should back your company (Figure 1).

Importantly, to achieve a successful IPO, your equity story must appeal to public market investors. If you have previously raised private capital from angel investors, venture capital firms or other private investors, you may need to refine your equity story to draw out the investment attributes sought by public market investors.

A strong equity story drives investor engagement and demand and will also influence an investor's perception around the positioning of your company relative to listed peers. It is critical in maximising value, achieving a quality shareholder register and ensuring a healthy aftermarket. It is important to consider management's ability to present that equity story credibly. It may be that management needs to rehearse or even change some members of the management team so that they are suitable for the public market.

FIGURE 1. Common characteristics of a strong equity story

Your equity story needs to be:

- *Clear:* Make it easy for investors to understand your business model and what is driving growth.
- *Compelling:* Remember, this is a sales pitch. Spell out why your business is an attractive investment opportunity.
- *Differentiated:* Articulate how you stand out from your listed peers.
- *Convincing:* Back up your story with evidence of substance. Use financial data, nonfinancial key performance indicators and credible industry data.
- *Accurate:* Do not try to 'borrow' attributes from other companies that do not fit your business model. You will need to deliver on your story once listed.
- *Delivered with conviction:* Avoid last-minute changes. Retain control of your equity story and convey it to investors with confidence and conviction.
- *Believable:* It is very tempting to try and 'big up' your story for the IPO. Resist this temptation because promising too much before IPO can lead to problems delivering on that promise when the first set of results come along. That letdown is difficult to recover from.

The equity story itself will evolve throughout the IPO process and is the blueprint for key IPO documents. It underpins the lead manager's preliminary IPO valuation, the presentation for research analysts and institutional investors, and your prospectus. It will form the basis of certain due diligence enquiries from banks, lawyers and accountants. Ultimately, your equity story will determine whether an investor participates in your IPO. Developing your equity story is therefore one of the most important workstreams in your IPO process and requires an early focus from management.

Where should you start?

Start preparing your equity story very early in your IPO preparations, and certainly well in advance of appointing a lead manager.

Gather your business plan, corporate strategy, board papers, marketing materials, KPIs, research and development program and other key internal documents relevant to your strategy and company's track record. Reflect on where you have come from as a business, and where you are going.

Identify the key value drivers of your business and any potential weaknesses or risks that may affect valuation or investor appeal for your IPO. Be sure to do the following:

- *Articulate your key achievements and the positive attributes of your business model.* For example, you may be a disruptive player or be using proprietary technology.
- *Consider your positioning.* Investors will compare your business to other similar companies listed on both domestic and potentially international stock markets, so it is important that you positively differentiate your business; make a strong case for why they should invest in it.
- *Look carefully at your financials, operations and growth prospects relative to your listed peers.*
- *Consider what financial and nonfinancial information you can provide investors to support your equity story and give greater confidence to investors.*

Create a first draft with the key ingredients

Common areas of focus for an equity story include the following:

- *Company platform and maturity:* What is your business model and strategy? Is it unique, and is there a demonstrated demand for your product/service offering? What has been achieved so far? What are the attractive attributes of your business model (e.g., disruptive player, high barriers to entry, market leader or proprietary technology)? How mature is your business model (i.e., do you have clear proof of concept, visibility of revenue and predictability of earnings potential)? Is there a reasonable operating history? Does the business have good systems and governance in place?
- *Addressable market and opportunity:* What is the size of the addressable market? Are credible industry data available that can be used to educate investors? What is your market share and competitive positioning? Can you maintain your competitive advantage as you grow? What is the geographic reach?
- *Financial and operational profile:* What is your revenue and earnings track record? What are your margins, and how will they change as your company grows? Do you have a track record of delivering growth? Is this growth sustainable in the medium term? What is your cash conversion? Are you profitable, or is there a clear path to profitability and improving operating leverage? Are your operating metrics (e.g., cost of customer acquisition, customer numbers and churn) improving? Do you have a sticky customer base?
- *Future growth prospects:* What are your key pillars of growth? Is your growth trajectory sustainable? Will future growth be organic or acquisition-led? How will you continue to grow your margins? How do you plan to

capitalise on your existing position, cross-sell to existing customers, enter adjacent markets/geographies, etc.? How will you use your IPO proceeds?

- *Management capability:* What is the background and experience of your management team? Do they have a proven track record in management and leadership?

Articulate your story to investors

The chief executive officer and chief financial officer must be able to convey the company's story to investors during roadshow meetings with genuine confidence and conviction because investors are ultimately backing the management team to deliver on the company's growth strategy. Management's ability to do so will have a direct bearing on demand and valuation.

Poor planning can result in an equity story changing at the eleventh hour before launching the IPO. This situation could undermine management's ability to deliver the story with conviction and may result in investors misunderstanding the business model or value proposition or lead to inconsistency in how investors value the company.

Update your website and other marketing materials

One of the first things a potential investor will do is look at your website. As you craft your equity story, also consider updating your website and other marketing materials to reflect it, to ensure you are putting out a consistent message. Be sure to do this well before commencing formal IPO preparations.

APPOINT YOUR LEAD MANAGER

Appointing the right lead manager is key to achieving a successful listing and your start to life as a publicly listed company (Figure 2). The lead manager role is performed by an investment bank or broker who will be responsible for managing the offering and marketing your IPO to investors. The number of banks appointed will vary depending on the amount of equity to be raised at IPO.

Understand the appointment process

It is common in Australia for a company to select a lead manager following a competitive appointment process, also known as a 'beauty parade'. This task would usually involve a company identifying a shortlist of suitable banks and inviting them to submit a written proposal that outlines their credentials, views on the IPO and fees. Each bank is subsequently invited to 'pitch' or present their views to the company's executive team and shareholders. A competitive process can provide a company with the opportunity to hear from a range of different banks and consider the personal fit with their internal deal team. It also gives the company the ability to compare the capability of each bank on a consistent and transparent basis.

In certain circumstances, it may be advantageous to avoid a broad process (which could leak into the media) and instead run a hybrid appointment process. For instance, the company may have previously met with several banks and understands the capabilities of each bank, one or two banks may be standouts or confidentiality is critical to the company. An independent financial advisor can also assist with bank negotiations to deliver competitive tension outside of a formal competitive process.

Make first impressions count

The appointment of a lead manager is usually a 'two-way' process. That is, while the company is considering which bank to appoint, each bank is also determining whether to accept the lead manager role. First impressions therefore count! The company's executive management and shareholders should consider how to succinctly communicate the company's equity story as well as the rationale for listing well before meeting with the banks.

As part of the appointment process, the company will also need to provide the banks with an overview of the business, explain the strategy and growth prospects, provide

FIGURE 2. What to consider when selecting a lead manager

The criteria for selecting a lead manager will vary for each company. However, some of the common considerations include the following:

- quality and experience of the individual team members and senior-level commitment; rapport with the company and strength of existing relationships
- track record, relevant credentials and distribution capability (both institutional and retail)
- sector expertise, understanding of the business and how best to present the equity story to investors, approach to valuation and positioning
- depth of existing research coverage universe in your sector as well as knowledge and credibility of research analysts (e.g., rankings)
- proposed fees and engagement terms
- ability to support the company and, if relevant, facilitate an exit for the major shareholders once listed.

If the company is appointing more than one bank, it is important to ensure that each bank brings complementary strengths to your IPO process. For instance, one bank may have excellent sector expertise whereas another may have a stronger distribution platform.

certain financial information and demonstrate the strength of the management team. This information will form the basis of their indicative valuation and preliminary recommendations in relation to the IPO. As with any third party, you should carefully consider what confidential company information you share and with whom you share it.

Maximise your negotiating leverage

A company's leverage to negotiate favourable terms with the banks is highest ahead of formal appointment. It is often beneficial to agree as much as possible with the banks before you confirm their appointment, either verbally or in writing.

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ASX: A LEADING EQUITIES MARKET FOR TECH COMPANIES

DLA PIPER AUSTRALIA

David Ryan, *Partner*

James Philips, *Consultant*

Over the past four fiscal years, technology has ranked as the leading industry sector by number of listings on the Australian Securities Exchange (ASX), with a total of 217 tech companies listed on the ASX in 2017, with a market capitalisation of A$60 billion. The ASX introduces companies to a pool of investors with a long history of supporting early-stage companies, particularly in the tech, mining and biotech sectors. ASX is also attracting a growing number of cross-border listings—showing a total of 270 in 2017.

Tech and early-stage companies should be aware of some of the key issues facing a tech or early-stage growth company seeking to list on the ASX.

GENERAL DISCLOSURE STANDARD

In order to be able to offer securities to Australian investors, the company will need to prepare a prospectus that complies with the *Australian Corporations Act 2001* (Cth) (Corporations Act).

The Corporations Act sets out a general test that governs the level of disclosure required in a prospectus. In short, the prospectus must include all the information that investors and their professional advisors would reasonably require to make an informed assessment of the assets and liabilities, financial position and performance, profits and losses and prospects of the company.

In the words of the Explanatory Memorandum to the legislation that sets out this requirement, the former disclosure requirement was:

> *'… replaced by much more basic disclosure rules and a general requirement that the prospectus contain a fair and accurate presentation of all information relevant to a decision by an investor to invest in the offering … The amendments aim to provide investors with the information they require to make an informed investment decision …'*

Australian prospectuses usually contain information on:

- offer details
- the offering company's (Company) business model
- risks in buying or holding the securities offered
- financial information on the financial position, performance and prospects of their Company
- related party disclosures
- a summary of material contracts.

INFORMATION SPECIFIC TO EARLY-STAGE AND TECH COMPANIES INCLUDED IN THE PROSPECTUS

RISKS APPLICABLE TO EARLY-STAGE OR GROWTH COMPANIES

Disclosed risks specific to early-stage or growth companies might typically include risks such as:

- limited trading history
- management of future growth
- future funding requirements
- contracts with IT service providers that are heavily favourable to the service provider
- intellectual property ownership and data security risks.

FINANCIAL INFORMATION MAY BE OF LIMITED USE TO INVESTORS

Many early-stage companies undergo a growth phase and incur operating losses up to the date of the prospectus as a result of reinvesting money to develop and expand their product offerings, platforms or services. As a result, historical financial information included in the prospectus may be of little value to investors and may involve disclosing accumulated losses or deficits for the latest financial years. Instead, early-stage and tech companies typically focus in their prospectus on growth and how the company intends to generate further revenue.

As early-stage and tech companies generally undertake a rapid growth phase at and prior to the time of listing, it is often difficult for the company to form a reasonable basis on which they can provide financial forecasts to investors in the prospectus or otherwise. This is often balanced with the desire (particularly of the lead manager to the IPO) to provide financial forecasts for valuation purposes. Early-stage and tech companies that have been or continue to be in a growth phase around listing typically do not include financial forecasts in their prospectus.

ADDITIONAL FUNDING

Given the rapid stages of growth of early-stage growth companies at or in the lead-up to the IPO, the offer proceeds raised under the IPO will often only cover the short-term business objectives of the Company. As a result, the Company will be required to disclose in the prospectus any expectation it has that further funding (by debt or equity) will be required to further accelerate growth or fund its growth plans moving forward.

REAL ISSUES FOR TECH COMPANIES IN SEEKING TO LIST ON THE ASX

A company seeking to list on the ASX will need to satisfy the admission requirements under the ASX's Listing Rules. Tech or early-stage companies seeking to list on the ASX, particularly if they are a foreign company, may not be aware of some of the requirements that it will need to satisfy to obtain an ASX listing. Some of the key requirements applicable to tech and early-stage companies are set out below:

STRUCTURE AND OPERATIONS MUST BE APPROPRIATE FOR A LISTED ENTITY

ASX may exercise its discretion to refuse admission of an entity to the official list of the ASX on various grounds, including that the entity does not have structure and operations appropriate for a listed entity. ASX may raise concerns if the entity is too early in its life cycle for listing on the ASX or where the entity's proposed business is little more than a concept or idea. If there are any doubts as to the entity's suitability for listing on the ASX, the entity should (together with its legal advisors) liaise with ASX early on in the process and submit an application for in-principle advice from the ASX, requesting confirmation that the ASX does not have any concerns about the entity's suitability for listing. Seeking this confirmation early in the process may save the entity much time and money if, towards the end of the listing process, ASX determines that it would be likely to refuse admission.

ASX MANDATORY ESCROW

As early-stage and tech companies seeking to list are still likely to be in a growth phase and incurring operating losses, it is likely that a company will be required to apply under the 'assets test' under the ASX Listing Rules rather than the profits test. This means that the Company's existing securities will be subject to mandatory escrow restrictions under the ASX Listing Rules, unless it can show that it has a track record of profitability or revenue acceptable to the ASX. It is a condition to listing that the existing shareholders subject to these mandatory escrow restrictions enter into mandatory restriction agreements with the ASX. As such, companies should identify any problem shareholders as soon as possible in the listing process to identify whether any such shareholders will be subject to ASX mandatory escrow and, therefore, have the ability to impede the IPO if they did not sign an ASX mandatory escrow agreement.

INTELLECTUAL PROPERTY OWNERSHIP

Tech companies should get their intellectual property ownership in order prior to listing. This may require some form of restructuring so that the group's intellectual property is held in a separate entity to the operating company to ring-fence the intellectual property from any claims made against the operating company. Also, the Company should conduct due diligence on its past and present employment agreements and contracting arrangements to ensure that any intellectual property created by employees or contractors in the course of their employment or engagement automatically vests with the Company. If this is not the case, the Company will need to seek from the relevant employee or contractor an assignment of any intellectual property arising from that person's employment or engagement with the Company.

THE CHOICE OF JURISDICTION OF FLOATCO

Foreign companies seeking to list will be faced with various factors in determining whether to list on their home exchange or the ASX. These factors include cost, time, ongoing regulatory requirements, whether or not the Company operates any business in Australia, threshold requirements of the local stock exchange that need to be met before the Company will be listed and various commercial and economic reasons.

A foreign company seeking to list on the ASX may directly list a foreign company on the ASX by way of CHESS Depositary Interests or may choose to incorporate a new Australian top company that will list its ordinary shares on the ASX.

Whether an offshore company chooses to incorporate an Australian topco or directly list the foreign company on the ASX will usually depend on whether the company operates any business in Australia and any tax considerations, given that the Australian entity will attract the Australian tax regime. For U.S. companies, this might also turn on whether the company has future plans to migrate to or dual list on the Nasdaq. If this is the case, it is advisable to list the foreign U.S. company on the ASX, which will obviously assist with the Nasdaq listing process in the future.

ASX has flagged that if a listing entity is incorporated, or has its main operations, in a developing or emerging market (such as China, India, Indonesia and Malaysia, to name but a few) or its operations are of concern to ASX, the listing entity may be required to undergo an initial approval process before the formal listing process. ASX has the discretion to impose certain conditions on such entities, such as the inclusion of takeover provisions in a company's constitution, where the laws of the company's home jurisdiction do not have a sufficient takeover regime.

SOME SUCCESSFUL CASE STUDIES

CREDIBLE LABS, INC.

Credible Labs, Inc. was the biggest tech listing on the ASX in 2017 with a market capitalisation on listing of approximately A$306 million. Credible is a U.S. company based in San Francisco that operates an online student loan marketplace and has developed its own proprietary technology platform that is integrated with credit bureaus and financial institutions.

UPDATER, INC.

Updater is a New York-based company founded in 2010 to reimagine the relocation experience for movers. Updater offers centralised services for updating movers' accounts and records, forwarding mail and organising and completing various relation logistics. Updater's vision is to turn a formerly painful and disjointed process into a helpful, efficient and enjoyable experience for movers.

Updater listed on the ASX in December 2015 and has a market capitalisation of around A$530 million with its shares (trading as ASX depository receipts known as CDIs) currently trading at over five times the IPO issue price.

DLA Piper acted as Australian legal advisor in the IPOs of both Credible Labs, Inc. and Updater, Inc. With DLA Piper's experience in advising on multi-jurisdictional matters and in particular its deep understanding of the issues facing U.S. technology companies listing on the ASX, DLA was well placed to assist both companies with their successful listings on the ASX.

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CORPORATE GOVERNANCE IN ADVANCE OF AN IPO

BOARDROOM

Tharun Kuppanda, *Company Secretary*

Tom Bloomfield, *General Manager, Corporate Secretarial Services*

This chapter addresses a common mistake made during the initial public offering (IPO) process: corporate governance as an afterthought. Corporate governance plays a key role in preventing corporate crimes, adding shareholder value, ensuring financial health and assisting in long-term sustainable growth. This chapter includes (1) a comparison of Australia's corporate governance regimes to similar corporate governance regimes in the U.S. and the U.K.; (2) a case study on the cost of poor corporate governance based on lessons from the collapse of HIH Insurance Group (HIH); (3) the importance of a robust corporate governance regime in advance of an IPO; and (4) what companies listing in Australia should consider when implementing their corporate governance systems.

OVERVIEW

At a recent Governance Institute of Australia event hosted by the Australian Securities Exchange (ASX), Kevin Lewis, group executive and chief compliance officer of ASX Limited, remarked how 'governance failures typically result in financial failures'. He was referring to the importance of corporate governance and learning from past failures, such as the collapse of HIH Insurance Group. (His speech, 'My Governance Journey', was delivered at the Governance Institute of Australia New South Wales Graduation Ceremony, ASX Exchange Square, 22 November 2017.)

The Royal Commissioner Justice Neville Owen's examination surrounding the failure of HIH was instrumental in shaping corporate governance in modern Australia. Owen described 'corporate governance' as 'the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account' (HIH Royal Commission, in *The Failure of HIH Insurance, Volume 1: A Corporate Collapse and Its Lessons.* Canberra: Commonwealth of Australia, April 2003, p. xxxiv).

In Australia and other common law countries, it is a widely recognised principle that a director owes a fiduciary duty to the company and must act honestly, in good faith and to the best of his or her ability in the interests of the company, according to s180-183 of the *Corporations Act 2001* (Cth).

Shareholders have a role to play in ensuring appropriate governance structures are in place. Shareholders are tasked with the appointment and removal of Directors and Auditors, as well as holding those appointed to account at mandated annual shareholder meetings. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put decisions into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meetings.

A poorly governed company is unlikely to benefit shareholders over the longer term. This result occurs regardless of initial growth, early strong share prices or even excellent products. Countless world experiences, including the Enron and WorldCom collapses in the U.S., and the subprime mortgage crisis, continue to demonstrate this idea. These parallel experiences reiterate that without defined and exercised internal controls backed by external checks, companies and their investors are vulnerable to potential error, negligence, malfeasance and fraud.

The best time for establishing strong corporate governance frameworks is as early as possible. The company secretary should be tasked with ensuring that the board continues to meet its corporate governance obligations and establishing a process or framework to ensure its governance obligations are met.

In our experience, nowhere is this notion more relevant than in advance of IPO. When setting out to be a listed Australian Company, implementing corporate governance is one critical step towards setting up the organisational culture, process and practices for ensuring shareholders enjoy long-term sustainable growth. The first step of that process is establishing the company secretariat.

OVERSEAS EXPERIENCE

Organisations with the greatest propensity to affect the most people can also be the most difficult to govern. However, an expectation has arisen from employees, investors and the market that these entities be regulated.

The foundation of modern corporate governance principles can be found in *Financial Aspects of Corporate Governance* (1992), a report issued by the Committee on the Financial Aspects of Corporate Governance (the Cadbury Report). This report gave rise to the Organisation for Economic Co-operation and Development *Principles of Corporate Governance,* 2004 (OECD Principles). The OECD Principles was the first formal attempt to stamp out and prevent bad corporate behaviour.

Although compliance with their principles is still voluntary, the Cadbury Report and the OECD Principles are guides on 'best practice' for companies with respect to their targets around corporate governance. The principles can and are applied as a marking scale by analysts, regulators and countless investors when considering an entity's corporate governance health.

The London Stock Exchange requires disclosure on compliance with the implementation of the U.K. Corporate Governance Code. The Code largely mirrors the recommendations in the Cadbury Report.

Similar developments occurred in the U.S. The Public Company Accounting Reform and Investor Protection Act of 2002 (commonly known as Sarbanes-Oxley) legislated some of the recommendations of the Cadbury Report. A significant change is the requirement for the chief executive officer (CEO) and chief financial officer, or persons who perform that function, to provide a personal sign-off to the Securities and Exchange Commission. This approach acts as a formal recognition of management's role in practicing good corporate governance and a reminder to directors of the need to ensure external oversight as part of its corporate governance regime.

THE AUSTRALIAN EXPERIENCE: A CASE STUDY ON HIH INSURANCE

The above-mentioned overseas experience of the need for focus and controls on governance holds true for the Australian listed company environment. The HIH collapse provided a catalyst for major corporate governance changes in Australia and acts as a reminder of the importance of ensuring a strong corporate governance framework in advance of an IPO.

BACKGROUND

At the time of its collapse in March 2001, HIH was the largest corporate failure in Australian business history. The group debts were estimated at A$5.3 billion. The resulting Federal Government–initiated Royal Commission examined corporate governance above all else. Led by Justice Owen as the Royal Commissioner, the Commission was charged with investigating 'the extent to which actions of directors, employees, auditors, actuaries and advisors contributed to the HIH failure or involved undesirable corporate practices'.

CORPORATE GOVERNANCE FAILINGS

Modern corporate governance principles recommend a clear distinction between the role of the board and the role of the CEO. With HIH, there was no clear distinction. Furthermore, there were no apparent restrictions on the authority of the CEO.

Role of the board to ask questions and provide oversight

According to Gregor Allan, a striking testament to poor management at HIH was its chronic under-reserving of a provision for cash reserves to pay out future claims ('The HIH collapse: A costly catalyst for reform', *Deakin Law Review,* 11, no. 2, 2006, p. 137).

The composition of HIH's board when seen through the governance lens is self-destructive in this regard. The board of HIH set the payout provisions based on reports of independent actuaries and assessments of those reports by its auditor, Arthur Andersen (Andersen).

The board members failed to adequately consider the reports themselves and were found to have failed to ask questions of either the actuaries or the auditors on the contents of these critical reports. The ultimate finding was a distinct lack of due care and skill expected of a director of a general insurer (Allan, *Deakin Law Review,* p. 137).

Lack of independence

At the time, in Australia amongst the Standard & Poor's/ASX top 100 companies, independent non-executive directors comprised only 45.3% of boards by personnel.

HIH did not have a single independent non-executive director on its board. Furthermore, of the four non-executive directors, two were former partners of the company's auditors (Andersen), and the other two directors were involved in providing legal services to the group—creating a conflict of perceived interests.

Catalyst for change

The demise of HIH was one of several high-profile and dramatic failures around 2001. As a part of the Royal Commission, 61 policy recommendations were made to strengthen and reform Australia's system of corporate governance.

Consequently, reforms have been introduced to bolster principles of corporate governance (Allan, *Deakin Law Review,* p. 137). In Australia, these reforms were implemented via the passage of the Corporate Law Economic Reform Programme (Audit Reform and Corporate Disclosure) Act ('the CLERP Act') on 25 June 2004.

Following the footsteps of the Sarbanes-Oxley reforms, in Australia the CEO and chief financial officer of listed companies now must declare in each annual report that the financial records

- have been properly maintained
- comply with accounting standards
- 'give a true and fair view'.

Listed companies must also include details of directors' remuneration and performance targets. Shareholders must be allowed time to discuss these matters at shareholder meetings.

Furthermore, as far as normal reportable disclosures, Australian shareholders must receive 'such information as they would reasonably require' to make an informed assessment of

- the operations of the entity
- its financial position
- its business strategies
- prospects for future financial years.

In addition, whistle-blower protection laws were implemented and regulated to encourage employees to report suspected breaches of its company laws. Similarly, there are stricter rules for auditors to maintain their independence.

THE ROLE OF EFFECTIVE CORPORATE GOVERNANCE IN ADVANCE OF AN IPO

Although HIH remains a powerful example for highlighting the risks of a poor corporate governance environment, the report resulting from the investigation by Royal Commissioner Justice Owen also emphasised the interdependent relationship between corporate governance and company culture.

ORGANISATIONAL CULTURE

Many companies continue to act on the premise that corporate governance can be considered 'an afterthought'. Where there is opportunity for poor corporate behaviours or unethical practices to deliver profit and create reward, management or the board can succumb (examples include WorldCom, Enron, Bank of America and Merrill Lynch). According to Ronald Francis, 'with economic opportunities come criminal ones, as well as opportunities for unethical profit' (*Ethics and Corporate Governance,* 2000, p. 19).

Good corporate governance should be instilled from the onset, not after it is too late.

Organisational culture provides an important makeup of a company's ability to stay profitable, drive growth and achieve customer satisfaction. Poor governance can allow an undesirable culture to fester.

Uber provides an example of how a good business model and value can be undermined by poor corporate culture. Uber Technologies, Inc. fell foul when reports arose of a 'Hobbesian environment where workers are pitted against one another and where a blind eye is turned to infractions from top performers' (Mike Isaac, 'Inside Uber's Aggressive, Unrestrained Workplace Culture', *New York Times,* 22 February 2017). In addition to reputational damage, Uber lost members of its board, its CEO and senior staff. There can be a tangible cost to the business where a framework of good governance is lost. It was reported that Uber, which was valued at US$70 billion (A$91 billion), lost US$20 billion (A$26 billion) of that value because of the scandal (Isaac, *New York Times,* 22 February 2017).

In Australia, poor practices by the big banks and in related services they provide (insurance and financial advice businesses) created the political climate for the Australian government to impose an additional $6.2 billion in taxes (James Eyers, 'Budget 2017: Dismayed Bank CEOs Say Shock "Stealth Tax" May Weaken Banks', *Australian Financial Review,* 10 May 2017). This represented a tangible cost to poor corporate behaviour.

INVESTOR CONFIDENCE

Corporate governance sets a framework for a company's organisational behaviour (Eyers, 'Budget 2017'). This concept is important because of how much easier it is to establish a good organisational culture than to fix a bad culture.

A corporate governance framework also provides a ready yardstick for investors to assure themselves that appropriate systems and processes are in place for that entity, in its circumstances and market segment.

A 2014 poll was conducted by Global Proxy Solicitation and the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne. It asked 1,000 retail investors about the impact of corporate governance on company performance. An overwhelming proportion of investors (80 percent) stated that they sought a rating system to identify poorly governed companies and would stay away from companies if they were rated poorly (Kylar Loussikian, 'Investor confidence takes a tumble over corporate governance, volatility', *The Conversation,* 24 February 2014).

In Australia, a company's IPO prospectus is required to make disclosures about its corporate governance policies and practices. Disclosures form part of investors' decision matrix for investment.

In an increasingly competitive capital market, ensuring an appropriate framework for corporate governance in advance of an IPO can be crucial for encouraging investor confidence and securing funding commitments. In addition, corporate governance reporting is an annual obligation imposed by the ASX.

PRE-IPO CORPORATE GOVERNANCE CONSIDERATION

In Australia, with a company listing on the ASX, the main document to consider in setting a corporate governance framework is *Corporate Governance Principles and Recommendations* (third ed.), published by ASX Corporate Governance Council, 2014, and referred to as CGPR.

The principles contained in the CGPR are intended to:

- minimise conflicts of interest for decision makers
- ensure independent review of company actions and claims
- align company policies and procedures with applicable laws and regulations.

The company secretary is often tasked with managing a company's corporate governance framework. Engaging a qualified company secretary early in the pre-IPO stage is a tangible step towards ensuring that best practice is implemented well in advance of an IPO.

ASX CORPORATE GOVERNANCE PRINCIPLES

The CGPR guides listed entities on best practice; however, it is not a rule book. The ASX Corporate Governance Council recognises that there should not be a 'one-size-fits-all approach' given the various maturity stages of entities. Instead, the council has adopted what is referred to as an 'if not, why not,' approach to self-reporting.

This approach means that if a listed company does not abide by any of the principles or recommendations, then the listed entity must explain *why* it chose not to follow that principle. The ASX requires that this disclosure must be lodged at the same time as the company lodges its financial reports.

Companies considering an Australian IPO should be familiar with the CGPR to assist in decision making and understanding best practice. The CGPR can also be a tool for educating an entity and its officers about the risks associated with detracting from the CGPR.

The CGPR is structured around, and seeks to promote, the following eight central principles (CGPR, p. 3):

1. *Lay solid foundations for management and oversight:* A listed entity should establish and disclose the respective roles and responsibilities of its board and management and how their performance is monitored and evaluated.
2. *Structure the board to add value:* A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively.
3. *Act ethically and responsibly:* A listed entity should act ethically and responsibly.
4. *Safeguard integrity in corporate reporting:* A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting.
5. *Make timely and balanced disclosure:* A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.

6. *Respect the rights of security holders:* A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.
7. *Recognise and manage risk:* A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.
8. *Remunerate fairly and responsibly:* A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders.

OTHER CONSIDERATIONS

Because there is no 'one-size-fits-all' approach to governance in Australia, the onus remains on the entities in advance of an IPO to take a holistic approach to their corporate governance framework. Corporate governance always includes broad principles of accountability, transparency, integrity and stewardship. These principles form the basis of the CGPR and, as standards of behaviour, are very much at the core for any overarching governance framework for listed entities (Simon Pordage and Frank Bush, *Corporate Governance and the Company Secretary,* Governance Institute of Australia, 2009, p.4).

ROLE OF THE COMPANY SECRETARY

The *Corporations Act 2001* (Cth) dictates that a public company in Australia (of which a listed entity must be) has an appointed company secretary.

The company secretary is charged with managing the company's corporate governance and regulatory obligations (Pordage and Bush, *Corporate Governance and the Company Secretary*). This person has a key role in advising the board on best practice, appropriate disclosures and managing the governance landscape.

When considering an IPO in Australia, it is important to engage a qualified company secretary, either as an employee or through a provider of professional company secretarial services, at the earliest opportunity. This approach will ensure that you commence the IPO process with corporate governance in mind.

CONCLUSION

Responses for global regulators and governments to prosecute and impose fines and increase taxes on entities with poor records is testament to the importance of adequate corporate governance. Poor corporate governance can result in significant cost for entities, and punishments range from fines to imprisonment for officeholders.

The pre-IPO stage provides a perfect opportunity to adopt appropriate policies and practices before the entity is in the public eye and under the review of shareholders and a market operator. Establishing effective corporate governance in advance of an IPO is important to start your listed company's journey on the right foot.

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A SIMPLE GUIDE FOR ENTREPRENEURS TO LISTING THEIR COMPANY ON THE ASX

KAIN LAWYERS

James Burchnall, *Director*

For a company founder, achieving a listing on the Australian Securities Exchange (ASX) is a significant milestone in the life cycle of their company. In addition to the prestige associated with an ASX listing, significant advantages also accrue for the listed company, such as the ability to raise capital from a broader market and to grow the profile of the company among institutional and professional investors.

For the company's shareholders, an ASX listing increases the liquidity of their investment and allows them to trade their holdings in a reputable and recognised market. For the company's founders and early-stage investors, an ASX listing provides an opportunity to exit, either fully or partially, through a sell-down as part of an initial public offering (IPO) or through ongoing market trades.

Although listing has significant benefits, additional compliance burdens will be placed on the company after it is listed. As such, it is important to have a good understanding of what is involved in the listing process and what key additional obligations will apply after listing, before making the decision to list.

In this chapter, we answer the following questions:

- What are the key requirements for listing on the ASX?
- What is involved in the listing process itself?
- What additional compliance requirements will apply to the company after listing?

THE KEY REQUIREMENTS FOR LISTING ON THE ASX

To be eligible for listing on the ASX, a company must satisfy the admission requirements set by the ASX. These are set out in ASX Listing Rules 1 and 2 and include the following requirements.

SHAREHOLDER SPREAD

The ASX needs to ensure that there will be an appropriate market in the company's securities. As such, the company to be listed will need to have at least 300 non-affiliated shareholders, each holding a parcel of shares with a value of at least $2,000 (excluding shares subject to escrow).

The designation of 'non-affiliated shareholders' excludes the company's related parties, such as controllers, directors and their close relatives and entities that any of them control, and their associates.

FREE FLOAT

The free float requirement, introduced as an amendment to the ASX Listing Rules in 2016, requires the company to have a free float of not less than 20 percent at the time of admission.

The *free float* is the percentage of the company's main class of securities that is not subject to escrow and is held by non-affiliated shareholders.

FINANCIAL CRITERIA

The ASX also needs to ensure that the company is financially suitable for listing by satisfying either the profit test or the asset test.

Profit test

The profit test requires the company to demonstrate a track record of achieving $1 million net profit in aggregate over the last three financial years and net profit of $500,000 for the 12 months up to a date no more than two months prior to applying for listing. The company must be a going concern, and its main business activity must have been the same for the last three years.

Asset test

The asset test requires the company to have the following:

- net tangible assets of at least $4 million (after deducting fundraising costs) *or* a market capitalisation of at least $15 million
- less than half of the company's total tangible assets (after raising funds) in cash or in a form readily convertible to cash (or, if this test is not satisfied, the company must have commitments consistent with its business objectives to spend at least half of its cash or assets readily convertible to cash)
- working capital of at least $1.5 million (or to be able to show that it would meet this test if its budgeted revenue for the first full financial year after listing was included in working capital)
- sufficient working capital for its stated objectives.

With regard to the first bullet, different thresholds apply for 'investment entities', which are entities set up to invest in non-controlling stakes in other entities or futures contracts.

COMPANY TYPE

Under Australian law, proprietary companies must have no more than 50 non-employee shareholders and must not offer shares to the public where a prospectus or other disclosure document would be required.

If the current holding company of the group to be listed is a proprietary company (a Pty Ltd), it will need to be converted to a public company before listing. Alternatively, a restructure can be undertaken to insert a new public company as the holding company of your group.

Public companies are subject to additional compliance obligations, particularly with respect to related party transactions, so careful planning is required around the preparatory steps for listing.

CORPORATE GOVERNANCE

The company must provide a statement to the ASX of the extent to which it will follow the *Corporate Governance Principles and Recommendations* of the ASX Corporate Governance Council. If the company does not propose to adopt any particular one of those recommendations, it must explain why not. The recommendations cover matters such as board structure, independent directors, committees and codes of ethics.

The company must also satisfy the ASX that each of its directors and proposed directors is of good fame and character.

ESCROW

Certain categories of persons associated with the company to be listed (such as promoters, seed capitalists and persons who have sold certain assets to the company in exchange for shares) may be subject to escrow requirements under the ASX Listing Rules, which will restrict their ability to trade their shares after admission.

Escrow requirements are less likely to be applied by the ASX if the company is admitted to listing under the profit test than if admission occurs under the asset test.

Even if the ASX escrow provisions do not apply, the lead manager or underwriter of an IPO may still require that founders or other early-stage investors are subject to voluntary escrow requirements for a period after listing.

CONSTITUTION

The company must have a constitution that is consistent with the ASX Listing Rules.

The company can choose either to include the standard provisions in Appendix 15A or 15B, which provide that the Listing Rules prevail to the extent of any inconsistency, or it can provide the ASX with a completed ASX Constitution Checklist to confirm that its constitution complies with the Listing Rules.

PROSPECTUS OR INFORMATION MEMORANDUM

If the company to be listed is raising capital at the time of listing, or if the existing shareholders are selling down their shares, a prospectus will be required. Otherwise, the ASX may instead accept an Information Memorandum, which has slightly reduced disclosure requirements and does not attract the statutory prospectus liability regime.

If a prospectus is required, it must include specific disclosures, such as the terms and conditions of the offer. It must also satisfy the general disclosure test of providing all information the investors and their financial advisors would reasonably require (to the extent reasonable) to make an informed assessment of certain material matters in relation to the company to be listed (including its assets and liabilities, financial position and performance, profits and losses and prospects, and the rights and liabilities attached to its securities).

Parties involved in an IPO may be subject to criminal or civil liability in the event that the prospectus contains a misleading or deceptive statement or omits information required to be included under the *Corporations Act 2001* (Cth) (Corporations Act), or if a replacement or supplementary prospectus is not issued where required to disclose any new information arising after lodgement of the original prospectus.

THE LISTING PROCESS

An overview of the listing process is shown in Figure 1. It is recommended that companies engage their core IPO team (including lead manager, legal advisor and independent accountant) at an early stage to assist with the process.

APPOINT THE IPO TEAM AND AGREE ON THE STRUCTURE

The first step in the listing process is to appoint the lead manager/underwriter, legal advisor, tax advisor and independent accountant. The team will then consider whether any pre-IPO restructuring of the business is required to prepare for listing.

CONDUCT DUE DILIGENCE

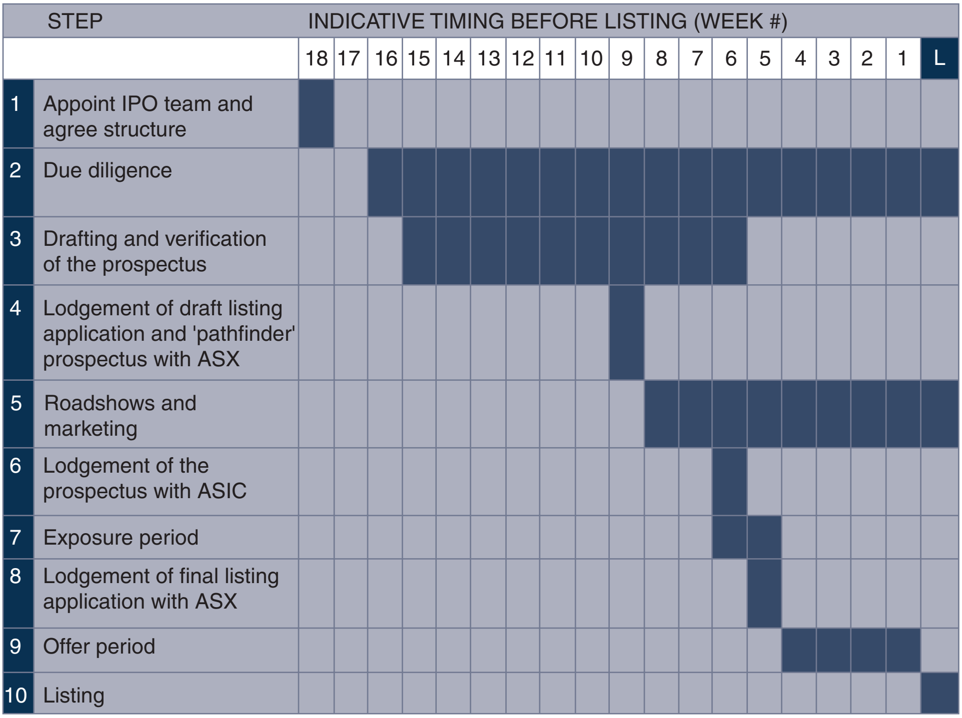
Due diligence is conducted to ensure that the prospectus is not misleading or deceptive and contains all information required by the Corporations Act. It is also essential to establishing the statutory ‘due diligence defence’ to liability for persons involved in the offer of the securities under the prospectus.

This step initially involves setting up a Due Diligence Committee (DDC) and preparing a Due Diligence Planning Memorandum to set out the scope and materiality level of the due diligence enquiries. The ongoing due diligence process involves detailed enquiry into the legal, tax and accounting affairs of the company to be listed, and reporting of material issues to the DDC. These issues are then considered by the DDC at its periodic meetings and reflected appropriately in the prospectus.

DRAFT AND VERIFY THE PROSPECTUS

Drafting of the prospectus takes place while the due diligence process is continuing, because

FIGURE 1. An overview of the listing process



ASIC = Australian Securities and Investments Commission; ASX = Australian Securities Exchange; IPO = initial public offering

the results of the due diligence will need to be reflected in the disclosures made in the prospectus.

Once the prospectus has been drafted, a verification process is undertaken (overseen by the DDC) to ensure that all material statements in the prospectus are supported by appropriate evidence and signed off.

LODGE THE DRAFT LISTING APPLICATION AND 'PATHFINDER' PROSPECTUS WITH ASX

ASX generally requires four to six weeks to consider a listing application, and in most cases ASX will not commence its review until the prospectus has been filed with the Australian Securities and Investments Commission (ASIC). However, ASX has a fast-track process that allows lodgement of a draft listing application and 'pathfinder' prospectus no less than four weeks prior to the formal ASX lodgement date. ASX will then 'front end' its review, which will generally mean that ASX requires only two weeks to review the formal application once it is lodged.

DIRECT ROADSHOWS AND MARKETING

The Corporations Act contains strict restrictions on advertising and publicity in relation to an IPO. Prior to lodgement of the prospectus with ASIC, only very limited statements are permissible. After lodgement of the prospectus, it is permissible to market the offer more generally, but all advertisements and publications must contain statements in a prescribed form directing investors back to the prospectus.

Despite these restrictions, it is possible to market to sophisticated and professional investors prior to lodgement of the prospectus with ASIC by sending them a 'pathfinder' prospectus and conducting roadshows to gauge interest and build institutional support for the IPO.

LODGE THE PROSPECTUS WITH ASIC

Once the prospectus has been drafted and verified, it is approved by the DDC and the company's board and lodged with ASIC.

WAIT DURING THE EXPOSURE PERIOD

After lodgement with ASIC, the prospectus is subject to an 'exposure period'. During this period, the prospectus is made available for public review and comment, and the company cannot accept applications under the offer. This process takes a minimum of seven days but can be extended to 14 days.

LODGE THE FINAL LISTING APPLICATION WITH ASX

The company must apply to ASX for quotation of its securities within seven days after the date of the prospectus by lodging an Appendix 1A listing application. Although ASX requires four to six weeks to consider this application, it is possible to accelerate this process and reduce the review period to two weeks by lodging a draft application and 'pathfinder' prospectus at an early stage.

RECEIVE APPROVAL FOR THE OFFER PERIOD

Once the exposure period has ended, the offer period will usually commence. During this period, investors can subscribe for securities under the prospectus. The length of the offer will depend on how the offer is structured, including whether it is a combination of a retail and institutional offer, and whether the price is fixed or determined by way of a book-build.

RECEIVE LISTING APPROVAL

Provided that the company satisfies the listing requirements, it will normally be granted conditional listing approval at the end of the offer period. The conditions to listing will ordinarily relate to the close of the offer and the provision of initial listing information to ASX for release to the market.

OBTAIN A LISTING DATE

Once the offer is closed, the company will determine the allocation of shares and then, once allotted, trading in the shares on the ASX can commence once all of the conditions to quotation on the ASX are satisfied.

ONGOING COMPLIANCE REQUIREMENTS

Once listed on the ASX, the company will need to comply with the ongoing compliance requirements set out in the ASX Listing Rules, including the following key requirements of continuous disclosure, periodic disclosure, related party transactions, restrictions on share issues and significant changes.

CONTINUOUS DISCLOSURE

A listed company must notify ASX immediately upon becoming aware of information concerning it that a reasonable person would expect to have a material effect on the price or value of the company's securities. This rule is subject to a limited exception, which allows the company to delay disclosure provided that the information remains confidential, a reasonable person would not expect it to be disclosed and one of five specific situations applies (including where the information concerns an incomplete proposal or negotiation or the matter is insufficiently definite to warrant disclosure).

PERIODIC DISCLOSURE

In addition to the listed company's continuous disclosure obligations, it must also periodically release reports to the market. The main financial reports are the Half Year Report (in the form of Appendix 4) and the Preliminary Final Report (in the form of Appendix 4E). The company's Annual Report must also be released to ASX at the same time because it is required to be lodged with ASIC. Some listed companies must also report cash flow on a quarterly basis.

RELATED PARTY TRANSACTIONS

Public companies are subject to the related party transaction rules in Chapter 2E of the Corporations Act. Listed companies are also subject to additional related party transaction rules under the ASX Listing Rules, which do not include an exemption for transactions on 'arm's length terms'.

RESTRICTIONS ON SHARE ISSUES

Subject to various exceptions, listed companies are restricted from issuing new shares comprising more than 15 percent of their issued share capital over a rolling 12-month period without shareholder approval. Smaller listed companies may issue a further 10 percent of their issued share capital, if pre-approved by shareholders at the company's last annual general meeting.

SIGNIFICANT CHANGES

Where a listed company undergoes a significant change in its scale or activities, that change may require shareholder approval. In extreme cases, the ASX may require the listed company to re-comply with the ASX admission requirements due to the significant change.

CONCLUSION

For entrepreneurs who are used to having a large degree of control over the direction of their company, and who may not be used to making public disclosures of all material developments in relation to the company, these ongoing compliance requirements may represent a significant change in the way their business will need to be run after listing. For this reason, it is important to consider whether the benefits of being listed on the ASX will exceed the additional ongoing compliance burdens that will be imposed after listing. Having a good understanding of these ongoing requirements prior to making the decision to list is fundamental to ensuring the success of the company as a listed entity.

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OPTIMISING YOUR PROSPECTUS FOR YOUR IPO

ALPHASTATION

Dominic Dirupo, *Principal*

An initial public offering (IPO) marks a significant milestone for a company. Having its securities listed on an internationally recognised stock exchange like the Australian Securities Exchange (ASX) signifies a new era of growth and development, a raised profile and market significance.

A company will look to an IPO when it is at a stage in its development where growth is poised to accelerate substantially. Listing a company has significant advantages to achieving this aim:

- *Access to capital:* Listing tends to improve a company's capital-raising ability from domestic and international investors to fund future growth and acquisitions.
- *Visibility and credibility:* The market develops a greater awareness of the company and its products or services.
- *Tangible value creation:* Existing shareholders crystallise the value of their holdings and have the ability to trade their holdings in the market, allowing for greater liquidity and the broadening of the shareholder base.
- *Greater institutional interest:* A listing may attract institutional investment as a result of increased liquidity and transparency.
- *Higher strategic value:* Listed shares are typically more attractive when offered as consideration for the acquisition of other assets.
- *Governance:* Listing encourages the implementation of good corporate governance practices.
- *Ability to incentivise personnel:* Equity incentive schemes encourage long-term employee commitment, motivation and performance.

Balanced against the costs, compliance requirements, higher standards of accountability and demands of being a public company, the benefits generally outweigh the drawbacks.

After deciding to list through an IPO on the ASX, the company will need to meet listing requirements. The foundation for meeting these requirements is the issuance of a prospectus. As a full-disclosure document, a prospectus comprehensively details the various aspects of the company for potential investors to make an informed decision regarding making an investment into your company. In short, you know why you want to list your company—can we demonstrate to potential investors why they would want to join you on your journey?

Not all prospectuses are built the same. Many are drafted purely by legal counsel and act as a solid compliance document but fail to capture the 'sizzle' of a company. Others, at the opposite side of the spectrum, end up lacking substance while erring on the side of non-compliance.

How do you strike a balance and have an optimised document for your IPO? The answer is to focus on two distinct but complementary elements:

- *Strategy:* the preparation required to create the prospectus properly
- *Composition:* how to put the document together for the best result.

STRATEGY

UNDERSTANDING THE PURPOSE OF THE PROSPECTUS

The prospectus is a full-disclosure document required for raising capital in the public market. The *Corporations Act 2001* (Cth) (Corporations Act) contains a general disclosure test for a prospectus so that a reader can make an informed assessment about investment. There is no checklist of all the content that a prospectus must contain. However, to be listed, companies must have a corporate structure, policies, processes and operations that ASX regards as appropriate for a listed entity.

All the information in the prospectus must be verified, with no false, misleading or deceptive statements, and with no material omissions. To ensure that this result occurs, the company will need to undertake a formal due diligence process prior to the IPO in parallel to drafting the prospectus.

The best practice for this step is the formation of a Due Diligence Committee made up of the legal counsel, the chairman and a director of the company. The committee discusses the ASX listing requirements and documents the responses, and this material provides the relevant 'inputs' for the prospectus.

From a commercial perspective, companies that are 'investor ready' demonstrate the following outcomes:

- Take less time to draft the prospectus.
- Create a more complete document to facilitate the investment decision.
- Find the listing process easier to manage.
- By showing a degree of corporate maturity, they may be regarded as a more attractive investment.

MESSAGING FOR THE PROSPECTUS

With legal counsel as a key advisor, first-time IPO participants tend to be cautious and overemphasise their compliance credentials but neglect the other crucial part of investor readiness—and it is pretty simple. Incoming investors will want to know why the business will be successful and why you will win. Investors will dissect the underlying business plan, do a stress test on the assumptions and look for risks that are unaddressed. Professional investors seek reasons not to invest. A prospectus that stands up to this rigour is investor ready.

A prospectus should address the following aspects to show that it is investor ready:

- *A concise, well-articulated vision:* A company needs investors to follow the dream. A detailed and achievable business plan is a stepping stone to ensure that the vision can be realised.
- *A clear product/service offering:* Demonstrate that the product/service offering is mature, with valuable next-generation versions in the pipeline.
- *A tangible market opportunity:* Show evidence of a sizeable market that has a need that the company can address to capture market share.
- *Content that addresses managing the expectation of forward revenues:* Show a clear commercial focus for the next two years, with key performance indicators that can be used for benchmarking and provide valuation inflection points.
- *A strong board and management team in place to bring commercial contracts and drive value creation:* Find a board suitable

for a public company (that is broad and has specific skill sets) with a relevant pedigree and track record.

- *Blue chip shareholders, incoming investors and commercial partners:* These people are needed to reassure the market that the company is surrounded by the right people to execute its growth plan.
- *An intellectual property portfolio that is secure:* Demonstrate patents that are on the offensive (have an increased time advantage) and provide defensive measures (have increased barriers to competition).

The ability to articulate the above threads into themes through the prospectus ensures that the company is telling a strong story that resonates with investors.

IDENTIFYING THE TARGET MARKETS FOR THE PROSPECTUS

Although a prospectus is effectively for the retail market (aka mum and dad investors), it is very rare that this market will be the target market for the prospectus. Australia has a superannuation investment pool growing and requiring placement and has the world's third largest pool of investable funds—A$1.6 trillion assets under management. Given these factors, several 'sophisticated and professional' investor markets have a continued and increasing interest in new equity offerings:

- the funds management industry (including small-cap and micro-cap funds)
- self-managed super funds
- broker networks connected to the Lead Manager of the IPO
- family offices managing their own funds and making significant investments
- an increasing number of overseas funds investing in ASX companies.

By speaking in the language of these high-value networks, a company can create a significant foundation of incoming investors. To target them effectively, the presentation of a compelling investor proposition with a solid business plan and a strong eye on compliance ensures that the company is positioned as 'investor ready'.

COMPOSITION

STRUCTURE OF THE PROSPECTUS

The prospectus is the offer document under which it will offer shares to the public on its IPO. A prospectus must contain all information that investors (and their professional advisors) would reasonably require and reasonably expect to find to make an informed assessment of material matters relating to the company. In line with this concept, the structure of a prospectus is typically as shown in Table 1.

In addition to the content, the Corporations Act also requires that a prospectus must be presented in a 'clear, concise and effective' manner so that investors (particularly retail investors) can understand the potential opportunities and risks associated with an investment in the company's shares.

STYLE AND LANGUAGE GUIDANCE

A prospectus is a legal document and a financial document. The corporate regulator specifies clear and concise content. To meet this criterion, which is sufficiently vague as to create confusion in writers, the following style guidance ensures that preparers of prospectuses will be able to get their message across easily:

- *Use a consistent voice:* Because the prospectus will include inputs from various sources, it is preferable to harmonise the language so the document is tonally consistent. Use an appropriate style that matches your audience and the expectation of the reader—professional, confident and direct.
- *Use simple and clear language:* Try to use simple words and sentences. However, this task can be challenging because some of the sections, such as Risk Factors, can be densely written. Attempt to simplify the language where possible while not losing meaning.

TABLE 1. Structure of a prospectus

Chairman's letter	A direct appeal by the chairman of the company to consider the documentation, outline the story, point to risk factors and encourage participation.
Investment overview	A summary of the prospectus covering all the sections outlined below.
Industry overview	Verifiable information about the industries and territories that the company operates in, or plans to operate in, to contextualise the business opportunity.
Business overview	A description of the business, products/services and pricing, business model, strategic relationships and why the company will succeed.
Risk factors	The main risk factors pertaining to the company, the market, and micro and macro factors that affect the company as well as an outline of general risks.
Financial information	The past performance and *pro forma* financial information of the company as prepared by the directors and validated by the investigating accountant.
Board and management	Overview of the board of directors who will manage the business, demonstrating that they have sufficient skills, experience and capabilities. This part will include biographies and details of interests in the company and other listed companies.
Corporate governance	Outline of the approach to corporate governance, including committees, meetings, voting and how the company is managed and benchmarked to Corporate Governance Standards.
Technical reports	Any third-party documentation to supplement the data in the prospectus, such as an independent intellectual property report, or experts' reports on the market for the company's products.
Additional information	Additional material information about the company such as material contracts, partnerships and joint ventures, the securities being issued, and interests of various parties, such as personnel and advisors.
Details of the offer	Information of the Share Capital Structure, Use of Proceeds, Costs of the Offer, How to Apply for Shares and supplementary information relating to these items.
Glossary	Definition and explanation of all words, terms and abbreviations used in the prospectus.
Corporate directory	Contact details and information about the company and its advisors.

- *Be specific:* Although simplicity is the aim, avoid vague language. It takes skill to impart complex information and yet make the document easier to understand. Using specific language makes the document easier to read.
- *Limit jargon:* Avoid jargon where possible. If you use specific industry terms, define them when first mentioned and reference them in the Glossary.
- *Avoid superlatives:* Superlatives are inherently misleading, and do not exaggerate any statement. However, do attempt to frame positions with active language (e.g., the company will seek to…). Action words make language more confident by default.
- *Use headings and subheadings to facilitate scanning:* Some people will read every word you write. Others will just skim. Grouping related ideas together and using descriptive headers and subheadings allows readers to easily navigate the document.
- *Structure the text for readability:* Craft clear transitions from section to section to orient

the reader. Presenting the information in bite-sized pieces makes the document content easier to digest.

- *Provide more bullet points and fewer paragraphs:* Where appropriate, break up large paragraphs into bullet points that are easy to read and comprehend.

Prospectuses that are written in plain English with short sentences will be easier for investors to understand than those with long, complex sentences. Using clear corporate language means that you realise the dual benefit of having a uniform, easy-to-understand document for your reader while making the writing and editing more efficient for your company.

AREAS OF FOCUS

Along with having the correct form and a clear writing style, you can use several methods to improve your prospectus and end up with a product that is an elite document (Table 2).

COMPLETING THE DOCUMENT

By now, if your company has followed the timetable, it should be 10–12 weeks after the start of the prospectus project. The document is nearing completion. Now is not the time for celebrating on almost finishing it. Completing the prospectus on schedule requires additional resources and focus:

- *Finalisation:* With a prospectus, the last 5 percent of the document is often drawn

TABLE 2. Ways to improve your prospectus

Appoint a project manager	With multiple parties contributing to the development of the prospectus, it is easy to lose focus, fall behind on the IPO timetable and end up with a substandard document. Appointing a project manager ensures that the project is driven forward, all gaps are addressed in a timely manner and you end up with an optimal document.
Use simple design principles	The right design choices make a document easier to read and its information easier to understand. The wrong design choices can make even a well-written document fail to communicate. Design serves the goal of communicating the information as clearly as possible.
Use effective graphics	The use of appropriate graphics illuminates information more clearly and quickly than text alone, especially when conveying data. Graphs and infographics also increase impact. When considering a prospectus, which is often considered to be a 'dry' document, any opportunity to increase impact should be accepted.
Avoid forecasts (if you can)	There is no requirement to include forecasts in an IPO prospectus. Inclusion of forecasts almost guarantees more attention from regulators. If the prospectus contains a statement about a future matter and there are no 'reasonable grounds' for making the statement, the statement may be regarded as 'misleading' and may give rise to legal action. Any forecast beyond a two-year period also is presumed to be misleading. It is worth noting that this factor can affect valuation. If the company's primary objective was to maximise its pre-money valuation, then a forecast could lead to a higher potential valuation. This factor needs to be weighed up counter to the considerable risks and regulatory issues associated with this approach.
Address risk factors	This part is often seen as the catch-all section for companies to bury all their bad information and surround it with an avalanche of clauses and conditions. It is recommended to thread the risk information throughout the document so it presents a balanced view of the company, thereby lessening the impact of the risk section by itself. Where possible, also outline a risk mitigation strategy to provide greater comfort to investors that each risk has been thoughtfully considered.

out, typically because a crucial piece of information comes in late. Often, a small change has flow-on effects elsewhere in the document. When drawing to the end of the document, it is good practice to keep a to-do list of final items and cross-references to minimise the impact of finalisation.

- *Verification:* Once the prospectus is in a substantially final form, a verification exercise is performed to ensure the accuracy of the prospectus contents. Where there are statements of opinion, the verification will need to investigate the reasonableness of the assumptions upon which these views are based. Substantial penalties can apply if the prospectus contains misleading information or omits material information.
- *Third-party read-through:* It is good practice to have third parties review the prospectus, especially ones who think like investors. A fresh perspective can quickly cut to the obvious issues that need to be resolved.
- *Prospectus lodgement:* The prospectus is lodged with the Australian Securities & Investments Commission (ASIC), along with supplementary listing information that is required. The regulator typically takes 7–14 days to review the document. Any minor but material changes or clarifications will result in an updated 'Replacement Prospectus'. Major material changes will require a 'Supplementary Prospectus'. By following the guidelines in this chapter, we maximise the chance that the regulator has no questions about your prospectus, and then the Lead Manager can start fundraising.

CONCLUSION

With a successful completion of the prospectus, all the information within it should be used to inform the IPO roadshow presentation and 'investor information' section of the company website. This is why the prospectus is a vital document for your company. It is the official word of the company as it transitions to a public entity. It will be the basis of the investor expectations and will be referred to constantly over the next two years as the company fulfils its strategy. Therefore, a prospectus needs to be optimised. You want a document that can support your company vision and encourage investors to become long-term shareholders in your company.

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ADVISORS, DUE DILIGENCE AND THE DISCLOSURE DOCUMENT

KPMG LAW

David Morris, *Partner, KPMG Law*

Hoda Nahlous, *Director, KPMG Law*

David Tink, *Senior Associate, KPMG Law*

One of the key considerations to be addressed when undertaking an initial public offering (IPO) and listing on the Australian Securities Exchange (ASX) is determining what information should be included in your disclosure document (typically a prospectus).

Applying an appropriate level of focus and diligence to this issue will help to ensure that your disclosure document is compliant with the disclosure requirements of the Australian Corporations Act 2001 (Cth) (Corporations Act) and meets all other relevant regulatory obligations.

The onus is on the issuer of the disclosure document, including its directors, and any other persons involved in its preparation, to ensure that it meets these disclosure requirements.

In order to decide what to include in the disclosure document, it is important to undertake a process of due diligence. Due diligence means undertaking various enquiries to ensure that all material information about your company or that is otherwise relevant to the IPO is properly identified. The relevant material information should then be included in the disclosure document, and any issues identified through the due diligence process should either be resolved so that disclosure of the issue is not required or is appropriately addressed in the disclosure document (for example, in the risks section). Your key advisors will play a pivotal role in this process.

This chapter provides an introduction to the key advisors that you need for an IPO and listing on the ASX. It also addresses, at a high level, the due diligence process and the advisors' role in that process, the impact this process will have on the information included in your disclosure document and the 'due diligence defences' that may be available if a claim arises in respect of the content of the disclosure document.

ADVISORS TO YOUR IPO

Appointing the right advisors to assist you with your IPO will be critical to its success. Your team should be experts in their field as the IPO process is complex and you will need to rely heavily on your advisors to help you navigate your way successfully through the process. Your team will typically include the following advisors:

- a lead manager (who potentially may also act as underwriter)
- a legal advisor
- an investigating accountant
- a tax advisor
- a technical expert (if required) to provide an expert report in relation to the IPO (e.g., a patent report, valuation report)
- an independent financial advisor.

Advisors provide standalone advice in relation to the IPO in their specific field of expertise but also normally come together in what is called a 'due diligence committee'.

This committee will normally be made up of representatives from the relevant advisors (either as members of, or observers to, the committee, as applicable), as well as representatives of the company (both from the board and management). Each member serves a specific role (generally based on their area of expertise), and together they agree and oversee the due diligence process and its interaction with the information that is included in the disclosure document. The role of the committee is discussed further below.

LEAD MANAGER (AND POTENTIALLY UNDERWRITER)

An investment bank or broker will be appointed as lead manager to the IPO. Depending on the size of the offer, more than one lead manager may be appointed.

The lead manager is responsible for managing the overall IPO process and marketing the offer to potential investors. The lead manager will market the offer using their marketing channels and contacts while at the same time gauging investor sentiment. They will work closely with you to identify investors, institutional and retail, who may participate in the offer. In addition, as part of the listing conditions imposed by the ASX, you will be required to have a minimum number of shareholders (i.e., shareholder spread), and the lead manager will assist you in identifying investors to satisfy this requirement.

The lead manager will also assist you to determine your offer structure and the offer pricing.

The lead manager and your company will enter into formal documentation prior to launch of the IPO, which will confirm whether they will also underwrite the IPO.

Underwriting provides certainty that the desired amount of funds to be raised under the IPO will, in fact, be raised, because the underwriter agrees (subject to the particular terms and conditions of the underwriting agreement) to take up any shortfall in subscriptions. That means they will take up (either personally or by procuring subscriptions for) any shares not taken up by investors.

There is no specific requirement to underwrite an offer of securities. For example, on smaller IPOs, or in a back-end book-build offer structure, it may be more practical for the lead manager to only manage the IPO, and not also underwrite it.

LEGAL ADVISOR

The legal aspects of an IPO are complex, with various types of legal documentation involved and advice required.

Your legal advisor will help to ensure that your IPO is legally compliant, including that the disclosure document meets the relevant legal and regulatory requirements. They will assess whether any waivers or relief are required from the requirements of the ASX Listing Rules and/or the Corporations Act. Your legal advisor will also assist with your listing application to the ASX, your corporate governance framework and documentation, and the pre-quotation disclosure requirements (among other matters). Your legal advisor can also assist by advising on pre-IPO preparations—for example, any pre-IPO corporate restructuring requirements.

Your legal advisor will also play a leading role in advising on, and coordinating, the due diligence process (detailed further in this chapter), which is a critical component of the IPO process.

INVESTIGATING ACCOUNTANT

The investigating accountant will conduct financial due diligence on your company. They will also provide a report for inclusion in the disclosure document on any historical and forecast financial information that is included in that document.

Importantly, the Australian Securities and Investments Commission (ASIC) considers that information about the financial position, performance and prospects of a company is often the most important consideration for investors.

ASIC also prescribes the financial information that needs to be included in a disclosure document. This information aligns with the financial information that the ASX will require a listing entity to provide as part of its listing conditions to being admitted to the Official List of the ASX. The ASX requires a listing entity to provide audited accounts for the last three full financial years, or two years, depending on the test for admission: profits test vs assets test.

ASIC provides guidance that, generally, the disclosure document should include: '(i) a consolidated audited statement of financial position for the most recent financial year (or audited or reviewed half-year depending on the date of the disclosure document) showing the major assets, liability and equity groups and a corresponding pro-forma statement of financial position showing the effect of the offer and any acquisitions (if relevant); (ii) the following audited information for the last three years (or two years of audited information, and a half year of reviewed accounts, depending on the date of your disclosure document); (iii) a consolidated income statement, and a consolidated cash flow statement'.

TAX ADVISOR

Your tax advisor will generally provide taxation advice on the structure of the IPO, any pre-IPO restructuring and the taxation implications of the offer being made. Their analysis is often key to the structuring of the offering process.

INDEPENDENT FINANCIAL ADVISOR

It is becoming more common to see independent financial advisors appointed by companies to assist with their IPO.

Generally, an independent financial advisor will provide you with independent advice on the key aspects of the IPO. The advisor can also assist with project management and preparation of key deliverables, which can be particularly beneficial if your key people have limited IPO experience or are capacity constrained.

An independent financial advisor's role may also involve advising on IPO feasibility and strategy, preparedness, documentation, structure, equity story, timing, the engagement and management of other advisors, IPO execution, investor targeting and pricing and allocation.

CONTENT OF DISCLOSURE DOCUMENT

As mentioned above, one of the key considerations to be addressed when undertaking an IPO and listing on the ASX is determining what information should be included in your disclosure document.

The general disclosure requirements for a disclosure document are designed to ensure comprehensive disclosure of relevant information to potential investors. These requirements prescribe that a disclosure document must contain all information that investors and their professional advisors would reasonably require to make an informed assessment of the rights and liabilities attaching to the shares on offer, and the assets and liabilities, financial position and performance, profits and losses and prospects of your company.

However, such disclosure is only necessary to the extent to which it is reasonable for investors and their advisors to expect to find the information in the disclosure document.

A disclosure document must be worded and presented in a 'clear, concise and effective' manner. There are other specific requirements;

however, there is no definitive 'checklist' that otherwise details what should be disclosed.

Accordingly, what is ultimately disclosed in a disclosure document becomes a factual exercise of determining what is material information for investors. In order to assist in making this determination, a thorough due diligence process, as noted below, is normally undertaken in respect of the company and a due diligence committee is established to oversee and evaluate this process.

Once these due diligence investigations are completed, the committee will normally be in a position to form a view as to whether the disclosure in the disclosure document satisfies the requirements of the Corporations Act, is not misleading or deceptive and does not omit material information. If the committee forms such a view, it will advise the board of the company of this view and the board, who is ultimately responsible for authorising the issue of the disclosure document, will determine whether to approve its issue.

UNDERTAKING DUE DILIGENCE

Due diligence is not a process prescribed by the Corporations Act. However, it is well accepted that undertaking a thorough due diligence process is essential for a company to be able to satisfy the disclosure requirements of the Corporations Act. Undertaking such a process helps to ensure that the disclosure document is not 'defective' (i.e., it does not contain a misleading or deceptive statement or omit key information).

In the ASIC Report 484: *Due diligence practices in initial public offerings,* 2016, ASIC also makes it clear that it expects companies conducting an IPO and their advisors to conduct (and document) a thorough and investigative due diligence process that promotes informed decision-making by investors and their advisors—one that adopts a 'substance over form' approach.

Undertaking a thorough due diligence process is also important in seeking to defend any claims that may be made in respect to a disclosure document.

DEFENCES IN BRIEF

Where a disclosure document is found to be 'defective', the Corporations Act contains various defences that defendants can seek to rely on, and many of these defences relate to due diligence.

In brief, the relevant statutory defences to claims made in relation to a defective disclosure document, include the following:

- *The 'due diligence defence':* This provides that a person has a defence if they can show that they made all reasonable enquiries in the circumstances, and believed on reasonable grounds that statements in the disclosure document were not misleading or deceptive, and that there were no material omissions in the disclosure document.
- *The 'reasonable reliance defence':* This provides that a person has a defence if they can establish that they reasonably relied on information conveyed to them by a third party, such as an advisor to the company.
- *The 'new matter defence':* This provides that a person has a defence if the person can establish that they were not aware of a new circumstance arising that would have been required to be disclosed in the disclosure document.

For completeness, there is also a defence in the Corporations Act, which provides that it is a defence for a person who is named in the disclosure document if they publicly withdraw their consent to being named in the disclosure document (however, this defence is not available to the listing company or any of its directors).

THE DUE DILIGENCE COMMITTEE

As noted above, a due diligence committee is normally formed by the company to oversee the due diligence process and is made up of representatives of the company and its key professional advisors who are advising it on its IPO.

The composition of the committee and the process it carries out and oversees are important for the purposes of being able to establish the above-mentioned 'due diligence defence' and 'reasonable reliance defence' in the event of a defective disclosure document.

In brief, the committee agrees, oversees and coordinates the due diligence process to be undertaken with respect to the disclosure document and the IPO. Each member of the committee plays a defined role and, where it has been agreed, will undertake focused investigations with respect to their particular area of responsibility.

The committee may also require certain enquiries to be made by other experts. The results of the enquiries are then reported to the committee for its consideration. Following analysis of the reports and findings produced, the committee will then decide what information is considered material and requires disclosure in the disclosure document.

Any decisions of the committee should be unanimous. Any dissenting opinion should be heard, and that particular matter should be debated further until the committee as a whole can agree on a position.

THE INTERACTIONS OF COMMITTEE MEMBERS

Each advisor will be engaged by the company through a separate mandate, and each mandate will be subject to its own set of terms and conditions. Accordingly, each advisor's observations and reporting obligations to the committee are defined within the parameters of their respective mandate terms and conditions.

Where an advisor has reporting responsibilities to the committee, the other members will naturally look to rely on the report prepared by that advisor (and their expertise). Each advisor's role, their particular expertise and the ability of other members and observers to rely on their expertise are important in being able to establish the 'reasonable reliance defence'.

The combined expertise of your advisors is therefore critical to ensuring that a proper due diligence process is conducted and that the risk of a defective disclosure document being produced is minimised.

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IPO DUE DILIGENCE AND AVOIDING DISRUPTION

WATSON MANGIONI LAWYERS

Chris Clarke, *Director*

Ashley Rose, *Director*

Robert Mangioni, *Director*

It is vital to ensure that an initial public offering (IPO) contains all material information for investors and is free from error; otherwise this may result in both strict criminal and civil liability. The strict compliance requirements that are enforced throughout the IPO process can appropriately be characterised as a legal maze that, if not navigated correctly, may result in severe delay and disruption to your IPO. It is only through the proper implementation of effective and robust due diligence procedures that a smooth IPO will occur. Consequently, in order to ensure that the proper processes take place it is important to have the right advisors, whether financial, accounting or legal.

The corporate regulator, the Australian Securities & Investment Commission (ASIC), regularly reviews disclosure documents issued to investors, conducts due diligence reviews and monitors the practices of the various parties involved in the IPO process to ensure compliance with the *Corporations Act 2001* (Cth) (Corporations Act). Where a disclosure document does not comply with the Corporations Act, ASIC also has the power, among other things, to extend, delay or prevent the IPO from taking place. Less drastic measures are more commonplace, which include a request by ASIC for further information or additional disclosures or seeking verification. Regardless, as all parties are aware, the timing of an IPO is crucial to ensure a successful raising and intervention by ASIC, or the Australian Securities Exchange (ASX) may disrupt the intended timeline.

Lastly, to provide you with some context, in 2015, as a result of ASIC's review of IPOs, ASIC raised concerns with 31 percent of IPOs, extended the exposure period (delayed) 80 times and issued 61 interim stop orders. Accordingly, the purpose of this chapter is to provide a brief introduction into what is involved in the IPO legal process.

DISCLOSURE BASICS AND RISKS

Most offers of securities to retail investors in Australia require a disclosure document, the purpose of which is to help retail investors assess the risks and returns associated with an offer of securities and make informed investment decisions. The most common type of disclosure document is a prospectus, which must:

(a) be worded and presented in a 'clear, concise and effective' manner

(b) include the information that investors and their professional advisors would reasonably require to make informed assessments

(c) make specific disclosures, including disclosure about interests and benefits of persons involved in the offer

(d) not be misleading or deceptive.

If the prospectus does not comply with these requirements, the offeror and certain other people involved in the preparation of the prospectus may be subject to strict criminal and civil liability. Those 'involved' and potentially also exposed to strict liability include the offeror of securities (being the issuer or selling shareholder), underwriters, investigating accountants, directors and proposed directors, solicitors, whoever provides statements in the prospectus and certain other persons who are involved in the contravention.

One such example where basic disclosure was not satisfied was the IPO of Sino Australia Oil and Gas Limited (Sino), an Australian holding company of a Chinese operating company that claimed to provide oil and gas recovery services in China. ASIC sought penalty orders against Sino and its directors, alleging that Sino had contravened the Corporations Act by:

(a) engaging in misleading and deceptive conduct in relation to the disclosure of the financial position of Sino

(b) failing to disclose material information concerning a profit downgrade

(c) making false statements in the prospectuses in relation to patents claimed to be held

(d) making misleading and deceptive statements in relation to a loan and certain service contracts said to be held by a Chinese subsidiary.

The Federal Court of Australia ultimately sided with ASIC, imposed a penalty of A$800,000 on Sino and disqualified the directors from acting as directors for a period of not less than 20 years.

DEFENCES

Whilst those involved in the IPO are subject to strict criminal and civil liability, there are several specific defences available that may be relied upon if an effective due diligence procedure is properly implemented. The due diligence defence may be available where a person has made reasonable enquiries that they have believed on reasonable grounds, whilst the reasonable reliance defence is available where the person can establish that they placed reasonable reliance on the information supplied. Importantly, however, both defences are reliant upon the proper legal processes established before and recorded throughout the IPO.

MITIGATING LIABILITY

To avoid the consequences described in the preceding sections, the Australian practice is to establish a due diligence committee (DDC) to conduct a thorough due diligence process to do the following:

(a) ensure as far as possible that there is a systematic process for preparation of the prospectus to ensure that it complies with legal requirements

(b) ensure as far as possible that the prospectus does not contain any misleading or deceptive statements and that there are no omissions of material information

(c) establish, for the benefit of all participants involved in due diligence and verification program, one or more of the defences available.

THE DUE DILIGENCE COMMITTEE

The formation of a DDC for an IPO will usually comprise representatives from the board and management of the company, any major selling security holder, the company's legal advisor, the investment bank/broker or underwriter and the investigating accountant. (In some cases, other experts may also be members.)

The DDC requires a chairperson to oversee the implemented due diligence process and is usually a representative from the legal advisor. A secretary, who is also usually a representative from the legal advisor, is required to convene meetings and maintain minutes. Other board members, management and experts are entitled to attend DDC meetings as observers.

TABLE 1. Roles of due diligence committee (DDC) members

DDC Member	Role
Legal advisor	Due diligence is usually driven by the legal advisors, who suggest the program for due diligence processes, carry out the legal due diligence enquiries, prepare a legal due diligence report and provide the board of directors with a legal opinion on the due diligence process and the prospectus.
Directors	Directors will have the oversight of the due diligence process so they can satisfy themselves that the prospectus meets the requirements of the Corporations Act.
Management	Management's role is to provide key commercial and financial information to the DDC.
Investigating accountant	The investigating accountant's role is to carry out due diligence enquiries into certain financial and accounting matters.
Underwriter or lead manager	The corporate advisors and lead managers will help coordinate the preparation of the prospectus and participate as a member of the DDC in its deliberations on the contents of the prospectus.

Regular formal meetings throughout the IPO process will be held by the DDC to ensure that the due diligence program developed by the DDC is properly implemented. Each member of the DDC will be required to contribute to the due diligence process in relation to their area of expertise.

ROLES OF DDC MEMBERS

It is market practice for the DDC to delegate particular tasks or areas of enquiry to certain members of the DDC. These members will be responsible for investigating and reporting on identified issues back to the DDC. The roles of DDC members are shown in Table 1.

According to our experience, having the right members on this committee with a balanced mix of expertise is vital to ensuring that an IPO is successful.

THE DUE DILIGENCE PROCESS

In a nutshell, the due diligence process will comprise four key phases, some of which occur concurrently. The phases are:

(a) Phase 1 – Scoping

(b) Phase 2 – Enquiry and prospectus preparation

(c) Phase 3 – Verification and sign-offs

(d) Phase 4 – Continuing due diligence.

To ensure a successful IPO, it is essential that each phase of the due diligence process be carried out robustly.

PHASE 1 – SCOPING

The first phase includes the determination of the scope of work, and the DDC will agree at the outset to:

(a) the format of experts' sign-offs, management sign-offs and the DDC report

(b) materiality guidelines, which essentially provide the DDC with qualitative and quantitative materiality thresholds to determine whether certain information is material and warrants further disclosure

(c) delegate tasks to persons and approve work programs for experts.

The project timetable will also be adopted at the first meeting of the DDC, and the chairperson of the DDC will also circulate any updates.

PHASE 2 – ENQUIRY AND PROSPECTUS PREPARATION

The DDC will undertake extensive enquiries into the issuer, the market within which it operates and its business in general to assist in the preparation of the prospectus and to ensure as far as possible that the prospectus complies with all legal requirements.

The issuer should be prepared to respond to extensive due diligence requests by the DDC throughout the whole process. Such requests are an essential element of an effective due diligence program and are integral to ensuring all reasonable enquiries are made to identify information that should be disclosed.

The underwriter or lead manager will usually have responsibility for preparation of the first draft of the prospectus. Subsequent drafts of the prospectus are then prepared by the legal advisors, the underwriter or management.

Clear, concise and effective

The Corporations Act states that information in a disclosure document must be worded and presented in a 'clear, concise and effective' manner. This requirement applies to both the wording of information (the choice of language) and the presentation (the choice of communication tools).

General disclosure requirements

Prospectuses must be prepared in accordance with certain general disclosure requirements. Accordingly, a prospectus for an issuer's securities must contain all the information that investors and their professional advisors would reasonably require to make an informed assessment of:

(a) the rights and liabilities attaching to the securities offered

(b) the assets and liabilities, financial position and performance, profits and losses, and prospects of the body that is to issue the securities.

One such example where ASIC has ordered several interim stop orders due to inadequate disclosure is the failed IPO of Bitcoin Group Limited (BGL), a holding company of an operating company that described its operations as bitcoin mining through service agreements in China, Iceland and Australia.

In 2015, BGL issued a prospectus and, because of various disclosure issues, ASIC issued several interim stop orders in relation to the prospectus lodged, which ultimately resulted in BGL lodging two replacement prospectuses and three supplementary prospectuses. The various issues ASIC raised were not limited to the following:

(a) the omission of an Independent Expert Report to support forward-looking statements

(b) explanation of Bitcoin's business strategy and operations

(c) compliance with ASIC Regulatory Guide 170 *Prospective Financial Information* in relation to forward-looking statements.

Specific disclosure requirements

In addition to the general disclosure requirements, there are specific disclosure requirements that require certain specific information to be included in a prospectus.

Although this chapter is focused on ASIC's powers, it is also important to be cognisant of the requirements from ASX and its independent review process. One such example where the specific disclosure requirements (amongst other things) were not satisfied is Guvera Limited (Guvera), which in 2016 attempted to seek admission on the ASX through an IPO.

The prospectus lodged by Guvera was reviewed by ASIC and resulted in the exposure period on the prospectus being extended because ASIC determined that the original prospectus did not contain the required disclosure. After discussions with Guvera in relation to these issues, significant alterations were made to the prospectus in respect to financial disclosure and the terms of the offer. However, ASX ultimately assessed the application for quotation and exercised its discretion not to admit quotation on the ASX.

PHASE 3 – VERIFICATION AND SIGN-OFFS

The objectives of the verification process are:

(a) to minimise the possibility that statements in the prospectus are misleading or deceptive and, as far as possible, that there are no omissions

(b) to provide a written record of the enquiries and evidence that have been conducted and relied on by those involved in the preparation and issue of the final form of the prospectus.

The issuer's legal advisors will be responsible for providing guidance for verification of the prospectus for ensuring that the verification procedures meet their objectives. The issuer will be responsible for compiling verification materials (under the general supervision of the legal advisors).

The approach taken in the verification process is to determine whether adequate information and documentation is available to support all of the statements of fact and opinion contained in the prospectus and to support any inferences that can reasonably be drawn from those statements.

Immediately before the prospectus is lodged with ASIC, all those who contributed to its contents will provide their final report and sign-offs to the DDC confirming its accuracy regarding their respective areas of expertise. The DDC's role is to then provide the board of directors of the issuer with a sign-off of the accuracy of the prospectus and the adequacy of the due diligence process.

PHASE 4 – CONTINUING DUE DILIGENCE

Following lodgement of the prospectus with ASIC, the due diligence process should continue to the last phase, which is until the issue of securities, to ensure that the DDC is made aware of any material new circumstances affecting the accuracy of the information in the prospectus.

The company and the DDC must be notified immediately in writing if, after the prospectus is lodged with ASIC but before the issue of securities, any director of the company, any member of the DDC or other reporting person becomes aware of the following:

(a) a misleading or deceptive statement in the prospectus

(b) an omission of any relevant requirements or

(c) any new circumstance that has arisen since the prospectus was lodged and may have been required to be included in the prospectus if it had arisen before lodgement.

This last phase is important to avoid disruption and mitigate liability if new disclosure is required.

LIABILITY AND DEFENCES

EXTENT OF LIABILITY

As mentioned earlier, a person may be subject to civil and criminal liability in several ways. Essentially, a person must not offer securities where:

(a) the prospectus, any application form that accompanies that prospectus or any other document that contains the offer contains a statement that is misleading or deceptive

(b) the prospectus or any accompanying or ancillary document omits a matter required to be included by the Corporations Act

(c) a new circumstance arises following the issue of the prospectus and such new circumstance is not disclosed to potential investors

(d) the issue of the prospectus involves conduct that is misleading or deceptive or likely to mislead or deceive (e.g., making a misleading or deceptive statement during marketing activities undertaken as part of the IPO).

A person who contravenes or is involved in a contravention of the the laws governing an IPO may be subject to both strict criminal and civil liability. This means that the person or any person involved in the contravention does not have to be negligent or have any intent to contravene any applicable law. The maximum civil penalty amounts are A$200,000 for individuals and A$1 million for corporations. It is a criminal offence if the misstatement or omission just mentioned is materially adverse from the point of view of the investor.

A person who suffers loss as a consequence of a contravention of one of the provisions mentioned in the preceding paragraph may be entitled to recover the amount of the loss from several individuals, even if the person did not commit and was not involved in the contravention. These individuals include any person named in the prospectus with their consent or any person who contravenes or is involved in the contravention.

One issue to be considered by the DDC will be liability insurance. Prospectus or IPO insurance offers protection to the offeror, its directors and officers for claims arising out of the IPO, which is increasingly becoming more common these days.

CONCLUSION

Ultimately, proper and effective due diligence procedures implemented and overseen by the right advisors should serve their purpose to avoid disruption and ensure that the IPO meets legal requirements.

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IPO READINESS: KEY CONSIDERATIONS FOR FAST-GROWING AUSTRALIAN BUSINESSES

TDM ASSET MANAGEMENT

Hamish Corlett

Ed Cowan

Your business is starting to scale quickly, with revenue growing more than 25 percent annually. You have already received local or international seed or venture capital, but as revenues race to $50 million to $100 million and beyond, invariably the attention of your founder, chief executive officer (CEO) and initial shareholders has turned to the question of how to fund this rapid growth. Initial public offerings (IPOs) are a potential source of capital, but is this the right choice for you?

Although the thought of tapping public markets for funding (and potentially a big payday for founders and shareholders) sounds enticing, how much work is required before this is, in fact, a reality, let alone a successful one? Moreover, another imposing strategic question looms—as a global business, do we list in Australia on the Australian Securities Exchange (ASX), or are we lured offshore and list on an exchange overseas? For fast-scaling tech businesses, the overseas exchange is usually Nasdaq or the New York Stock Exchange (NYSE).

At TDM, we firmly believe that ASX provides a compelling opportunity for your business to take the next step, and if you prepare adequately, there is no reason that listing on ASX cannot become a reality for your business. This view is without bias. Our unique investment mandate has no time horizon, and our ability to invest domestically and overseas in listed and unlisted companies provides a rare and objective view to make this judgment.

Presuming an IPO has been settled upon, before the question of ‘where to list’ is resolved, the onerous task of ‘how’ needs to be addressed.

ARE YOU READY FOR AN IPO?

In our experience, IPO preparation takes at least 24 months. This timeline is not a consideration but a necessity on such a long journey. A timeline of this length will not only enable you to create long-term shareholder growth through a higher valuation multiple, but more important, establish a strong and supportive shareholder registry. Furthermore, a well-prepared IPO will lessen the burden on management during the formal IPO process and can significantly reduce transaction costs.

The IPO preparation process is intensive and will include (but certainly not be limited to) the following steps:

- *Choose the right growth equity partner at least two years prior to IPO.* Traditional post–venture capital/pre-IPO private equity partners can provide both beneficial financial and strategic support. However, their finite time horizon on investments can be a significant conflict to long-term value creation. It is important to understand what their post-IPO intentions are well before letting them fund your pre-IPO growth. The right equity partner will also take significant pressure (time and otherwise) off the management team and CEO by adding significant value and expertise throughout the transition process.
- *Develop a long-term strategic plan and financial model.* A four- to five-year high-level strategic plan and accompanying long-term financial model is critical to the IPO process. By now, you probably have a well-developed 12- to 18-month financial forecasting and budgeting model. However, we have found that most private growth companies have not developed a long-term strategic plan and financial model with the same rigour. These symbiotic pieces of work become critical to being able to scale your business effectively and will ease your transition to the public market. Investment banks and investors heavily scrutinise your long-term strategy and forecasts as part of the IPO process and hold you accountable to these post-listing. Table 1 outlines some of the differences in your company's 12- to 18-month budget model and the separate long-term financial model.
- *Be relentless in establishing your corporate governance.* Move to regular board meetings and finalise board composition. The importance of a high-quality and balanced board cannot be underestimated. It is vital that all board members are high-impact and add value to your business. In Australia, non-executive directors (NEDs) tend to be retired executives at the end of their professional careers. It is extremely challenging to find

TABLE 1. Differences between a company's 12- to 18-month budget model and a long-term financial model

Budget Model	Long-Term Model

• Rolling 12–18 months forward
• Month by month (or daily)
• Highly detailed—including all revenue and operating expense lines (multi-sheet/workbook)
• Resource intensive to update—quarterly/semiannual process—used only within the finance team
• Used for
  ◦ planning short-term resources
  ◦ setting 12-month key performance indicators
  ◦ providing executive committee short-term incentives
  ◦ assessing the impact of short-term tactical changes
	• 1–5 years forward
	• Annually or semiannually
	• Higher level—driven by key performance indicators (single workbook/sheets)
	• Flexible to update and adjust scenarios regularly—relevant and usable by business development teams
	• Used for
	  ◦ planning long-term resources
	  ◦ assessing long-term impact of strategic decisions
	  ◦ planning long-term scenario modelling
	  ◦ aligning the business around key long-term metrics
	  ◦ setting long-term incentives

NEDs that are passionate about helping your business and who think like owners. It can take years to find the right people who have these attributes and persuade them to join your board. We interview 50 to 60 potential NEDs for our portfolio companies every year. Less than five percent make the cut.

We believe the best boards will have a mix of NEDs who are successful current operators as well as retired executives, with vast networks that can be tapped into to help your business grow. Whilst board members who are currently in executive roles at other businesses tend to be shorter on time, their 'value add' can be significant because they can share their current experiences, challenges and successes with you.

Another key consideration, and perhaps the most important when it comes to the board, is finding the right chairperson. The chairperson must be highly engaged, with a diverse range of experiences, and most important, must be willing to act as a mentor and pillar of support to you as the founder and CEO.

Not only must your board be engaged to ensure the execution of your growth strategy and vision, but equally important, the quality of the board becomes a key driver for attracting high-quality investors once you do make the transition to the public markets. In our experience, your board must be experienced in the pressures and demands of listing, and it is crucial that they think and act as owners of the business.

We firmly believe that the formation of the board needs to be done well in advance of any IPO—preferably at least 12–18 months ahead, in our experience.

More crucially, as a rule of thumb, we believe that board members should hold *at least* five times their annual board remuneration in equity. This measure demonstrates a real commitment and belief in the business and enhances the principle that we seek to encourage—to 'think like an owner'.

- *Create the right incentives through a remuneration plan.* Successfully scaling a business is all about people and culture. A well-developed executive remuneration plan is critical for attracting the best people and fostering a great culture. In particular, a long-term incentive plan for management and new hires that rewards your team for the success that lies ahead is particularly important prior to IPO. In our experience, executive remuneration plans are usually 12- to 24-month projects, but every business is unique in terms of what it will look like.
  No doubt you already understand the power of long-term incentives on your employees who share your vision and passion for what your business will become. Like long-term investors, you need your employees to be thinking and acting as owners of the business.
- *Establish and practice your financial reporting framework.* It is essential that management develop and foster the skill of providing formal investor presentations and financial forecasts to current shareholders on a semiannual basis while in a private setting. In making your business ready for the public market, it is imperative that you practice the rhythm of not only preparing regular forecasts but also making a good habit of meeting or exceeding them. It is much better to make your mistakes and learn from them as a private company in this area. It is so important that you use this time to get into good habits around setting and meeting targets. The public market disproportionately rewards companies who have a track record for meeting or beating guidance and punishing those who miss them.
- *Establish investor relations and education.* Start now to raise awareness and understanding of your business among public market investors. We encourage our private portfolio companies to do one to two investor presentation events each year in the lead-up to the IPO. These events are usually hosted by investment banks that invite their institutional public market investor clients to attend.
  A well-supported IPO that will optimise value is only possible if public market investors fundamentally understand what

critical problem you are solving, where your competitive advantage lies and why your management team is worth backing. You will need to have a well-developed investor presentation and be well-practiced at delivering it in an interactive group forum. In particular, using these opportunities to learn how to deal with a public market investor 'Q and A' session is invaluable for getting you ready for the scrutiny of the listed company environment.

This situation is particularly pertinent if no close comparable business is listed in Australia, which can often be the case in the technology space. We have seen fantastic Australian businesses be misunderstood and thus undervalued upon IPO.

- *Select your advisors carefully.* With a scarcity of great IPO opportunities each year, a range of advisors will be clambering to be a part of one. Investment bankers and legal and accounting firms all have a valuable role to play in the IPO process, but it is important to understand the potential perverse incentives that can emerge. For example, investment banks are consistently trying to strike a balance between delivering a fair price for existing shareholders and a cheap price for their public market institutional clients who are looking to invest in the IPO. High-integrity bankers will manage this challenge, but it is important that you are aware of these potential conflicting outcomes. Having the right capability on the board to navigate the process of advisor selection is critical.
- *Develop the ability to scale all systems and processes very quickly.* After well over a decade of investing in newly listed, fast-growing public companies, we have found that the vast majority have underinvested in their back-end systems and processes. While taking on the new challenge that is becoming a successful public market company, your business will be expected to continue to grow rapidly. Developing a highly scalable operational infrastructure will not only enable you to effectively support and manage this growth but will also be a source of significant competitive advantage as the business scales and you win market share. This multiyear effort usually requires an overhaul of financial, human resources and operational systems and processes. We have seen so many fast-growing companies hit a wall as they pass through $100 million of revenue—lack of investment in scalable back-end systems and processes is often a key contributor. If you have invested well ahead of your next phase of growth, public market investors will have comfort that the business is well positioned to succeed over the coming years.
- *Review your talent and the structures that manage it.* Up to this point, you have managed to retain a huge amount of talent and passion within your organisation. The reality, sadly, is this: practicalities will dictate that not everyone in the team has the necessary skills required to flourish during the next stage of growth. Having the ability to self-reflect objectively on the capabilities that you and your team have, without being blinded by the nostalgia of your successes, is fundamental. It is important to empower your human resources team by providing them with the necessary tools and mandate to make any required changes well in advance of any IPO preparation.

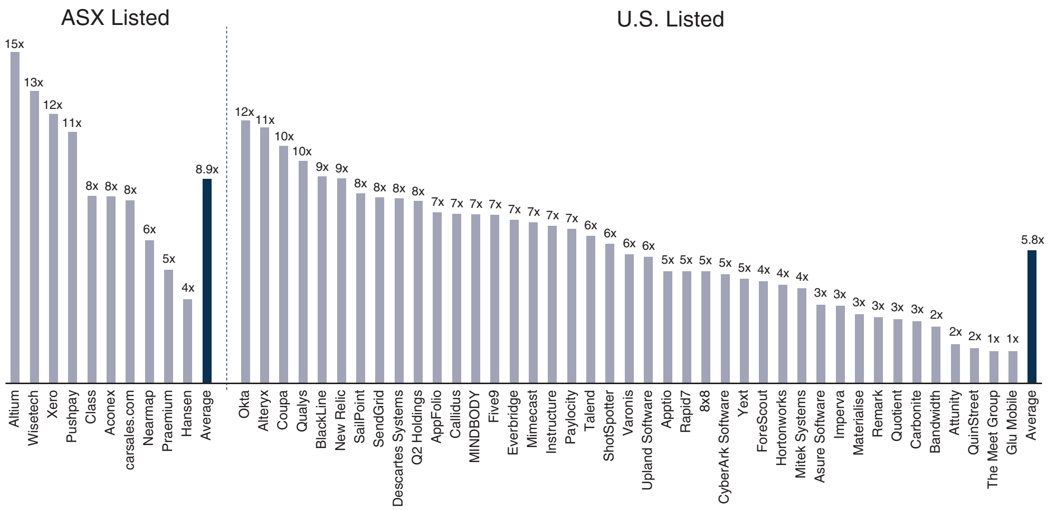
WHY ASX?

Fast-growing, Australia-based businesses could reap many advantages by listing on ASX rather than on Nasdaq or NYSE. Although a multitude of myths exist regarding why you would choose to list overseas, the following sections will describe the facts.

RATINGS

Fast-growing global businesses are generally not as highly rated in the U.S. as they are on ASX: there is a commonly held misbelief that U.S.-listed businesses trade at a premium to those listed in Australia. However, this is often not the case. For example, in Figure 1, we compare software and online businesses that are listed on

FIGURE 1. Next 12 months' enterprise value/revenue multiples of businesses listed on ASX and on NYSE or Nasdaq



Source: CapIQ Consensus Estimates (10th January 2018)

ASX and those listed in the U.S. on the NYSE or Nasdaq that met the following criteria:

- 2018 forecast revenue between $30 million and $500 million
- revenue growth in excess of 15 percent

ASX-listed software and online businesses trade on an average enterprise value/revenue multiple of 8.9x, whereas comparable U.S. businesses trade at 5.8x.

It is worth noting that even if this value gap closed between the U.S. and Australia, we still think it is beneficial to list on ASX.

'SCARCITY' VALUE

Fast-growing Australian businesses with a global presence that are listed on ASX are certainly not all that common. As such, a business with a great growth outlook and a fantastic management team will not be lost in the crowd in the Australian capital markets. Thus, it will be easier and much more likely for fund managers to fundamentally understand your business. It is a huge risk for institutional investors to not know you or understand your business, and this risk is only amplified by the volatility and scale of the North American market.

This factor also provides some justification for the data in regards to valuation—the ease of standing out from the crowd on ASX will certainly help you trade at a higher multiple.

To give you an idea of how scarce fast-growing global businesses are on ASX compared to U.S. exchanges, consider this:

Only ten software and online companies are forecast to grow revenue at 20 percent or more over the next 12 months on ASX, compared to approximately 90 on the U.S. exchanges.

REPORTING FREQUENCY

Having to report only twice a year has some advantages. Companies listed on any exchange in the U.S. are required to report every quarter. Superficially, reporting only twice as often as Australian-listed companies may not seem like a big deal, but it can have the following significant repercussions for your business.

- Semiannual reporting allows you to continue to concentrate on growing your business rather than face the constant burden of compliance. Not only is the cycle of quarterly reporting an onerous one from a time perspective, but the pressure of hitting revenue and earnings guidance every three months is stressful and can encourage the prioritisation of 'short-termism' in your business decisions. These decisions will often be highly contradictory to what is best for the company over the long term.

- The trading volatility around quarterly reporting can significantly affect your business. In a self-fulfilling cycle, missing revenue guidance by small margins only for the market to react poorly can further encourage more short-term management to ensure that the next revenue guidance is met. Your job is to grow shareholder value—which often does not equate to maximising short-term growth measures—yet volatility in the market will lessen your ability to do this as effectively or as efficiently as you would like.

A MORE STABLE SHARE REGISTRY

ASX provides an opportunity for a more stable share registry while still maintaining sufficient liquidity. Looking at the trading volumes across the NYSE and Nasdaq, on average, the free float (i.e., the shares owned by the public) of software and online companies changes hands over 2.5x a year in the U.S.! This situation implies an average holding period of less than five months. For ASX-listed software and online companies, the average turnover of free float is just 0.66x a year (with an average holding period of 18 months).

Moreover, the free float of the most highly traded U.S. software and online stocks turnover is more than 10x per annum—implying a holding period of only 35 to 40 days! The free float of the most highly traded ASX-listed software and online stocks turnover is between 1.0x and 1.5x per annum. This means a very significant time savings for CEOs and chief financial officers, who have to allocate many hours to meeting and educating investors.

This situation in itself provides much food for thought: owning a share is exactly that—would you like your 'owners' to have such short-term thinking?

Although this higher rate of ownership turnover on the U.S. exchanges may suggest a deeper liquid market, ASX certainly provides sufficient liquidity (in our opinion) to ensure no discernible disadvantage. The benefits of a stable share register are widely reported.

LOGISTICS

The simple question is this—if you are an Australia-based company, even though it is possible to list in the U.S., is it practical to do so? Logistically, the relentless back-and-forward travel involved by management for investor presentations and conferences creates a huge real and opportunity cost burden. Some questions you may want to ask when considering such travel are:

- Could your time be spent more efficiently?
- Will splitting management teams for prolonged periods have an impact on productivity?
- What is the real cost of having a satellite investor relations team?
- How much access will U.S.-based fund managers have to you and your management team based in Australia? If they will not have much access, how much will this affect your performance in the capital markets?

CONCLUSION

Scaling quickly is undoubtedly exciting (and stressful). It is so important that you maintain a long-term view on how you are going to keep this momentum going as your company grows. Poor strategic decisions can cost you significant time and money.

Be well prepared and well informed. Good luck! We will be watching on with interest. If you feel that you need some help navigating this tough process or that you are not yet there and need some guidance, we would love to hear from you.

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TAX CONSIDERATIONS

KPMG

Len Nicita, *Partner, Deal Advisory – Tax*

Robert Ignjatic, *Director, Deal Advisory – Tax*

Florence Liang, *Senior Consultant, Deal Advisory – Tax*

Amidst all the commercial considerations involved in listing your business, overlooking the associated tax consequences would be unwise.

As always, when approaching any significant business decision, we recommend that you involve your tax advisors during the early planning stages of your initial public offering (IPO) to ensure that you have properly considered all potential tax factors.

Exiting your business via an IPO will require consideration of the following matters:

- Will a restructure be required prior to IPO and, if so, what are the tax consequences of the restructure?
- Have you fully considered the options provided by employee incentive arrangements, and are these appropriately structured?
- What is the most tax-efficient means of exit from the business, and does this dictate that a dividend be paid prior to sale?
- What transaction costs will be incurred in the IPO, and how will these be treated for tax purposes?
- What tax attributes are currently in the business, and how will these be treated going forward after exit?

This chapter provides a broad overview of these key tax considerations for when you decide to go public.

STRUCTURING YOUR EXIT

IS YOUR BUSINESS IPO READY?

One of the first questions that needs to be addressed prior to a public offering is whether a restructure of the existing business is required.

A pre-sale restructuring may be favourable or necessary for several reasons, often to simplify the holding structure for ease of investment and to create an efficient tax structure going forward for incoming shareholders. The business may include assets that you do not wish to sell, such as real estate assets or other businesses that are not proposed to be part of the IPO offering.

Additionally, you may wish to merge with another potential vendor on the basis that the combined businesses may be complementary and/or provide synergies, and therefore offer a more compelling investor offering.

Examples of restructures that may be undertaken prior to an IPO include the following:

- combining or removing certain subsidiaries and/or businesses from the corporate group prior to the offering
- reorganising the funding injected into the structure (i.e., debt and/or equity)
- transferring any assets to a corporate vehicle from a trust or a partnership
- introducing a new holding entity as the float vehicle
- carving out certain assets from the public offering given the nature of startup businesses.

It will also be important to consider the likely future profile of the group post-IPO. It will be necessary to ensure that the IPO business has sufficient future profits, cash and franking credits from which to pay dividends to the public post-IPO, and that the payment of a pre-IPO dividend does not prejudice the ability of the business to pay franked dividends post-IPO in a manner consistent with what may be disclosed in the prospectus.

WHAT ARE THE TAX IMPLICATIONS OF A RESTRUCTURE?

In relation to a restructure, it will be important to ensure that no adverse tax outcomes accrue, both for you and the business going forward, which may affect its attractiveness to investors.

In many instances, it may be possible to implement the restructure in a way that allows capital gains tax 'rollover relief' to be available (e.g., in relation to the exchange of shares in one company for shares in another). This approach may be necessary where it is preferred to have a new holding company to raise capital from the public to acquire the existing business to be listed. Where the share-for-share exchange is structured properly, it should be possible to claim rollover relief. This means that you would not be immediately liable to pay tax when you receive the shares in the listed company (FloatCo). Instead, any tax paid would be deferred to when you sell the shares in FloatCo at a future point in time. The availability of this rollover relief will therefore be important where a continuing shareholding in the IPO business is retained post-IPO.

Similar rollover relief is available for other aspects of business restructures, including, for example, the transfer of assets from trusts and partnerships into corporations.

The Goods and Services Tax (GST) and stamp duty implications of a restructure and eligibility for any concessions would also need to be assessed. For example, the transfer of business assets may be undertaken as a GST free transfer of a going concern, and certain States and Territories in Australia provide for an exemption from stamp duty for the transfer of otherwise dutiable property between related entities.

A restructure does not necessarily just mean a restructure of the financing arrangements or assets. Consider whether the tax function in the business and tax risk management procedures and processes are reasonable and appropriate, or whether these will need to be more sophisticated or rigorous—especially given the increased revenue authority scrutiny that comes with being a public company.

SHOULD YOU TAKE ADVANTAGE OF TAX CONSOLIDATION?

One decision that will need to be made as part of the tax planning process is whether the entities forming the IPO business should form a tax consolidated group.

Generally, for income tax purposes, separate entities are treated as separate standalone taxpayers. However, where a group of entities is all ultimately wholly owned by a single entity (i.e., a single FloatCo), it is possible for the ultimate parent entity to make an election to form a tax consolidated group comprising itself (as head company) and its wholly owned subsidiary entities.

Where such an election is made, it allows the members of the group including the head company to be treated as a single entity for income tax purposes. This approach allows transactions to occur within this tax consolidated group that are generally free from income tax implications and therefore reduce the tax complexities of running a business.

In addition, on formation of a tax consolidated group, the tax bases of the assets will generally be reset because the assets held by subsidiary members of the group are treated as if they were assets held by the head company at the time of group formation. In some cases, this process of resetting the tax cost bases of assets can result in the tax cost base being increased, potentially to market value, thereby enhancing tax depreciation deductions/reducing taxable gains on disposal.

The implications of forming a tax consolidated group are complex and involve other considerations in addition to those discussed (e.g., implications for the availability of tax losses going forward).

Given the complexities, the issues of tax consolidation will need to be considered at an early stage of the IPO planning process. In particular, the calculations required to determine the impact on the tax basis of assets are complex and will have an impact on the financial disclosures in the prospectus, including deferred tax asset and liability balances.

EMPLOYEE INCENTIVE ARRANGEMENTS

When preparing for an IPO, it is important to determine whether the employee incentive arrangements are structured as efficiently as possible. This is especially true for rapidly growing businesses that may lack operating capital. Funding may need to be committed and reinvested into the business itself to shore up a successful venture. Thus, there is an inherent difficulty in meeting the needs of employees to be regularly and fairly remunerated and also ensuring the continued success and expansion of the business.

One way to meet these challenges whilst still satisfactorily remunerating employees is by providing staff with equity in the company. This method of compensation can be an excellent way to align employee and business interests, as well as to provide employees with exposure to potential upswings in the startup's business expansion. Providing equity to employees through an Employee Share Scheme (ESS) allows a business to do so with effective commercial outcomes for their employees (Figure 1).

HOW DO ESSs WORK?

A business may provide shares or share rights to employees as part of their total remuneration package. This type of remuneration may be provided under an ESS—a type of remuneration plan with a potential for efficient tax outcomes. This section outlines some of the more common arrangements of ESS variants. The tax outcomes for employees depend on their personal circumstances and the design of the ESS, so the following is only a general summary of possible tax outcomes.

Under an ESS, an employee may acquire, for no consideration, either shares in the company or a right to purchase shares in the company at a

FIGURE 1. Advantages of using an ESS

An ESS is a fantastic way to reward and retain talented employees of startup companies. It has two major advantages over other remuneration:

- provides a way to structure fair and attractive remuneration
- does not divert precious capital away from the business operations of a budding company when needed most.

predetermined price. The ESS can be developed so that the shares or share rights may be subject to tax in the hands of the employee either at the time of grant or at a later time. Typically, for tax to be deferred until a later time, shares must be subject to a real risk of forfeiture, and share rights must be subject to a genuine disposal restriction.

For example, a real risk of forfeiture will exist where the employee forfeits the shares if they voluntarily cease employment within two years of the time of grant. A genuine disposal restriction will exist where the employee is prevented from disposing of their share rights within one year of the time of grant. The requirement for such restrictions allows the company to develop an ESS, which supports employee retention and reward.

Where restrictions apply to defer tax until a later time, shares will typically be subject to tax in the hands of the employee when those restrictions no longer apply. Where the employee has been granted share rights, the employee will typically be subject to tax when the shares that are acquired from the exercise of their rights are no longer subject to any restrictions. The amount that is subject to tax is generally the market value of the shares at that time, and tax can arise even if employees choose not to immediately sell their shares.

Where the employee chooses to hold onto their shares following the deferred taxing point, any further gain/loss arising from the eventual disposal of those shares should be subject to capital gains tax in the hands of the employee.

An ESS is an effective way to remunerate employees because it gives the employees 'skin in the game', providing an incentive to perform and increase the company's share price. For employees of startups, ESS interests can prove an exceptionally valuable form of remuneration where a nascent business generates exponential profits.

THE STARTUP ESS CONCESSION

More generous tax concessions exist for shares or share rights acquired under an ESS of a startup.

The startup concession provides that, where the eligibility criteria outlined in the next section are met, **tax is not payable** until the employee disposes of the shares. Tax does not arise for the employee when the shares or share rights are granted to the employee, or when restrictions no longer apply to those shares. Instead, any gain or loss on disposal of the shares will be assessed under the capital gains tax regime. In addition to further deferring when taxation occurs, the employee may be eligible for a 50 percent capital gains tax discount where the shares are held for more than 12 months.

WHAT ARE THE ELIGIBILITY CRITERIA?

The following general conditions applying to all ESS schemes must be met to qualify for tax deferral:

1. The recipient of the ESS interest must be employed by the company (or its subsidiary).
2. The ESS must relate only to ordinary shares.
3. Integrity rules must not be breached (relevant only for share trading/investment companies).
4. The employee does not hold more than 10 percent of the shares in the company, nor control more than 10 percent of the votes in a general meeting of that company.

For the startup concession specifically, the additional requirements are as follows:

1. The company must be unlisted (i.e., it does not appear on any stock exchange).
2. The company must have been incorporated for less than 10 years.
3. Aggregated annual turnover does not exceed $50 million.
4. The employing company must be an Australia resident company.
5. The employees must hold the ESS interests for at least three years.

For shares, they must be provided at a discount no greater than 15 percent of the market value.

For share rights, they must have an exercise price greater than or equal to the market value of an ordinary share in the company at the time of grant.

For a private company, valuing the shares in the company can be a difficult exercise. However, the Australian Taxation Office provides approved valuation methods to make it easier.

DIFFERENCES TO THE STANDARD ESS REQUIREMENTS

Importantly, the interests provided under a startup ESS do not need to be subject to a genuine risk of forfeiture, nor in the case of shares do they need to be offered to 75 percent of eligible full-time employees to qualify for tax deferral.

EXITING THE BUSINESS

Several matters will need to be considered in relation to the actual exit from the business. These include ensuring that the structure for the actual exit under the IPO is as tax efficient as possible and that concessions are claimed where appropriate. For example, a seller who is an individual or trust may be eligible for the 50 percent capital gains tax discount for capital gains on shares that have been held for 12 months or more.

In some cases, a seller may also be eligible for certain small-business concessions that are available in relation to the exit from an investment. For example, this may mean that gains on the sale of the business could be eligible for a 75 percent discount or that gains could be fully exempt from income tax.

Residency is also a relevant consideration in determining the tax outcomes from exit. Generally, non-resident investors are not subject to Australian capital gains tax on the exit from their investment where the investment is not considered taxable Australian property (broadly, when the underlying business assets do not consist principally of Australian real property).

PRE-IPO DIVIDENDS

If the sale group has a store of franking credits for taxes paid, a key exit consideration will also be whether fully franked dividends should be paid prior to exit. Usually, it will be more tax efficient for the vendor to receive fully franked dividends rather than capital gains subject to the 50 percent capital gains tax discount.

However, a range of factors should be considered. First, the company will need to have a store of franking credits from which to pay the dividend. In addition, there will usually need to be sufficient profits from which to pay the dividend, and questions about how dividends will be funded will need to be considered. For example, will dividends be funded from existing cash held by the business, or from capital to be raised from the public in the IPO?

TRANSACTION COSTS

Undertaking an IPO will likely incur significant transaction costs for both the vendor and the business. The income tax deductibility of the full amount of the transaction cost is not often a clear matter and will depend on the entity that has incurred the transaction costs and the nature of the transaction costs incurred.

Transaction costs can be treated in several possible ways:

1. immediate deduction
2. capitalised into the cost base of an asset
3. deductible over time (e.g., business capital expenditure is deductible over five years).

Examples of common transaction costs include tax advisor costs, legal costs, prospectus preparation costs and commissions/fees paid to investment banks. Generally, the treatment of costs will depend on the nature of the costs incurred, including whether they are revenue or capital in nature. A careful review of costs will be required to determine the tax treatment, including the impact of these costs on the financial disclosures in the prospectus.

In addition to the income tax treatment of costs, it will be important to consider the associated

GST recoverability. An input tax credit will only be available for GST incurred on costs relating to the making of an input taxed financial supply where the Financial Acquisitions Threshold (FAT) is not breached.

An entity will have exceeded the FAT if either or both of the following tests apply to a 12-month period (forward-looking or backwards-looking):

- the amount of all the input tax credits to which the entity would be entitled for its financial acquisitions during the 12-month test period would exceed $150,000
- the amount of all the input tax credits to which the entity would be entitled for its financial acquisitions would be more than 10 percent of the total amount of input tax credits to which it would be entitled for all its acquisitions and importations (including the financial acquisitions) during that 12-month period.

It is therefore important to monitor the GST incurred on transaction costs relating to an IPO and monitor the share register to ascertain to what extent shares have been issued to Australian residents and non-residents.

For completeness, we note that where the FAT is breached, a reduced input tax credit of 75 percent may be available in respect of certain specific costs, and partial credits may be available for GST incurred on costs to the extent that any shares are issued to non-residents.

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TIPS AND TRAPS IN PLANNING YOUR COMPANY'S IPO

ADDISONS

Li-Jean Chew, *Partner*

Jeff Mansfield, *Partner*

Dwight D. Eisenhower once said that plans are worthless, but planning is everything. The first step in your company's initial public offering (IPO) is to plan for the journey.

PLANNING IS EVERYTHING

Early planning will help you in overcoming any twists and turns encountered during your company's IPO journey and its listing on the Australian Securities Exchange (ASX).

The first question you need to ask is: is my company ready to list? Do I, the board of directors and the company's major shareholders understand what a listing on the ASX entails and what areas I need to be aware of?

This chapter provides some practical tips that might help you in planning your company's IPO, and it also covers some traps you might encounter.

TIP 1: PREPARE YOUR COMPANY TO BE A GOOD IPO CANDIDATE

Like a good product, a good IPO will sell itself.

Not every company's IPO can be fully subscribed within 24 hours, but you should prepare your company in the best way you can to attract investors and create circumstances where investors have a 'fear of missing out' on your company's IPO.

A good candidate for an IPO and an ASX listing is a company that has several of the following features:

1. an understandable corporate structure
2. a business model that investors can easily understand and is clear on how investors will earn a return on their investment
3. a board of directors with a range of skills and experience that add value to the company
4. a good management team with experience in managing a listed company
5. a good team of advisors that includes underwriters, accountants, lawyers and tax advisors

6. an IPO price that balances the interests of existing shareholders and the interests of incoming shareholders, so that there is upside in the IPO price after listing to benefit incoming shareholders
7. a good plan for the expenditure of the money raised in the IPO
8. existing shareholders who are committed to the future of the company and have agreed to have their shares escrowed (i.e., with restrictions on sale) for a certain period.

It would be good for your company to have a profit history, but that is not a prerequisite to listing on the ASX, which allows a company to satisfy an 'assets test' as an alternative to the 'profits test'.

TIP 2: GET THE BACKING OF AN UNDERWRITER

In an IPO, it is usual to have the support and help of an underwriter. An underwriter, usually a broker, will agree to take up any shares not taken up by the investing public (whether retail or professional) in your company's IPO, subject to certain conditions. This backing of an underwriter gives confidence to the market that your company's IPO will be successful and that your company will list on the ASX in accordance with the publicised timetable.

One of your first tasks, then, is to market your company's IPO to an established broker and persuade the broker to become your underwriter.

TIP 3: GET YOUR COMPANY'S AFFAIRS IN ORDER

You can take some preliminary steps to demonstrate that your company is ready for its IPO before you approach a potential underwriter:

(a) *Have only one class of ordinary shares.* The ASX's Listing Rules only allow for one class of ordinary shares. If your company has several classes of ordinary shares (e.g., created to provide for different dividend rights or voting rights), you should consolidate them into one class. Note that the ASX, unlike some other exchanges, generally does not allow some ordinary shares to be voting and others to be non-voting.

(b) *Optimise your company's structure.* If your company is operated through a trust structure, convert to a corporate structure. It might also be desirable to set up a holding company that would hold the shares in your company and to list that holding company. Some listed groups have their intellectual property (e.g., patents and know-how) in a separate company to the operating company to protect these assets from any adverse consequences of trading in the operating company. Others have a separate company that employs all the group's employees.

(c) *Remove assets that will not be valued in the IPO.* Speak to your accountant about how an underwriter would value your business, because particular assets the company owns might not be properly valued in the valuation model used by an underwriter. For example, a real property asset not core to your business model might not be valued at its full market value. In that case, it might be better for the company to lease the real property asset rather than own it.

(d) *Remove non-business-related expenses.* Non-business-related expenses might have been put through your company because you and the other owners may have invested all your spare funds in your company, so they became the only source of available funds to pay these expenses. These expenses should be removed from your company before its IPO.

(e) *Appoint a project manager.* Management can sometimes get consumed by the IPO and listing process and forget that they need to run the company for success during and after the listing. The appointment of a project manager to manage the IPO as a separate project can be the key to the success of an IPO. This position can be an internal appointment (e.g., the company's chief financial officer) or an external appointment (e.g., a specialist project manager from an accounting firm).

(f) *Get your company's accounts in order.* In the two to three years before the proposed listing, have your company's accounts audited. Here are some requirements for a company seeking to list on the ASX:

  (i) Under the *profits test*, it would require audited accounts for the past three full financial years before the listing and a reviewed *pro forma* statement of financial position.

  (ii) Under the *assets test*, it would require audited accounts for the past two full financial years before the listing, a reviewed *pro forma* statement of financial position and audited income and cash flow statements for the past three financial years.

  There will be different accounts requirements if your company has operated for less than three financial years or if it has recently acquired a business (or will do so before the listing). Because accounts take time to prepare and audit, it is advisable to check the specific requirements for your company and speak to your accountant early in the process.

(g) *Get your company's tax affairs in order.* Make sure you have your company's tax affairs in order (e.g., tax lodgements are up-to-date).

(h) *Review related party transactions.* Related party transactions are those between the company and its directors, past directors, proposed directors and major shareholders. A public company requires shareholder approval to undertake a related party transaction unless one of the stated exceptions under the law applies. Shareholder approval should be obtained to those related party transactions that your company wishes to continue once listed, and they should be disclosed in your company's IPO prospectus.

TIP 4: RAISE PRE-IPO FUNDING

Your company's IPO will consume time and money before it receives funds from its IPO. This period could be funded by raising some funds before the listing from sophisticated investors. This step is often done by issuing convertible notes that convert to ordinary shares at listing on a favourable basis, giving noteholders a good return for the risk they took that your company might not list at all.

TIP 5: BULK UP YOUR BUSINESS

You might decide to acquire a similar or complementary business to bulk up your company for its listing.

Here are a few things to keep in mind:

1. The acquisition must be done in as tax-effective a way as possible to avoid tax issues for the sellers as well as for your company.
2. The sellers must be made aware that they might receive only ordinary shares in your company that might be subjected to escrow conditions (i.e., the shares cannot be sold or mortgaged for one to two years after listing—see further information in the section 'Trap 1: Agreeing to purchase classified assets for cash').
3. The business to be acquired might best be acquired in a subsidiary of your company. This approach might be desirable for tracking the performance of the acquired business and quarantining the effect of any downside as a result of the acquisition.
4. Consider whether the business being acquired will be a 'classified asset' (see the following section).

TRAP 1: AGREEING TO PURCHASE CLASSIFIED ASSETS FOR CASH

If a 'classified asset' has been acquired from a related party or a promoter of your company in the two years before the date of application for listing, the payment for the acquisition can only be in the form of escrowed shares (except to the extent that the payment is reimbursement of expenditure incurred in developing the classified asset). The escrow restriction might be for up to two years, depending on the circumstances.

The term 'classified asset' is interpreted broadly by the ASX and includes the following:

(a) an interest in intangible property that is substantially speculative or unproven, or has not been profitably exploited for at least three years, and that entitles the entity to develop, manufacture, market or distribute the property

(b) an interest in an asset that, in ASX's opinion, cannot be readily valued

(c) an interest in an entity with a substantial proportion of assets, held directly or indirectly, of the type referred to in items a and b.

The ASX might determine that sellers of an asset who would be future employees or executives of your company would be regarded as 'promoters'. This issue can come as a shock to the sellers if they expect to receive some cash from the sale of their assets or business. The issue should be explored at an early stage in the IPO process and discussed with the ASX.

TRAP 2: ISSUING PERFORMANCE SHARES WITH MORE THAN LIMITED RIGHTS

If your company is buying an asset or business before listing, performance shares might be used to bridge a valuation gap between the sellers and your company, or used as a form of deferred consideration (e.g., where the value of the asset is unclear or might vary materially).

A *performance share* is a share with limited rights unless and until a nominated performance milestone is achieved. If the performance milestone is achieved, then the performance share will convert into an ordinary share.

If your company is thinking about issuing performance shares, bear in mind that the ASX expects that a performance share must have limited rights, including the following:

1. It must not be transferrable (therefore, it cannot be quoted on the ASX or any other exchange).
2. It must not have any voting rights (unless required by law).
3. It must not have any dividend rights.

TRAP 3: ISSUING TOO MANY CONVERTIBLE SECURITIES

Your company may already have or may be thinking of issuing performance shares, options or other securities than can be converted into ordinary shares (*convertible securities*). If so, keep in mind that the ASX considers a company with convertible securities that could be converted into more ordinary shares than the number of ordinary shares at the date of listing as having an inappropriate structure for a listed company.

TRAP 4: NOT CONSIDERING ALL OF THE LEGAL AND TAX IMPLICATIONS WHEN ISSUING SHARES OR OPTIONS TO EMPLOYEES

You might want to reward your employees by granting them some shares or options in your company before the IPO or as part of the IPO process.

In issuing shares and options to employees, it is necessary to consider:

1. if shares or options could be legally issued to employees without a prospectus, if they are to be issued before the IPO
2. the law's requirements in relation to any loan or other financial assistance given to employees to take up shares in the company, including the related party considerations for directors of your company
3. the tax implications for employees in taking up and subsequently selling those shares
4. any requirement to disclose the terms of these arrangements in the prospectus.

These issues might seem complicated but can be worked through with appropriate professional advice.

In relation to point 3 in the preceding list, the tax concession introduced in 2015 for the benefit of employees in small startup companies might apply to your company's employees. However, certain conditions must be satisfied for this concession to apply. These include that your company must:

1. be an Australian resident taxpayer
2. have aggregate turnover not exceeding A$50 million
3. be incorporated for fewer than 10 years
4. not be listed.

Another condition is that if your company will be granting options, the *exercise price* of the option (the amount that the employee must pay to exercise the option) must be at least the market value of an ordinary share in your company at the time the option is granted. The market value can be determined using one of the 'safe-harbour' valuation methods approved by the Australian Taxation Office.

TRAP 5: NOT GIVING YOURSELF ENOUGH TIME TO CONVERT TO A PUBLIC COMPANY

Your company has probably been operating as a proprietary company, which is identified by the 'Pty Ltd' or 'Pty Limited' at the end of your company's name. A proprietary company has a limited ability to issue shares to and raise funds from retail investors. Your company will therefore need to convert to a public company before the IPO.

Although converting to a public company is a simple process of passing a shareholders' resolution, the change does not take effect until one month after the Australian Securities & Investments Commission (ASIC) publishes a notice in the *ASIC Gazette* of the intention to make this change. This one-month period must be factored into your IPO planning process.

Many listings were delayed because the planners forgot about this requirement.

TRAP 6: NOT CONSIDERING THE LEGAL RESTRICTIONS WHEN MARKETING YOUR IPO

Strict legal restrictions on advertising an IPO apply, so you need to be careful of them. Before the prospectus is publicly available, any public statement (except statements to a limited list of specific groups) referring to the IPO can *only* contain the following items and nothing more:

1. the identity of the company undertaking the IPO
2. a statement that a prospectus will be made available when the shares are offered
3. a statement that anyone who wants to acquire the shares will need to complete the application form accompanying the prospectus
4. a statement of how to obtain a copy of the prospectus.

You will have more freedom to advertise the IPO after the prospectus is publicly available, but certain requirements still need to be complied with.

TRAP 7: NOT GIVING YOURSELF ENOUGH TIME TO OBTAIN DIRECTOR BACKGROUND CHECKS

The ASX requires each director or proposed director of a company at the date of its listing to be of good fame and character. This step requires that the ASX receives criminal and bankruptcy check results for each country that these persons have resided in during the past 10 years. For instance, if a director has lived in the U.S. in the past 10 years, the ASX requires a criminal history check from the Federal Bureau of Investigation (or a third-party search provider that covers U.S. federal level offences) for that director.

These checks can take time to obtain, so they should preferably be obtained early in the IPO planning process. Otherwise, you risk delaying your company's listing date if these checks are not obtained in time.

CONCLUSION

The IPO journey is an exciting one for a company and the people involved, but it can also be a stressful time. To minimise this stress and potential disruption to your company's business, keep in mind the above tips and traps, and start planning early!

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HOW LINK HELPS NEWLY LISTED COMPANIES NAVIGATE THE FIRST YEAR OF BEING A LISTED COMPANY

LINK MARKET SERVICES

Lysa McKenna, *Chief Executive Officer, Link Market Services Australia*

Melissa Jones, *General Manager, Company Matters*

The transformation of a private company to a public entity via an initial public offering (IPO) is a rigorous and highly regulated process. It also represents one of the most important milestones in a company's history.

HOW REGISTRIES HELP COMPANIES NAVIGATE THE IPO PHASE

A company's first experience of working with a share registry usually occurs during the listing phase of the process. Companies can expect their share registry provider to work closely with the advisors to the transaction and provide expert advice and end-to-end project management.

SERVICES PROVIDED BY THE SHARE REGISTRY

Services provided by the share registry include the following:

- management of key IPO processes
- the establishment of an online offer facility
- pre-registration and offer acceptance management (including management of all prospectus and application requests)
- comprehensive distribution and banking services
- mailhouse and third-party management
- broker liaison
- commission payments
- investor relations (IR).

ONLINE SOLUTIONS

The success of your IPO depends on the ability to effectively communicate and engage with prospective investors to maximise offer uptake. Nowadays, companies planning to list look to online technology solutions to expand their reach to both local and global investors. Investors can access a wealth of information about your company through a dedicated offer website that is targeted to investors.

An IR platform should be designed to support strategic communications during corporate actions. Investor participation outcomes are enhanced through effective, tailored communications and the select use of communication channels providing accessible and relevant information.

A market-leading IR platform provides strategic advice, comprehensive analysis services, tailored communications, integrated delivery and campaign flexibility. The invaluable insight derived through campaign activity enables timely and effective strategic action or issue mitigation, driving the success of your offer.

POST LISTING

An entity's first year after admission to the Australian Securities Exchange (ASX) is often a quite exciting (and challenging) transition point in its life cycle, especially to those new to the listed environment. The well-worn road from private entity to IPO is a unique experience for each company, with external influences such as market conditions, the economy, the industry, and the entity's internal experience, which can quickly reshape the company at launch date.

Many a newly listed client may be baffled, wondering which step to take next. The breadth of in-house services delivered through a dedicated, experienced account manager is invaluable at this time.

Initially, the first year is dedicated to managing and maintaining the regulatory compliance and taking stock of the shareholder base.

Also important is looking ahead and planning the major financial calendar events such as the half-year/full-year financial results announcements/presentations, considering the payment of a maiden dividend and planning the first Annual General Meeting (AGM), where all directors face the shareholders as well as their first election.

CONTINUOUS DISCLOSURE AND COMPLIANCE

Listing provides access to capital markets to pursue new opportunities; however, the increased transparency required of a listed entity can be daunting. The pre-listing securityholders and management team may have an intricate knowledge base for developing and selling a product/service, yet they find themselves facing a steep learning curve in respect of the new compliance and regulatory regime, as well as the new 'owners' expectations for increased visibility and reporting.

The expectations for a listed entity's continuous and periodic disclosure are higher than for unlisted companies, as detailed in the ASX Listing Rules and *Corporations Act 2001* (Cth). In particular, the ASX Listing Rules often present a challenge for a newly listed entity in content, interpretation and execution of the 'rules'. Compliance with the rules is not always straightforward, and matters to be considered are often many shades of grey.

Although a suite of governance documents is required to be submitted as part of the admission requirements by the ASX, the practical working and interpretation of these documents can cause, at a minimum, frustration, and at worst, errors at the board and management levels.

A key area of risk for newly listed entities is the continuous disclosure regime, which aims to create a level playing field for all investors, ensuring that all material information is disclosed to investors on a timely basis. Establishing what needs to be immediately disclosed can be challenging for a newly listed entity and is often the most difficult area for the management team to navigate.

At a practical level, disclosure is not a clear-cut matter. It is essential that, in addition to the entity's Disclosure Policy, an effective framework be established to capture the right information and interpret and communicate that information to the right people in the organisation in a timely manner.

This step includes establishing guidelines and procedures in addition to the entity's Disclosure Policy that address the following issues in a practical manner:

- Learn what constitutes materiality from both a qualitative and a quantitative sense, and review and adjust those guidelines as business conditions change and the entity evolves.
- Provide training for all relevant personnel to understand the requirements and the people who must be informed, as well as the implications of failing to do so.
- Understand what acting promptly, without delay in response to events, actually means. Where there may be unavoidable delays, having a trusted advisor if matters fall under a 'carve-out' provision or instigating a trading halt can protect the integrity of the market and, ultimately, the reputation of the entity.
- Know how to apply the disclosure regime consistently and fairly. Both good and bad news must be shared. A material revision to the earnings guidance as stated in the prospectus or product disclosure document (although potentially detrimental to the share price) is made worse when called to account publicly via the ASX listing platform for any delays in distributing the information.

The ASX Corporate Governance Council has provided a series of recommendations on good corporate governance practice, *The Corporate Governance Principles and Recommendations* (3rd ed., 2014). Each listed entity must record and disclose its policies and corporate governance charters publicly.

Entities are required to detail a self-assessment each year of their compliance with these principles on an 'if not, why not' basis. It is often a significant cultural challenge in a newly listed entity to implement and, in practice, follow such guidelines. Assistance from governance professionals to perform independent reviews and document what actually happens in a post-listing world, with associated training, can soften this cultural change.

Assistance from open-minded governance professionals can help boards embrace these principles in a way that makes compliance a positive experience rather than a burden. Many institutional investors expect entities in which they invest to have a robust and effective corporate governance framework. Failing to do so can limit an entity's ability to attract high-quality investors.

MANAGEMENT QUALITY AND CONTINUITY

Organisations are not just about policies, processes and procedures. Transitioning from a private to a public entity can be difficult for employees and management. Post listing, the board's composition and senior management may need to be reviewed. Some of the previous owners/management may not wish to remain or may not possess the appropriate skill set to operate in the listed environment. It is important for the entity's long-term success and reputation that a newly listed entity's directors and management be jointly committed to carrying out their respective roles that reflect the strategy contained in the prospectus and in accordance with market expectations.

Company secretarial experts are well placed to provide guidance to newly listed board and management teams who have not previously worked within a listed environment and are not familiar with the increased reporting and regulatory regime. Company secretarial experts assist with establishing and managing the new board's meeting habits and expectations through advice on:

- establishing meeting conduct and drafting well-considered board and committee agendas to maximise meeting time and coincide with annual reporting requirements and material business decisions
- preparing meeting materials to encourage internal authors to prepare documentation that is clear and concise, to enable sound decision making
- taking minutes of discussions on business matters in an appropriate manner for a listed

entity—in a way that satisfies the directors. Note that many newly listed entities include new non-executive directors who may have significant listed company experience and have high expectations of the management team.

The conversion to a public entity from a private one can be transformed into a positive and rewarding experience with the right support to guide and inform a new board and management team. Preparation is essential, and a practical approach with experienced governance professionals working alongside a knowledgeable management team will be well positioned to meet the performance and reporting expectations of the entity's new audience: the ASX, the Australian Securities & Investments Commission, securityholders and the media.

INVESTOR RELATIONS

Companies normally start building out their IR capabilities before going public. During this pre-IPO phase, IR departments can help establish corporate governance and start communicating with potential IPO investors.

IR service providers provide valuable information for listed companies, such as beneficial ownership analysis reporting, voting analysis reporting and—from your beneficial owners—who subscribes to a corporate governance advisor and how much voting influence each of the corporate governance advisors controls. Some full-service companies also include a standalone proxy solicitation division that can contact the institutional investors in the lead-up to the voting deadline. This division can determine voting participation and gauge how the institutions are planning to vote and when they are planning to lodge their votes.

Often, regardless of the resolutions (whether contentious or not), the client and the board want to know how things are shaping, well before the proxy votes are finalised. The real pressure-cooker element in an institutional vote is that each year, the nominee/custodians hold on to all of the votes and lodge right before the voting deadline. Generally, clients go from 10 percent of issued capital lodged to 40 percent of issued capital overnight, a scary proposition for any company secretary unaware of how the institutions have voted.

Retail-heavy registers share the same voting fundamentals. Will my shareholders participate? How do they intend to vote? For these registers, shareholder voting apathy is a major threat to a harmonious AGM. If the majority of shareholders do not vote, the impact of the minority grows and can unbalance a fair outcome (or press their agenda) at the meeting. In these scenarios, it becomes paramount to drive shareholder participation and identify dissident shareholders, who often require direct company dialogue.

Taking stock of the shareholder base is a major focal point for the board, executives and the company secretariat. The initial shareholder base (generally mostly comprising those investors who applied for a stake in the company during the IPO) may have experienced a significant churn rate in the first days of listing. The first questions asked tend to be, Who sold? Who increased their holding? Who still holds our stock?

After the dust has settled, this is where most of the interest lies for companies. For new listings whose register composition contains institutional investors (fund managers/superannuation funds), this is the point where the company should complete its first Beneficial Ownership Analysis Report (Analysis Report) to determine who the underlying holders are under the nominee/custodian positions on the register. Institutional investors will hold shares in the company through a nominee or custodial position; rarely will they hold shares in their own name as a registered holder.

It is recommended that a newly listed company run its first Analysis Report around five business days after listing to allow for the trades (particularly the spike in volume of first-day trades) and new holders to settle on the register. Without this report, the company is simply guessing the institutional composition (of course, the company will be informed of any holders with over a 5 percent stake through substantial notices). The board will want to know who is a shareholder and who sold during the IPO.

For companies whose register is weighted with more retail holders than institutional investors, reviewing the shareholder base is the first step. Assessing the shareholder types, holding distribution, geographic distribution and top holders—and monitoring major movements via the online register—are the fundamental first measures in understanding the shareholder base.

Once the company has taken stock of the shareholder base and established the register's composition, it is time to plan. Three major events lie ahead: two financial results and the AGM.

For institutionally weighted companies, the Analysis Report and subsequent analysis reports identify the underlying institutional investors and, importantly, their net movements (increase, decrease, new and exited) from under the nominee/custodial positions on the register. The Analysis Reports offer valuable insight as to whom they should invite and/or meet with during the financial results call and subsequent results roadshow. For the AGM, the Analysis Reports also determine who maintains the voting rights (the asset owner, such as a superannuation fund, or their asset manager). This is an important factor when planning the pre-AGM roadshow. Most of the executive team will be familiar with the asset managers because generally these are the contacts with the Buy/Sell investment discretion over the shares. However, increasingly it is the asset owners who maintain the voting rights on the shares, and this group must be contacted prior to voting.

CORPORATE GOVERNANCE

Adding to the complexity, many beneficial owners subscribe to a corporate governance advisor. The corporate governance advisors can provide a valuable service to beneficial owners, especially those with multiple holdings.

They provide the Voting recommendations ahead of the AGM, namely For, Against and Abstain. By using individual internal metrics, governance guidelines and fundamentals aligned with shareholder value and Environmental, Social and Governance principles, these corporate governance advisors will review the company, the voting resolutions, the board's gender composition, experience and past financial results. They will deliver an in-depth report to the beneficial owner that summarises how the institutional investors should vote.

Many new companies, specifically new ASX 300 companies, are simply blindsided by these phenomena each year.

AND FINALLY ...

Most companies have little or no experience in the process of taking a company from private to public, and they can find the process quite difficult due to the new level of governance and compliance required in the listed environment. The breadth of in-house services delivered through a dedicated and experienced registrar is invaluable for the company navigating its way through a listing.

In summary, if you are a company considering going public, it is worthwhile to understand the level of support you will require from your share registry, IR provider and governance advisors so that you understand what is involved in the following:

- managing and maintaining regulatory reporting compliance
- knowing who your shareholders (major and minor) are
- knowing the composition of the initial register (institutional versus retail split)
- knowing whether the initial IPO investors sold or still hold shares (for the report to the board)
- constructing the board report (shareholder composition and holding information, ASX reporting data)
- opening dialogue with the investors (through the website and announcements)
- looking ahead and planning for the results announcements and AGM.

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MANAGING CONTINUOUS DISCLOSURE OBLIGATIONS FOR SUCCESSFUL GROWTH POST-IPO

JACKSON McDONALD LAWYERS

Will Moncrieff, *Partner*

Hamish Taylor, *Senior Associate*

The Australian Securities Exchange (ASX) provides an attractive market for technology and industrial companies seeking to go public at an early stage.

Some 44 technology companies listed on ASX over the 2016 and 2017 calendar years, raising a total of A$800 million.

Early-stage companies are attracted to ASX's comparatively low admission requirements, in terms of assets and historical financial performance, and Australian appetite for early-stage equity investment. A feature of the Australian securities market is that it is well regulated and provides companies with the ability to raise equity funding quickly and flexibly.

Companies can list on ASX at a relatively early stage of development, but this means that after listing, early-stage companies will often be raising further equity capital in a public market.

Going 'public' means more than public ownership. Listing on ASX also entails going 'public' with material information.

In this chapter, we discuss the ASX continuous disclosure requirements, with a focus on their application to early-stage technology and industrial companies.

THE CONTINUOUS DISCLOSURE REGIME

ASX-listed companies operate within a disclosure-based regime, requiring the release of announcements and reports to ASX's announcements 'platform' in circumstances where:

- The onus is on the company and its officers to ensure information is released in a timely and accurate manner.
- The general disclosure obligation is broad in nature.
- The timing and content of disclosure is regulated by the *Corporations Act 2001* (Cth) (Corporations Act) and the ASX Listing Rules.

- Disclosure compliance is intrinsically linked to the regulation of further capital-raising activity.
- The company must publicly warrant both to investors and the Australian Securities & Investments Commission (ASIC) that it has complied in order to raise equity capital and issue further quoted securities.
- Compliance is closely monitored by ASX and Australia's securities regulator, the ASIC, who both have the ability to apply sanctions for breach in a manner that may affect investor perception and curtail the company's ability to raise further capital.

Continuous disclosure looks to maintain market integrity by seeking to ensure that a listed company's securities do not trade on ASX whilst the market is not properly informed of all material information.

The continuous disclosure obligation arises immediately when the company is listed on ASX—companies must be able to 'hit the ground running'.

Understanding when and how announcements should be made, how releases can be managed and how compliance is monitored and administered by ASX and ASIC will assist companies in maintaining investor confidence and undertaking fundraising.

Before listing on ASX, a company must usually provide investors and ASX with a prospectus that satisfies general and specific disclosure requirements set out in the Corporations Act, regulations, ASIC regulatory guidance and the ASX Listing Rules.

The initial public offering (IPO) prospectus will not be 'pre-vetted' by ASIC or ASX. The onus is on the company and its officers to ensure that the prospectus complies with relevant requirements, meaning, in the case of the general disclosure requirements, that care needs to be taken to determine relevant information and assess it for materiality.

Properly prepared, the IPO prospectus and other pre-admission information required by ASX should provide the market with all information that may be material to assessment of the value of the company's securities once listing occurs.

After listing, a core obligation of the company will be to keep the market informed of material information relevant to the company and its securities.

CONTINUOUS DISCLOSURE REQUIREMENTS FOR ASX-LISTED COMPANIES

At the heart of the continuous disclosure regime is Listing Rule 3.1 (Figure 1).

Listing Rule 3.1 is simply stated, but within it lies various considerations, including the following:

- *Materiality:* An assessment must be made as to whether information is price sensitive and requires disclosure. Information is deemed to have a material effect on the price or value of securities if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to buy or sell the securities. Assessing materiality depends on several factors, including the nature of the information, the size and circumstances of the company and the nature of its business.
- *Awareness:* A company is deemed to be aware of price-sensitive information when an officer of the company (e.g., a director, a company secretary or a senior manager) has, or ought reasonably to have, come into possession of the information in the course of performing his or her duties.

FIGURE 1. Listing Rule 3.1

3.1	Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.

- *Immediate disclosure:* Price-sensitive information must be disclosed immediately, placing the onus on listed companies to monitor and consider relevant information and, if disclosure is required, to either make an announcement or, if appropriate, request a trading halt or voluntary suspension until an announcement can be made.
- *Disclosure to ASX first:* Price-sensitive information must be given to ASX before it is released elsewhere, including to the media (even on an embargoed basis).

EXCEPTION TO THE GENERAL DISCLOSURE RULE

It will not always be possible or desirable for a listed company to make disclosure of a material matter and, in some cases, it may be contrary to the company's and shareholders' own interests to do so. For example, the fact that a company is negotiating a deal may in itself constitute price-sensitive information—investors might well like to know of these negotiations before deciding whether to buy, sell or hold the company's shares. But the premature announcement or leak of information before agreement is reached might, of course, preclude agreement at all, thereby denying the company the benefit of the deal.

Listing Rule 3.1A recognises this issue and provides for an exception to the general disclosure obligation (Figure 2).

The exception concerning an incomplete proposal or negotiation is commonly relied upon by listed companies to avoid having to release information prematurely.

Critically, however, a company can only rely on the exception if the information withheld from disclosure is and remains confidential. If confidentiality is lost, the company must disclose the information.

Where a substantial change in the price or trading volume of the company's quoted securities occurs and an announcement has not been made to substantiate the change, ASX may require the company to publicly state whether or not it is relying on an exception in Listing Rule 3.1A. If a company is relying on the exception, ASX will usually consider that confidentiality has been lost and require disclosure of the withheld information.

MANAGING THE 'GOOD NEWS' STORY

Early-stage companies have an obvious commercial interest in keeping good news flowing—it attracts potential investors, promotes liquidity and facilitates future capital-raising activity.

In their natural desire to maintain positive news, companies need to be conscious that the continuous disclosure obligation cuts both ways; both good news and bad news need to be released if material.

FIGURE 2. Listing Rule 3.1A

3.1A	Listing rule 3.1 does not apply to particular information while each of the following is satisfied in relation to the information:
3.1A.1	One or more of the following 5 situations applies: • It would be a breach of a law to disclose the information; • The information concerns an incomplete proposal or negotiation; • The information comprises matters of supposition or is insufficiently definite to warrant disclosure; • The information is generated for the internal management purposes of the entity; or • The information is a trade secret; and
3.1A.2	The information is confidential and ASX has not formed the view that the information has ceased to be confidential; and
3.1A.3	A reasonable person would not expect the information to be disclosed.

Whilst information that is 'good news' but not in itself material to the market price of the company's shares can be released to ASX, care needs to be taken as to the extent to which the company promotes itself in this manner. Companies cannot engage in misleading conduct by being 'selective' or merely promotional in their disclosure.

Companies need to be careful about setting an unnecessarily low materiality benchmark for disclosure. The release of 'good news' stories that are not necessarily price sensitive may signal to the market that the information *is* considered price sensitive. The company may need to make follow-up announcements on that matter, even if they are not positive.

Particular care needs to be taken with announcements of a future anticipated event. If the event does not occur within the previously announced time frame, the company may be required to make an announcement to the effect that matters have not progressed as expected.

Companies should consider the longer-term implications of releasing news that is not of itself price sensitive and may require future correction. It can distract from the key message that the company is seeking to deliver and can erode investors' confidence in the company.

PROVIDING CONSISTENT MESSAGES AND INFORMATION

Directors and management play a key role in managing investor relations and promoting the company. They should expect to receive requests for information from potential investors, brokers and the business media, particularly if the company is distinctive or has been successful in its IPO.

The obligation to 'inform ASX first' means that information provided in investor presentations, at conferences, on social media and to news outlets must be consistent with previously released information and not contain price-sensitive information that has not previously been announced.

HANDLING DISCLOSURE IN THE DEVELOPMENT STAGE

The future success (or failure) of companies with businesses, technology, products or services in the development or testing phase will usually hinge upon actual development. For early-stage companies, many events related to their development may be material for disclosure purposes.

It can be difficult to identify what information must be disclosed to the market about product, technology and service development. Broadly speaking, purely scientific or technical information *may* not of itself be price sensitive, but conclusions that may be drawn from it (e.g., the potential for the company's business) *may* be. For example, how a medical device technically operates may not be material, but its operational capability may well be.

To avoid publishing misleading announcements, the company must ensure that information released about such development, or the potential effect it may have on the company, is sufficiently certain and, in the case of forward-looking statements, that a reasonable basis exists for such statements.

Companies should establish procedures to collect data as development progresses, and they should consider whether sufficient information and reasonable certainty exist to justify the announcement about the status of development.

MAINTAINING CONFIDENTIALITY BEFORE THE ANNOUNCEMENT

Security and confidentiality protocols assist in preventing leaks or misuse of price-sensitive information. Information on matters such as third-party negotiations or product/service development must often be withheld from the market under the continuous disclosure exception. However, this issue relies upon (among other things) the information remaining confidential as a matter of fact.

If any sudden change in the trading price or volume of a company's securities occurs, ASX may presume confidentiality has been lost and require the company to make a statement to the market regarding the withheld information. This situation can result in the company having to make a 'premature' announcement, which suggests that the company is not in control of its own affairs. It may also cause problems with potential transaction counterparties, who may not wish for an announcement to be made before an agreement has been finalised.

To assist in the management of their disclosure obligations, companies may seek 'trading halts' (for up to two trading days) and, in some circumstances, 'voluntary suspension' of quotation of their securities, features that are unique to ASX.

MAKING COLLABORATION ARRANGEMENTS

Early-stage companies will often collaborate with established larger companies on matters such as funding, accessing customer networks, product development or general project management.

Negotiations with larger counterparties can influence a company's share price, even before any arrangement is formalised. Investors may perceive the negotiations as an informal endorsement of the company's business. Non-binding or conditional arrangements may still be material for disclosure purposes.

Any formal agreement between a listed company and a counterparty should permit the company to release information to ASX regarding the collaboration arrangements, as required. If the counterparty is also listed, its materiality threshold for disclosure may be greater than that of the startup.

To avoid the risk of damaging commercial relationships, protocols for disclosure regarding the collaboration can be useful. Larger companies often have strict internal procedures for third parties disclosing their name, as well as their own market releases generally. Any protocol should seek to manage the startup's obligation to make immediate disclosure, whilst having regard to the counterparty's internal procedures.

Notably, ASX generally requires a transaction counterparty to be named in an announcement, except where the transaction is incomplete and announcing the name may create a false market.

USING THIRD-PARTY EVALUATION

Startup companies may engage third parties to conduct evaluation or testing of products and services (e.g., clinical trials of a medical product by a university or medical institute).

Logistical issues associated with such evaluation and the ability to obtain information for release to ASX need to be considered.

It is common for independent evaluation bodies to withhold their findings until they are published in official journals or presented at conferences, even from the party that engaged them.

Companies should clarify if findings of third-party evaluation will be withheld, and if so, when they will be released. This information is relevant when providing indicative time frames to the market. To avoid enquiries from ASX, companies might make it clear in announcements that it will not have access to the information during the evaluation process.

CAPITAL RAISING

ASX-listed companies generally enjoy the ability to raise equity capital in a relatively expeditious and flexible manner as compared with companies in other countries.

The listed company's obligation to give continuous disclosure forms an intrinsic part of the securities laws governing the offer of securities in Australia and the subsequent trading of those securities on ASX.

Depending on market circumstances and investor demand, typical post-IPO fundraising alternatives include the following:

- *Private placement of equity securities to 'sophisticated', 'professional' and other qualifying investors without a prospectus and* *minimal additional disclosure:* Placements may or may not require shareholder approval, depending on the number of securities being issued. Typically, placements can be completed in a matter of days if shareholder approval is not required.

- *Placements of equity securities to 'retail' investors:* Such placements are made under a reduced-form prospectus containing only certain information specified by the Corporations Act.
- *Offers of securities to shareholders of the company on a* pro-rata *basis ('rights issues'):* Offers for shares only may be made without a prospectus pursuant to a simple offer document containing only certain specified information.
- *Share purchase plan offers to shareholders of the company of up to A$15,000 worth of shares:* Offers for shares only may be made without a prospectus pursuant to a simple offer document containing only certain specified information.

A common feature of all such equity raisings is that to facilitate secondary trading of the securities once issued, the company must publicly state that it has previously disclosed to ASX all material information under continuous disclosure and that it is not relying on the continuous disclosure exception. In short, the company must confirm that the market has already been fully informed of all material information.

Depending on the type of offering being undertaken and the nature of the potential investors, these matters will need to be disclosed in either:

- a short-form prospectus or offer document for the offering, if required
- a 'cleansing notice' given to ASX immediately after completion of the issue of the securities.

If the issued securities are to be quoted on ASX, the company will also need to warrant in its application for quotation to ASX that the above matters have been satisfied.

These requirements have particular and practical implications for companies seeking to conduct capital raisings.

USING PLACEMENTS THAT ONLY REQUIRE A CLEANSING NOTICE

In circumstances where the company is seeking to raise capital quickly by means of a placement without a prospectus, the company cannot continue to withhold information under the continuous disclosure exception.

If the company is engaged in material negotiations at the time, the company may need to either:

- defer the capital raising until the transaction has been completed and announced (or otherwise terminated)
- complete the transaction and the capital raising simultaneously so they can be announced at the same time.

MAINTAINING CONFIDENTIALITY AND USING TRADING HALTS

Where a company is seeking to arrange a capital raising and is engaging with potential investors, care must be taken to ensure that confidentiality is preserved until such time as the equity raising is announced.

The company will want to avoid downward movement in its share price before the equity-raising price is determined to minimise the 'cost' of the capital, minimise equity dilution and allow for price determination. To facilitate this result, companies typically request a trading halt before engaging with potential investors on an equity raising and endeavour to arrange the raising within the two-day trading halt period, before an announcement of the raising is made.

But before going into the trading halt, the company needs to be well organised and plan for the capital raising, thereby ensuring that it will be in a position to announce the capital raising and any other material information not previously released to ASX. This step is done so the company can issue a cleansing notice immediately on completion of the capital raising to allow the new securities to be quoted on ASX.

UNDERSTANDING REGULATORY SANCTIONS

A breach of continuous disclosure obligations or an inability to keep the market informed may result in the company's securities being suspended from quotation. These issues can impede future capital raising.

For example, if a company's securities have been suspended for more than five trading days in the preceding 12 months, the company cannot issue a 'cleansing notice' for the issue of the securities. Instead, the company will be required to issue a prospectus to enable secondary trading of the securities, which adds to the time and cost for the capital raising.

CONCLUSION

Listing on ASX provides the early-stage company with the ability to raise further equity capital for post-IPO growth in a speedy and flexible manner. However, to preserve this ability, it is essential that the company comply with its continuous disclosure obligations and be cognisant of how the rules operate and are enforced in practice.

Positive news flow and capital are often the lifeblood of an early-stage listed company. Compliance with the ASX's continuous disclosure rules are essential to maintaining a company's ability to build on its successful IPO, retain investor interest and raise further capital.

In planning for an IPO, the company should ensure that it has a proper understanding of the continuous disclosure regime, the tools that can be used to facilitate compliance and the pitfalls to be avoided. These precautions will ensure that growth and development are facilitated by timely and proper news flow and not impeded by the lack of it.

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LESSONS FROM GROUND XERO: EARNING A COMPETITIVE ADVANTAGE FROM CAPITAL MARKETS

XERO

Rod Drury, *Founder*

Building a business is a continuous voyage, and establishing a strong capital structure can ensure that the journey survives high seas and stormy weather. Our capital-raising approach has played a critical role in Xero's evolution. Here are a few things I have learned as the company's market capitalisation has grown nearly one hundredfold to more than A$4 billion.

GOING EARLY

When it came to initial funding, we did everything backwards. We went public very early, and then we raised money from U.S. hedge funds and, most recently, venture capital. Our investor pitch at our IPO was not that we were necessarily worth NZ$55 million. Our pitch was that we were an exciting business with a great idea and team—and if they gave us the opportunity, we had a chance to grow into a very large company.

Xero was my fourth business, but it was a different animal. In my previous ventures, I had a simple road map: build a business around a solid product, then look for a buyer. Xero, on the other hand, was always going to be a long-term global venture. That is a completely different task than building a business up for trade sale. We were not in it just for the money. We wanted to address some of the world's big problems—for example, boosting employment in the small-business sector globally. We have kept that concept in mind throughout our journey.

Accounting software is incredibly complex, and we knew when we set out in 2006 that we could not build it without significant resources. It was clear that we would need about 50 full-time employees to launch Xero. That equated to about half a million dollars a month in salaries alone. We figured we would need about three years to build the product and about NZ$15 million to get Xero off the ground.

At the time, the biggest venture capital in the New Zealand market was only around NZ$3 million. We probably could have raised the NZ$15 million we needed on the U.S. West Coast, but at a company valuation of maybe just NZ$25 million. That would have given the venture capital firms control and would have most likely led us to a quick trade sale. That option clashed with our long-term vision, and we quickly ruled it out.

Around that time, a vodka maker called 42 Below listed on the New Zealand Stock Exchange (NZX). The company pitched to investors on its potential and little else.

And Bacardi went on to buy 42 Below, giving its shareholders a good return. That established a playbook we could follow for going public early on the market.

Although no one had tried it with a tech company, the story of 42 Below suggested that if you had a solid business plan and could tell a credible story, there was an opportunity to raise money early. To create Xero the way we wanted to, we needed funding before we built the product. The only real option was to float the company at a very, very early stage.

It was a bit of a unique proposition. Many investors were seeking growth stocks in their portfolio, and there was a shortage of high-quality candidates. A well-balanced portfolio typically contains 3–5 percent high-risk securities. That meant hundreds of millions of dollars were seeking well-managed, high-risk startups. The interesting point was we did not have to win everybody over. We just had to convince enough investors who wanted healthy upside risk.

As it happened, we actually sold most of the equity round ourselves. We placed the first NZ$7 million to NZ$10 million through our own networks, and that gave us a good start. We then opened it up to the market, and many new investors came in. That first NZ$15 million in funding was raised to yield a NZ$55 million valuation in 2007.

Although we were happy with that valuation, it was never our main focus. We were more concerned with raising the money we needed to execute our business plan.

GOING BIG

Although the first phase of funding was about telling a story and banking our reputations on it, later capital raisings have been different. Since the initial public offering, we have established a pattern of working with strategic investors to place shares with them every year or two. This approach not only delivers the capital we need to keep growing, but it is also a way of bringing exceptional knowledge and experience into our business.

Our first such investor was Craig Winkler, the founder of MYOB, the software company that was our biggest competitor. I remember watching MYOB move into private equity ownership and Craig transition to an innovation role, then move out of the business entirely. When I saw that, I contacted him. After talking with Craig for about two hours, waving my arms around trying to convince him of our value, I paused and asked what he would do if he were me. He said, 'I'd let me give you $20 million'.

That was a huge moment. First, having Craig's knowledge and experience on board was invaluable. Second, it helped redefine our funding strategy. Whereas I thought we might need another NZ$6 million or NZ$7 million, Craig demurred. He told me we would always need much more money than we expected. That has been sage advice. Entrepreneurs tend to plan for an optimistic scenario, but you need money in the bank so that you can weather the inevitable storm.

There is a focus on lean startups today, but that is not the only way to do things. Having healthy capital allows you to conduct valuable research and development. It also lets you protect yourself from competitors by building a defensible moat. It is unlikely that we would be challenged by an accounting-software startup today; it would have to deploy somewhere between half a billion and a billion dollars in capital over seven to 10 years to build a competing platform.

One of the best bits of advice I can share is to raise money before you need it and to raise as much as you can.

All told, we have managed to raise almost half a billion dollars from a variety of investors. Our most recent round was from a tier-one venture capital fund.

I was never greedy in terms of my own shares. Starting with a large percentage of the company means that as you naturally dilute it down, you own a smaller portion. It is far better to have a small chunk of a large pie than a large chunk of something that is less valuable. As long as you are building a good business, it should not matter.

Some founders have raised too little capital or none at all because they have worried about diluting their own stake and ceding control. That can be a big mistake. If you get a good board and shareholders whose vision aligns with yours, you should not be too concerned about control. Targeting strategic investors, whether they be high-net-worth individuals or large investment funds, is a great way to ensure that your biggest shareholders are on the same page.

SEIZE THE MOMENT

During the formative years of Xero, share prices in the tech sector were high, but there was great uncertainty about the market's direction. This situation presented an opportunity. The board suggested we increase the company's cash reserves while the market was delivering good valuations. This would ensure we had enough capital to execute our plan independent of market conditions. I have always been grateful that our board had such foresight. The broader tech sector later experienced a downturn, and our share price fell by about two thirds. But it hardly mattered. We were able to keep sailing because we had the cash to execute our plan and reach cash flow breakeven.

We also watch how competitors are using public markets, and we try to derive as much advantage from that as we can. One of the biggest strokes of luck we have had was that while we were building Xero, our largest competitor, MYOB, sold itself twice to private equity firms.

While accepting private equity funding can provide much-needed cash, it usually changes the direction of a business. Though not always the case, the standard private equity playbook is to cut costs, which hampers innovation. The next step is to bolster revenue, often by acquisitions and price increases, and lastly, sell for a profit.

In our competitor's case, the private equity owners seemed uninterested in expanding the business or investing to create a global offering. Rather, it appeared they were focused on short-term returns so they could sell down. This approach made it easier for us to build our business.

While the competition was focused on streamlining its domestic operations, we took the opportunity to expand globally. We could do so because we had cash in reserve. Our worldwide presence is now an enormous advantage, as all big platforms are global and they need to connect with one another. We are truly a worldwide platform, and our subscribers and accounting and bookkeeping partners benefit from that. We have outgrown our major competitor because we were well funded and able to pursue our strategy.

GOING DEEP

Although our cash reserves are adequate, we know we need the support of global investors to continue our growth agenda. With this in mind, we delisted from the NZX in early 2018, resulting in a sole listing on the Australian Securities Exchange (ASX). (We had been dual-listed since 2012.)

As we hit cash-flow breakeven, new types of investors will want access to a growth company like Xero. For some of them, such as U.S.-based funds, investing in a New Zealand–based company is unfamiliar. Details like this are important. The ASX is one of the leading exchanges in the Asia-Pacific region and attracts international investors.

Consolidating our listing on the ASX also offers our shareholders more liquidity. If a large fund wants to come in and bet A$50 million on a company, it needs to know that it can buy and sell the shares without distorting the market. For us, being in a deeper pool makes sense.

Additionally, consolidating on one exchange has earned us inclusion in the S&P/ASX 100 Index, Australia'a premier large-cap equity index. This approach should put Xero on the radar of passive funds that invest based on indices, as well as attract an expanded pool of growth investors. Our goal is to become a top ASX company and further raise awareness of Xero in our largest market, Australia.

IN THE PUBLIC EYE

Decisions on a company's capital structure can affect all aspects of the business, including marketing. Going public early made us a story of interest. From day one, we have had a highly public profile and received media coverage. All in all, that attention has been great for us, but at times it has been challenging. Being a listed company generates heavy scrutiny of the business, and you have got to be pretty thick-skinned.

Raising as much capital as we did in a short period has allowed us to grow at a phenomenal rate without sacrificing the quality of our product. We have been able to invest across our entire business, from our corporate operations to our sales channel, enter new markets and expand platform development.

Our journey is unique, like that of every company. As an entrepreneur, you have to define your own goals and determine how capital markets can help you realise your vision. Considered, creative and effective use of these markets has helped Xero achieve much in a short time and has put us in good stead to fulfill our global vision. Our voyage is far from over, and I am confident we are well positioned to execute our plan and reach our destination.

CONTRIBUTOR PROFILES

AUSTRALIAN SECURITIES EXCHANGE

20 Bridge Street
Sydney NSW 2000
Australia
Tel: +61 2 9227 0000
Web: www.asx.com.au

MAX CUNNINGHAM

Executive General Manager, Listings, Issuer Services & Investment Products
Email: listed@asx.com.au

Mr. Cunningham is Executive General Manager, Listings and Issuer Services at ASX. He has had extensive experience in equities markets both in Australia and overseas for 20 years and joined ASX in April 2013 to run the Listings, Issuer Services & Investment Products business. He has led the Listings franchise to expand internationally and oversaw a new Listings framework for New Zealand companies that has seen NZ Listings increase from 16 to over 50. He also expanded the Foreign Exempt Listing category and oversaw listings of early- and mid-stage tech companies from markets including the U.S., Singapore, Ireland and Israel. Prior to ASX, Max ran the Goldman Sachs Equity Capital Markets (ECM) Syndicate business in Australia. He also worked for Goldman Sachs in New York, and before that with Macquarie Group in both London and Sydney. In addition to ECM and Equities Sales, he has extensive experience developing a series of Equities Conferences and roadshow programs for Australian companies marketing to overseas investors.

JOSH COLLARD

Business Development Manager, Listings
Email: listed@asx.com.au

Mr. Collard is responsible for the development of ASX's domestic and international listings business, working with companies across industry sectors to help them raise capital to fund their growth ambitions via ASX. Prior to joining ASX, Josh spent nearly a decade in various roles within the Investment Banking industry in both Australia and the U.K. at Morgan Stanley and Nomura. He holds a Bachelor of Property Economics degree from the University of Technology, Sydney, and a Masters of International Business from the University of New England.

NATIONAL AUSTRALIA BANK

Level 27
NAB House
255 George Street
Sydney NSW 2000
Australia
Web: www.nabventures.com

500 Bourke Street
Melbourne VIC 3000
Australia
Tel: +61 452 660 652
Web: www.nab.com

ANTHONY HEALY

Chief Customer Officer, Business and Private Banking

Mr. Healy commenced his role as NAB's Chief Customer Officer – Business and Private Banking in January 2018. He was previously Managing Director and CEO of Bank of New Zealand (BNZ), a position he held since May 2014. He has held a number of senior executive and director-level roles over more than 20 years in New Zealand, Australia, Asia and the Middle East. He joined the NAB Group in 2009, taking on the role of Director, BNZ Partners, where he led the transformation of BNZ's Institutional, Corporate Business, Private and Agri Banking business. Following the BNZ Partners role he took on the role of CEO & Managing Director of BNZ. Before joining BNZ, Anthony worked for ANZ Group, as CEO of UDC Finance and prior to that, Deputy Group Managing Director of AmBank Group in Malaysia. He also held senior roles in Australia in ANZ's Institutional, Corporate and Business Banking divisions. He has a Graduate Diploma in Finance, a Graduate Diploma in Economics and a Bachelor of Science, double major in economics and psychology, all from the University of Melbourne.

LUCINDA HANKIN

Investment Associate, NAB Ventures
Email: nab.ventures@nab.com.au

Lucinda is an Investment Associate at NAB Ventures, NAB's dedicated corporate venture capital fund, in which she invests in and works with innovative startup companies, which can leverage NAB's expertise, assets and market position to drive scale. After being admitted as a Lawyer in New South Wales, Lucinda commenced her career in Financial Advisory at Goldman Sachs in Sydney, covering Financial Institution clients. She subsequently shifted into financial markets, joining the Macro-FX Asset Sales team, providing FX-related products and services to Goldman's global client base. Lucinda relocated to London in 2015, where she worked as an analyst for Perella Weinberg Partners, covering several European and U.S. FinTechs. She then made the leap into the startup scene—working with and consulting several startups and brands in the e-commerce and retail space in London and Sydney. Lucinda returned to Sydney to join NAB Ventures in January 2016.

OWEN HEREFORD

Business Development & Strategy
Email: owen.d.hereford@nab.com.au

Owen is a globally experienced investment banker with more than 15 years of work experience in the U.K. At Citi and Goldman Sachs, he successfully identified and converted opportunities into specific business strategies, divisions and investments. At Citi, Owen established, headed and led the U.K. mining industry group for the Corporate & Investment Bank, providing specialist industry expertise for Citi branches in Europe and overseeing Citi's risk and credit exposure. Moving up to Citi's private debt capital markets in leverage finance, Owen helped build the private coverage desk for bank and institutional accounts in European loans. He subsequently joined Goldman Sachs, where he became the European Head of Collateralised Loan Obligation Origination in 2013. Since his return to Melbourne in 2016, Owen has been working in Business Development & Strategy at NAB. He is responsible for several innovations, including spearheading an Australian-first collaborative initiative with an Israeli-based global crowdfunding platform for NAB Private's accredited investors.

ADDISONS

ADDISONS

Level 12
60 Carrington Street
Sydney NSW 2000
Australia
Tel: +61 2 8915 1000
Web: www.addisonslaywers.com.au

LI-JEAN CHEW

Partner
Email: li-jean.chew@addisonslawyers.com.au

Ms. Chew is a Partner at Addisons, a corporate and commercial law firm. She works closely with companies and businesses on a range of corporate transactions to assist with their growth and expansion. Ms. Chew specialises in capital raisings, private and public mergers and acquisitions, and corporate governance. As a legal adviser, she strives not only to provide answers to her clients' legal questions, but also to be a key member of their team who provides solutions that ultimately create value for their businesses. Her experience includes acting for FinTech company, Class Limited, on its successful Australian Securities Exchange (ASX) listing; accounting business consolidator, Countplus Limited, on its acquisition of accounting firms and ASX listing; Bega Cheese on its $460 million acquisition of Vegemite and Mondelez International's other Australia and New Zealand grocery and cheese business; and accounting firm Moore Stephens Sydney on its merger with Pitcher Partners Sydney.

JEFF MANSFIELD

Partner
Email: jeff.mansfield@addisonslawyers.com.au

Mr. Mansfield has over 35 years' experience in mergers and acquisitions and has been a partner with Addisons since 2004. His practice includes mergers and acquisitions, takeovers, initial public offerings and private equity transactions, as well as provides advice to company boards, both listed and unlisted. Prior to joining Addisons, he spent three years at Redfern Photonics, first as General Counsel and then as CEO. Redfern Photonics was a corporate venture capitalist specialising in commercialising photonics technology. Before joining Redfern Photonics, he was a Partner at Mallesons Stephen Jaques in Sydney. He is recommended as a lawyer in *Doyle's Guide of Leading Corporate/M&A Lawyers (Small & Mid-Market Matters) – New South Wales, 2017.*

ALPHASTATION

ALPHASTATION

Level 14
380 St Kilda Road
Melbourne VIC 3004
Australia
Tel: +61 3 8391 3041
Web: www.alphastation.org

DOMINIC DIRUPO

Principal
Email: d.dirupo@alphastation.org

Mr. Dirupo is the Principal of Alphastation Communications, a corporate communications consultancy specialising in compelling pre-IPO and IPO investor documents. These include presentations, prospectuses, information memorandum and equity capital market documents for stock exchange listings and private placements, as well as token issue white papers for the cryptocurrency industry. He has helped highly innovative, emerging companies in the fields of biotech, medtech, greentech, nanotech, advanced materials, energy and critical systems list in Australia, Hong Kong, the U.S., the U.K. and Europe over the past 20 years.

ASHURST AUSTRALIA

5 Martin Place
Sydney NSW 2000
Australia
Tel: +61 2 9258 6000
Web: www.ashurst.com

STUART DULLARD

Partner, Corporate
Email: stuart.dullard@ashurst.com

Mr. Dullard is a Partner in the corporate transaction practice and has expertise in early-stage companies, venture capital, fundraising and initial public offerings. He also has deep experience in mergers and acquisitions, shareholder/consortium arrangements and equity capital market transactions for both private and listed companies. Mr. Dullard's clients benefit from his experience working at the Takeovers Panel in Australia and in the investment banking team at Rothschild & Sons in London. In recent times, he has worked on seed capital raisings and shareholder arrangements for AirTree Ventures, Brighte Capital, Judo Capital, Pentalpha Funds Management, Loc8, Dementia Caring Australia and Leezair. Mr. Dullard has also worked on some of Australia's largest and most complex corporate transactions, including advising a consortium comprising KKR, Varde and Deutsche Bank on the A$9.4 billion acquisition of the GE's consumer finance business and Luye Medical Group on the acquisition of Health-e care.

TIM BROOKES

Partner, TMT
Email: tim.brookes@ashurst.com

Mr. Brookes specialises in telecommunications, IT and privacy and is one of Australia's leading telecommunications and IT lawyers. He advises several leading technology suppliers and customers on complex technology and outsourcing contracts and also advises extensively on privacy issues. Mr. Brookes has undertaken several significant technology and data protection matters. Recent and ongoing matters include negotiating arrangements for the commercialisation of an online betting exchange and the co-development and use of a core software application used in valuing infrastructure projects. Chambers Asia-Pacific (2016) recommended Mr. Brookes for his 'razor-sharp intelligence and ability to spot the critical issues underpinning a significant negotiation and its strategy.'

JONATHAN GORDON

Partner, Financial Services
Email: jonathan.gordon@ashurst.com

Mr. Gordon has advised on financial services and markets regulation both in Australia and overseas for nearly 30 years. He assists clients to establish and acquire businesses and to develop new products and services in the financial sector. Mr. Gordon is Australia's pre-eminent legal advisor in the development of new market infrastructure, a sector that continues to evolve rapidly through technological change. He also advises clients on regulatory investigations and enforcement action. Mr. Gordon's offshore financial markets experience, coupled with his focus on the regulation of financial services and markets in Australia, means he is well placed to advise offshore providers on the Australian marketplace and cross-border implications. He has been praised for his sound technical ability as well as his absolute pragmatism and commercial acumen across the regulatory environment.

JENNIFER SCHLOSSER

Partner, Securitisation and Structured Finance

Email: jennifer.schlosser@ashurst.com

Ms. Schlosser is one of Australia's leading lawyers, specialising in securitisation and structured finance. She was called 'an exceptional structured finance lawyer' by Legal500 Asia-Pacific 2016. Ms. Schlosser has extensive securitisation and structured finance experience in the Australian, U.K. and European markets and has represented participants including sponsors, issuers, financiers and arrangers in international and domestic transactions. Advising clients across a broad range of asset classes, she has been the lead securitisation partner on several of the most significant transactions in the market recently. Her market-leading experience includes bespoke securitisation warehouses and the establishment of securitisation programmes in the Australian FinTech sector. Ms. Schlosser is a member of the Australian Securitisation Forum Regulatory & Prudential subcommittee and guest lectures at the Master of Laws programmes at Sydney University and the University of Melbourne.

BoardRoom

BOARDROOM

Level 12

25 George Street

Sydney NSW 2000

Australia

Tel: +61 2 8016 2875

Web: www.boardroomlimited.com.au

THARUN KUPPANDA

Company Secretary

Email: Tharun.Kuppanda@boardroomlimited.com.au

Mr. Kuppanda is a lawyer with a Graduate Diploma in Legal Practice; Bachelor of Business & Commerce (Accounting); and Bachelor of Laws. Prior to joining Boardroom, he worked at a national law firm for their Corporate Advisory team and within an in-house legal team at a private equity house. Mr. Kuppanda's experience includes Australian Securities Exchange (ASX)-listed, dual listed and unlisted entities. He has been involved in the listing of several entities on ASX as well as advising entities in relation to the listing rules and the Corporations Act. Mr. Kuppanda has managed the Corporate Secretarial functions of ASX-listed technology, gaming and mining companies and large unlisted public companies. He also provides transaction support as an advisor, including secretary of due-diligence and project committees. Mr. Kuppanda is a member of the law society of New South Wales and an Associate of the Governance Institute of Australia.

TOM BLOOMFIELD

General Manager, Corporate Secretarial Services

Tel: +61 2 9290 9617

Email: Tom.Bloomfield@boardroomlimited.com.au

Mr. Bloomfield manages the market-leading Corporate Secretarial team, including driving strategy, business development and key partner relationships. He has over 15 years of international Corporate Secretarial experience working for global organisations, both 'in-house' and for corporate services providers. Mr. Bloomfield has experience working with and consulting to a range of international and domestic clients who are intending to set up in new jurisdictions and outsource current activities. He has acted as Company Secretary to several ASX-listed, unlisted and private companies in Australia in numerous industry sectors. Mr. Bloomfield is a Chartered Company Secretary, Fellow of ICSA (Institute of Chartered Secretaries and Administrators) and Member of the Australian Institute of Company Directors. He holds a Law degree with Honours and a Graduate Diploma in Applied Corporate Governance.

CBRE

Level 21
363 George Street
Sydney NSW 2000
Australia
Tel: +61 2 9333 3333
Web: www.cbre.com.au

NICOLE FITZGERALD

Director, Workplace Strategy, Pacific
Email: Nicole.fitzgerald@cbre.com.au

Ms. Fitzgerald leads CBRE's Workplace Strategy and Change Management team in the Pacific. With a background in business strategy, planning, brand and design, she brings a people-focused approach to creating highly engaging workplaces and is known for challenging the status quo, creating opportunities and reducing risk. Ms. Fitzgerald is a recognised leader in creating and driving transformation programs across a diverse range of industries, including health, education, services, technology, food & beverage and finance. She believes the office should play an integral role in building and maintaining organisational culture and creating a workplace community.

CICADA INNOVATIONS

Suite 145
4 Cornwallis Street
Eveleigh NSW 2015
Australia
Tel: +61 2 9209 4444
Web: www.cicadainnovations.com

PETRA ANDRÉN

Chief Executive Officer
Email: petra@cicadainnovations.com

Ms. Andrén is Chief Executive Officer of Cicada Innovations, Australia's only deep technology 'super incubator' for Australia's largest collection of 70+ advanced technology entrepreneurs across industry verticals such as medical, agtech, engineering and data sciences. She is an ambassador for the global nonprofit, InBIA, which works with sustainable entrepreneur support programs in every industry and demographic around the globe. Ms. Andrén lectures on entrepreneurship at the University of Sydney, the University of Technology and the Australian National University. She holds an MA (University of Uppsala, Sweden/exchange for thesis work University of Salzburg and University of Vienna, Austria) and an MBA from the Australian Graduate School of Management (the University of New South Wales and the University of Sydney). Ms. Andrén is a graduate of the Australian Institute of Company Directors (GAICD).

CLYDE & CO.

Level 15
333 George Street
Sydney NSW 2000
Australia
Tel: +61 2 9210 4493
Web: www.clydeco.com

CHRISTOPHER SMITH

Partner
Email: Christopher.smith@clydeco.com

Mr. Smith has over 20 years of experience as an insurance lawyer, principally in the areas of directors and officers insurance and professional indemnity insurance, acting both as coverage counsel and defence counsel. He advises on a wide range of insurance risks, acting for insurers based in Australia, the U.S. and London. Mr. Smith has acted in several large claims against directors and officers, many arising out of high-profile corporate collapses involving Australian Securities Exchange–listed public companies. He has extensive litigation experience in the Courts of New South Wales and Victoria as well as in the Federal Court of Australia. As an insurance lawyer, Mr. Smith for many years co-presented classes of the University of New South Wales postgraduate course in Insurance Law on policy conditions and exclusions.

DLA PIPER AUSTRALIA

GPO Box 4082
Sydney NSW 2001
Australia
Tel: +61 2 9286 8000
Web: www.dlapiper.com

DAVID RYAN

Partner
Email: David.Ryan@dlapiper.com

Mr. Ryan advises clients on mergers and acquisitions (including distressed mergers and acquisitions), equity capital markets transactions, reconstructions and recapitalisations, as well as public company and securities law. He has more than 18 years' experience in regulated and unregulated takeovers, schemes of arrangement, debt and equity raisings, ASX listings, share buy backs, foreign investment, employee incentive schemes and company law and governance matters. He is recognised in the Best Lawyers Guide for his Corporate and Mergers & Acquisitions expertise. Chambers and Partners Australia describes him as a 'very pragmatic, very responsive lawyer with a good industry understanding' and a 'a measured adviser' who 'doesn't overcook things and provides good commercial advice and tactics'. The Legal 500 praises him as a 'very seasoned operator' and a 'consummate professional' who takes a 'very measured approach to negotiations and discussions'.

JAMES PHILIPS

Consultant
Email: James.Philips@dlapiper.com

Mr. Philips has advised on transactions valued at more than A$100 billion, including strategic investments, private treaty purchases, recommended and hostile takeover bids, schemes of arrangement, public to privates, redomiciles and privatisation acquisitions. His clients include Australia's leading financial institutions and banks, and insurance groups. He is a ranked Partner in the Chambers and Partners Guide; he has been described as 'a very experienced and well-regarded individual' who has led complex transactions within energy, financial services and real estate sectors. He is also named in the Best Lawyers Guide for his Equity Capital Markets and Natural Resources expertise. He is also a Recommended Lawyer in The Legal 500 Australia Corporate/M&A category.

employsure
workplace relations specialists

EMPLOYSURE

180 Thomas Street
Sydney NSW 2000
Australia
Tel: 1300 651 415
Web: www.employsure.com.au

ED MALLETT

Managing Director
Email: comms@employsure.com.au

Ed is the Founder and Managing Director of Employsure, Australia's leading workplace relations specialist organisation. Cambridge-educated, he was a successful employment barrister (and professional rugby player) in the U.K. before establishing Employsure in 2011. Ed saw a growing need for workplace relations advice following the introduction of the Australian Fair Work Act 2009. Employsure is at the forefront of workplace issues and has a profound impact on Australian businesses; offering a suite of cost-effective, end-to-end solutions so employers can focus on achieving business success. Employsure works with over 16,000 businesses, receiving over 200,000 advice calls every year, conducting over 800 face-to-face meetings per week, traveling over 1.5 million kilometres per year to visit business owners—there is arguably no one doing more to place safety and people at the forefront of small business in Australia.

GILBERT +TOBIN

GILBERT + TOBIN

Level 35
Tower Two, International Towers Sydney
200 Barangaroo Avenue
Barangaroo NSW 2000
Australia
Tel: +61 2 9263 4000
Web: www.gtlaw.com.au

DEBORAH JOHNS

Partner, Corporate Advisory
Email: djohns@gtlaw.com.a

Ms. Johns's work focuses on funds establishment and complex joint ventures. She also handles a broad range of business acquisitions and disposals, corporate governance and general corporate and commercial matters. Her funds establishment practice focuses on infrastructure, private equity and venture capital funds, representing numerous fund managers and investors. Ms. Johns has extensive experience with different fund vehicles and assists fund managers with a wide variety of regulatory issues, including Australian Financial Services Licence, Financial Services Regulation and Anti-Money Laundering/Counter-Terrorism Financing compliance. She has particular expertise in dealing with collective investment vehicles that have special restrictions (Managed Investment Trusts, Venture Capital Limited Partnerships, Early Stage Venture Capital Limited Partnerships, Innovation Investment Fund licences and government grant programs). Ms. Johns is also an expert in matters involving Australia's foreign investment laws. She has been heavily involved in ongoing consultations with industry bodies and Government staff in relation to amendments to Australia's foreign investment laws and has handled many foreign investment applications by foreign investors, including foreign government investors.

TIM GOLE

Partner, Technology + Digital
Email: tgole@gtlaw.com.au

Mr. Gole focuses on IT, telecommunications and broadcasting matters, such as outsourcing, systems integration, cloud and payment system arrangements and other complex contracting matters. He is listed as a leading IT & telecommunications lawyer by Chambers Asia-Pacific 2017 and the Legal 500 2018. Mr. Gole has also been recognised by Best Lawyers 2017 in the Information Technology Law, Privacy and Data Security and Outsourcing Law categories. Chambers described him as having 'extreme attention to detail and technology knowledge, and a fantastic manner when it comes to negotiation and presentation. He is completely thorough, and very engaging'.

MUHUNTHAN KANAGARATNAM

Partner, Tax
Email: mkanagaratnam@gtlaw.com.au

Mr. Kanagaratnam leads Gilbert + Tobin's tax practice, where he helps clients in a range of industries understand and manage their tax exposures. His specialties are mergers and acquisitions and tax disputes. Mr. Kanagaratnam has advised on many cross-border corporate acquisitions, disposals and restructures; privatisations on both the Government and private enterprise sides; and equity raisings, floats and debt raisings. He regularly presents at conferences for The Tax Institute and has written training materials for the Institute of Chartered Accountants in Australia. Mr. Kanagaratnam has also represented CPA Australia in Treasury consultation and has participated in other Treasury forums.

JOHN LEE

Partner, Intellectual Property
Email: jlee@gtlaw.com.au

Mr. Lee leads the Patent sub-practice within the intellectual property group and is regarded as one of Australia's most experienced and successful patent litigators. He has many years' experience dealing with all aspects of intellectual property law, with a focus on patent litigation across a range of industries including resources, life sciences, financial services and digital technologies. Mr. Lee was awarded Lawyers Weekly IP Partner of the Year in 2017. He has acted in several leading cases in the Federal Court in recent years. Mr. Lee also has considerable expertise in advising leading corporates on strategic intellectual property management. He is a recognised leader in his field. Legal 500 2016 notes, 'Patent litigator John Lee "stands out for his customer focus, clear guidance and ability to simplify complex issues"'.

Glasshouse
Advisory

GLASSHOUSE ADVISORY

Level 29, Northpoint, 100 Miller Street
Sydney NSW 2060
Australia
Tel: +61 2 9925 6300
Web: www.glasshouseadvisory.com

DAVID HUGHES

Director - Strategy
Email: david.hughes@glasshouseadvisory.com

Mr. Hughes is a Director - Strategy at Glasshouse Advisory and a registered Patent Attorney (Australia and New Zealand). He has been working in IP professional services for more than 30 years and believes IP is the building block of Australia's competitiveness in a global market. Through a collaborative approach, Mr. Hughes brings legal, technical and financial skills to clients to maximise the impact in innovation. He has guided many clients—from Australia's largest listed companies to startups—through this process.

TRACEY MURRAY

Director – Innovation Incentives & IP Economics

Email: tracey.murray@glasshouseadvisory.com

Ms. Murray is a director at Glasshouse Advisory, where she specialises in transfer pricing and R&D Tax Incentives. Her diverse experiences have enabled her to develop a well-recognised level of expertise in these two areas of tax. Ms. Murray has worked within the accounting and advisory field for more than 30 years. She is a member of CPA Australia, a registered Tax Agent (specialising in transfer pricing and R&D Tax), and a Chartered Tax Advisor with The Tax Institute. Ms. Murray's technical knowledge, coupled with a strong commercial focus and practical approach to problem solving, has led her to become a trusted advisor for her clients. Her depth of expertise is so highly regarded that she was invited to provide expert evidence at the Senate Estimate's Enquiry into the introduction of the new R&D Tax Incentive program in Australia.

EMMANUEL MASTIO

Industry Professor

Email: emmanuel.mastio@uts.edu.au

Prof. Mastio is an Industry Professor of Sustainable Innovation at the University of Technology Sydney, School of Systems, Management and Leadership. Before embracing an academic career, he spent over 20 years as an inventor, innovator and intra-preneur within multinational organisations. He has extensive experience in product development and technology portfolio management, strategic IP and innovation management. Throughout his career, he has combined technical leadership and financial discipline to deliver successful products and services across multiple domains and cultural contexts.

Google

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ALAN NOBLE

Former Director of Engineering, Google Australia and New Zealand

Founder of Australian Ocean Lab

Email: alan@ausocean.org

Mr. Noble was the Engineering Director for Google Australia and New Zealand from 2007 to 2018, overseeing the dramatic growth of the Australian engineering operation from 20 engineers to over 600. In 2005, he founded NetPriva, a networking software company based in Adelaide, which was acquired by Expand Networks in 2007 (now part of Riverbed). From 1986 to 2002, he lived in California. He got his taste for tech startups, moonlighting for Pure Software (later Pure Atria), then in 1996 co-founded NetMind. NetMind was acquired in 2000 by Intellisync (now part of Nokia), where he was VP of Engineering until he returned to Australia. In 2017, he founded the Australian Ocean Lab (AusOcean), where he has been full time since April 2018. He is also a co-founder and director of StartupAUS, a director of the South Australian Museum, and a Fellow of Engineers Australia. He attended Adelaide University and Stanford University.

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JACKSON McDONALD LAWYERS

PO Box M971
Perth WA 6843
Australia
Tel: +61 8 9426 6611
Web: www.jacmac.com.au

WILL MONCRIEFF

Partner
Email: wmoncrieff@jacmac.com.au

Mr. Moncrieff practises in the areas of corporate, commercial and resources law, including mergers and acquisitions (M&A), capital raisings, corporate advisory, corporate governance and company restructures. He has extensive experience in advising public and private companies, directors, corporate advisors, broking firms and insolvency practitioners on corporate advisory and transactional matters. Mr. Moncrieff has successfully worked with many companies and advisors (local, national and international) on several significant M&A, initial public offerings and capital-raising transactions, including cross-border acquisitions, divestments and fundraisings.

HAMISH TAYLOR

Senior Associate
Email: htaylor@jacmac.com.au

Mr. Taylor is Senior Associate in Jackson McDonald's Corporate & Commercial Team, practising predominantly in equity capital markets, M&A, commercial transactions, corporate advisory and corporate regulation matters. He has acted for several public and private clients over a diverse range of industries, including technology, mining and resources, agriculture and manufacturing. Mr. Taylor has advised on several successful initial public offerings, backdoor listings, secondary capital raisings and M&A transactions for companies listed on the Australian Securities Exchange.

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KAIN LAWYERS

315 Wakefield Street
Adelaide SA 5000
Australia
Tel: +61 8 7220 0900
Web: www.kainlawyers.com.au

JAMES BURCHNALL

Director
Email: james.burchnall@kainlawyers.com.au

Mr. Burchnall has over 13 years' experience as a corporate lawyer at top-tier law firms in Melbourne, London and Adelaide. He has worked on high-profile mergers and acquisitions (M&A) and equity capital markets transactions in Australia, as well as internationally across multiple industry sectors for listed entities and private companies. Mr. Burchnall has extensive experience in takeovers and schemes of arrangement, private M&A, joint ventures, restructurings and capital raisings, as well as corporate governance and corporate advisory. He is listed in the areas of M&A and Equity Capital Markets in the 2018 edition of *Best Lawyers in Australia* and is listed as a recommended Corporate Lawyer in the 2017 and 2018 editions of *Doyle's Guide.*

KPMG

Tower Two, Collins Square
727 Collins Street
Melbourne VIC 3008
Australia
Tel: +61 3 9288 5555
Web: www.kpmg.com

Tower Three, International Towers Sydney,
300 Barangaroo Avenue,
Sydney NSW 2000
Tel: +61 2 9335 7000
Web: www.kpmg.com.au

DAVID MORRIS

Partner, KPMG Law
Email: davidpmorris@kpmg.com.au

Mr. Morris is the leader of KPMG Law's Australian Corporate Practice. He has spent most of his career working in corporate and securities law, both in Australia and the U.K. He advises his clients on all aspects of their business, including acquisitions and disposals, initial public offerings and capital raisings, restructurings, corporate governance, Australian Securities Exchange (ASX) Listing Rules and Corporations Act 2001 (Cth) compliance and Foreign Investment Review Board approvals. He has been recognised as a leading Australian Equity Capital Markets lawyer by *PLC Which Lawyer?* and as a leading Australian mergers and acquisitions (M&A)/Corporate lawyer by Chambers. David is noted for being a 'hands-on, innovative, commercial and proactive lawyer' whom clients value for his 'no nonsense advice' and as 'a very good sounding board; a bridge between legal and commercial'. He has also been noted as being 'a very special attorney who is authoritative on both Australian and U.S. law, and is great at counselling—not just turning the crank and producing documents'.

MICHAEL HINE

Partner in Charge, Tasmania, KPMG Enterprise
Email: mhine@kpmg.com.au

Mr. Hine has more than 27 years of experience in providing advice on income tax, capital gains tax, goods and services tax and fringe benefits tax to a large range of clients in both the private and public sectors. He was a member of the Commissioner of Taxation's Division 7A task group. With the advent of cloud accounting, Mr. Hine has led KPMG's cloud accounting and business process outsourcing approach, which allows him to combine his technology, small-business accounting, taxation and practical commercial advice for a diverse client base. He has developed tax-effective structures and has provided taxation advice to a wide range of sectors, both to the firm's clients and on a referral basis, covering income tax, goods and services tax, fringe benefits tax and payroll tax. Mr. Hine has managed Australian Taxation Office and State Revenue Office audits and investigations on behalf of clients. He also has transitioned clients to both cloud accounting platforms and to Business Process Outsourced platforms and provided strong commercial advice through a variety of business acquisitions, disposals and restructures.

LEN NICITA

Partner in Deal Advisory – Tax
Email: lennicita@kpmg.com.au

Mr. Nicita is a Partner in the Deal Advisory – Tax practice of KPMG's Sydney office. He has over 18 years of taxation experience and had previous roles in both tax advisory and the front office of financial institutions. During his career, Mr. Nicita has specialised in the corporate mergers and acquisitions (M&A), capital markets and private equity industries. He spent five years in the Sydney and London offices of Macquarie Group, where he was responsible for structuring international financing and M&A transactions, as well as three years at Morgan Stanley.

FLEUR TELFORD

Director – Technology Lead, KPMG Enterprise
Email: ftelford@kpmg.com.au

Ms. Telford is a specialist in the Professional Services industry with 20 years of experience in financial controlling, IT management and operations management. She is currently the Director for Technology for KPMG Enterprise and is responsible for their 2020 Technology Strategy plan, guiding the accounting professionals through the automation, robotics and artificial intelligence revolution that is occurring within the financial services industry. Ms. Telford has been a vocal advocate for the shift of focus that needs to occur in accounting services—away from the traditional style processing of accounts and tax returns to a more business advisory approach that assists small to medium enterprises (SMEs) to make the most of their day-to-day business opportunities. She was an architect of Deloitte Private Connect, the back-office transaction outsourcing service offered by Deloitte, and is responsible for the technology component of KPMG Finance Hub, the KPMG competing product to Connect. Ms. Telford is now working on bringing a range of subscription service products to the mid-market for KPMG.

CECILY CONROY

Head of Equity Capital Markets, Australia
Email: cecilyconroy@kpmg.com.au

Ms. Conroy is the National Head of Equity Capital Markets (ECM) Advisory at KPMG. She provides strategic and tactical advice to clients on raising equity in the global capital markets, such as helping private companies prepare for and execute an IPO, listed companies to raise new equity or strategic shareholders to monetise a stake in a listed entity. She has advised on a broad spectrum of ECM transactions raising c.A$50 billion across Australian, New Zealand, Asian, European and U.S. equity markets. Her deal experience spans a diverse range of sectors, deal types and deal sizes, including a number of landmark transactions. She has specialised in ECM and corporate finance for the past 15 years. She brings a unique perspective to a client's internal deal team gained from her deep experience as both an independent equity advisor and an investment banker in the ECM division of a global investment bank.

HODA NAHLOUS

Director, KPMG Law
Email: hoda.nahlou@kpmg.com.au

Ms. Nahlous is a Director at KPMG Law and is a leading securities law expert. She specialises in capital markets (having acted on numerous primary and secondary raisings for both issuers and brokers), public and private mergers and acquisitions, and board advisory, including corporate governance. Frequently, her practice consists of advising ASX-listed companies on securities laws and other compliance matters. Most recently, Hoda has advised foreign and dual-listed clients on complex raisings and ongoing corporate governance requirements. She has also held senior legal counsel roles at a leading global investment bank and a major infrastructure organisation. Prior to her career in private practice, she worked for the Australian Securities and Investments Commission, dedicated to two of its highest-profile wins in relation to directors' duties: HIH Task Force and James Hardie Task Force.

ROBERT IGNJATIC

Director in Deal Advisory – Tax
Email: rignjatic@kpmg.com.au

Mr. Ignjatic is a Tax Director in the Deal Advisory – Tax practice of KPMG's Sydney office. His principal area of expertise is advising on M&A transactions, including initial public offering (IPO) transactions, financing, refinancing, tax consolidation and cross-border tax issues. Mr. Ignjatic's recent experience includes advising a range of clients in their restructures and IPO transactions, including dual-track trade sale and IPO processes and restructures. He has worked with clients in the financial, insurance and property sectors. In addition, Mr. Ignjatic has worked with a diverse range of property sector participants and various sovereign wealth funds in recent property transactions and the structuring of their Australian property funds.

KAAJAL PRASAD, CA

Director – Tax & Advisory Services, KPMG Enterprise
Email: kdprasad@kpmg.com.au

Ms. Prasad is a Director in the KPMG Enterprise Tax and Advisory team in Melbourne and an accredited Chartered Accountant and Family Business Adviser. She has over 10 years of experience across Australia and New Zealand in providing accounting, taxation and commercial advisory services to privately owned businesses and family groups. Ms. Prasad is well experienced in advising on strategic planning, growth and exit strategies, commercialisation of new businesses, franchising, mergers and acquisitions, capital raising, structuring, governance, financial modelling and forecasting, management and statutory reporting, and tax compliance and advisory. Amongst her client portfolio are some well-known names, and her client experience spans a multitude of industry sectors covering startups, retail, wholesale and distribution, agribusiness, investment portfolios and family office.

ARISTIDIS SEMERTZIDIS

Associate Director – Digital Assets, KPMG Enterprise
Email: asemertzidis@kpmg.com.au

Mr. Semertzidis is Associate Director of Digital Assets at KPMG Enterprise, working on KPMG Finance Hub. Having grown up in a number of family businesses, combined with over 10 years of professional experience, he has witnessed firsthand, the challenges that startups, SMEs and family businesses face and experience on a daily basis. As part of the KPMG Finance Hub team, he and his team work to identify and deliver convenient solutions for clients who want, and need, to focus on growing their businesses, whilst KPMG takes care of the client's financials—ensuring that business owners get access to the best possible advice to guide them through the business life cycle. Utilising KPMG's Digital Assets and market-leading cloud technology, he ensures that business owners have the right information at their fingertips when making decisions that affect their businesses.

DAVID TINK

Senior Associate, KPMG Law
Email: dtink@kpmg.com.au

Mr. Tink is a Senior Associate at KPMG Law, with extensive experience in capital markets and public and private mergers and acquisitions. More specifically, he advises on primary and secondary raisings on the ASX, compliance with the ASX Listing Rules and the Corporations Act 2001 (Cth), and also corporate governance matters. He is a dual qualified legal practitioner, being qualified in Australia as well as in the jurisdiction of England and Wales. David was previously based in London for a period of five years, where he successfully acted on the listing of numerous companies on the London Stock Exchange and AIM, as well as advising on various other capital markets and M&A transactions. He advises large, medium and small cap companies as well as dual listed entities, and he recently acted on the successful cross listing of a U.K.-based oil and gas exploration company on the ASX.

FLORENCE LIANG

Senior Consultant in Deal Advisory – Tax
Email: fliang3@kpmg.com.au

Ms. Liang is a Senior Consultant in the Deal Advisory – Tax group at KPMG and has worked on a several significant infrastructure privatisations, public-private partnerships and real estate transactions. Her experience includes providing buy side and sell side advisory services, tax due diligence and structuring advice in the M&A tax practice. Prior to her work at KPMG, Ms. Liang advised private enterprises and self-managed super fund clients from the health professional industry for two years.

LEGALVISION

67 Fitzroy Street
Surry Hills NSW 2010
Australia
Tel: +1300 544 755
Web: https://legalvision.com.au

JILL McKNIGHT

Practice Leader
Email: info@legalvision.com.au

Mrs. McKnight is a Practice Leader at LegalVision, specialising in startups as well as banking and finance. She has over 15 years' experience practising as a lawyer at top commercial firms in Europe, Asia and Australia. She is qualified in England and Wales, as well as Australia. She previously worked at Norton Rose Fulbright, Herbert Smith Freehills, Corrs and Clayton Utz, where she advised large corporates and other sophisticated clients on complex cross-border transactions. In these roles, she developed a comprehensive understanding of banking and finance law, including the Personal Property Securities Act. In addition to banking and finance law, she now also has an active practice focusing on the legal needs of startups – including business structuring, capital raising, shareholders agreements and employee share schemes. She draws on her experience working on large, complex transactions to provide startups, small- and medium-sized enterprises and corporate clients with high-quality and commercial legal advice.

LACHLAN McKNIGHT

Chief Executive Officer
Email: info@legalvision.com.au

Mr. McKnight is the CEO of LegalVision, an innovative and tech-driven law firm. He trained as a lawyer with Freshfields Bruckhaus Deringer in London, Paris and Amsterdam before moving to Hong Kong with Norton Rose's banking and finance team. He subsequently returned to Australia in a structuring role with Barclays Capital. He launched LegalVision in 2012 with a vision of disrupting Australia's legal industry and transforming the way in which Australian businesses access legal services. LegalVision has assisted more than 50,000 businesses and startups. The firm was crowned NewLaw Firm of the Year at the 2017 Australian Law Awards and 2018 Fastest Growing Law Firm in Asia-Pacific by the *Financial Times*.

LINK MARKET SERVICES

680 George Street
Sydney NSW 2000
Australia
Tel: +61 2 9375 7870
Web: www.linkmarketservices.com.au

LYSA McKENNA

Chief Executive Officer
Email: lysa.mckenna@linkmarketservices.com.au

Ms. McKenna is the Chief Executive Officer of Link Market Services (Link) Australia. She is responsible for the management, strategy and growth of Link Australia and Orient Capital. Link is an ASX100 company that administers financial ownership data and drives user engagement, analysis and insight through technology. Link has a history in financial services spanning more than half a century. It is a leading global provider of share registry services and a leading administrator of Australian employee share plans for businesses listed locally and overseas. Orient Capital is the Investor Relations arm of the Link Group and is a global leader in the provision of a comprehensive suite of services, including share ownership analysis, market intelligence, investor communication and shareholder management technology.

MELISSA JONES

General Manager, Company Matters
Email: Jones@companymatters.com.au

Ms. Jones, a lawyer and governance professional with over 17 years' experience, manages Company Matters. Company Matters is the consulting arm of the Link Group and assists over 300 clients per year, from S&P/ASX 20 entities to small-caps and not-for-profits, across a range of capacities from statutory Company Secretary, independent Governance Consultant, Chief Financial Officer and Director. Company Matters' specialised service offering is unique—focusing on prevailing governance and company secretarial matters within a boutique law firm structure.

MAIN SEQUENCE VENTURES

Building 52/5 Julius Ave
North Ryde NSW 2113
Australia
Tel: +61 430 460 780
Web: www.mseq.vc

PHIL MORLE

Partner
Email: phil@mseq.vc

Mr. Morle is a Partner at Main Sequence Ventures, a venture capital firm built by the CSIRO focused on deep-tech. Prior to this, Phil was the founder of Australia's first Silicon Valley–style incubator, Pollenizer, and played an instrumental role in developing the startup ecosystem across the Asia Pacific region. He has advised some of the world's biggest organisations on practical ways to deliver new growth and the cultural change that is required to start new ventures. He cut his teeth in technology as the CTO Kazaa, one of the world's largest peer-to-peer applications. Phil's contribution to the startup ecosystem has been recognised through awards including the Founder Institute Mentor of the Year in 2015 and the Deloitte Fast 50 in 2010 for Pollenizer.

BILL BARTEE

Partner
Email: bill@mseq.vc

Mr. Bartee is a Partner at Main Sequence Ventures, a venture capital firm built by the CSIRO focused on deep-tech. Prior to this, he was a cofounder and Venture Partner of Blackbird Ventures. Mr. Bartee and the Blackbird team sourced and invested in 16 companies in Blackbird's first fund. Before that, he was a cofounding partner of Southern Cross Venture Partners. At Southern Cross, he focused on early-stage software security. Prior to Southern Cross, he was the startup CEO of Mantara, a company that made high-performance, content-based message routing systems. He is also an angel investor with investments including Freelancer and rome2rio.

From 1997 to 2001, he helped build and lead the early-stage investing for Macquarie Technology Ventures, a balanced venture fund focused on software, telecommunications, Internet and life sciences.

muru-D

Level 9
175 Liverpool Street
Sydney NSW 2000
Australia
Web: www.muru-d.com

MICK LIUBINSKAS

Co-Founder
Email: mick@muru-d.com

Mr. Liubinskas lives with his wife and three kids in San Francisco, California, USA. He surfs, plays soccer and writes. Mr. Liubinskas grew up in Australia on the New South Wales Central Coast. He has been programming software since the age of 8 and building tech companies since he was 18. Surviving the first dot-com boom, he went on to lead marketing for the controversial peer-to-peer file-sharing platform Kazaa, based on the North Side of Sydney. After working in Tanzania on education micro-finance, he returned to Australia, working on two tech companies and launching them into the U.S. He then co-founded Pollenizer with Phil Morle, was a co-founding mentor and investor of Startmate and became known as Mr. Focus. In 2013, he teamed up with Charlotte Yarkoni and Annie Parker to setup muru-D, the technology accelerator backed by Telstra. In 2016, he moved to San Francisco to help Australian companies get customers and capital in the U.S.

PARTNERS FOR GROWTH AUSTRALIA

Level 13
50 Carrington Street
Sydney NSW 2000
Australia
Tel: +61 4 22094033
Web: www.pfgrowth.com/australia

KARTHI SEPULOHNIAM

Director
Email: karthi@pfgrowth.com

Mr. Sepulohniam is a Director at Partners for Growth Australia. He has 11 years' experience in investment banking and private equity. Prior to joining PFG, Mr. Sepulohniam co-founded Health Live, a health-care investment group in Sydney, and also worked in private equity with Evolution Healthcare Partners and in investment banking with Macquarie Capital and Credit

Suisse. At Partners for Growth, he works with high-growth tech and non-tech companies in Australia and New Zealand on structuring custom debt capital solutions in the range of $1 million to $20 million. Mr. Sepulohniam graduated in Law from The University of Melbourne and also holds a master's degree from the University of Oxford.

JASON GEORGATOS

Managing Director
Email: jason@pfgrowth.com

Mr. Georgatos is the Managing Director of Partners for Growth Australia. He has 16 years of experience financing growth businesses and managing private investment funds and has particular expertise in providing mezzanine debt financing to growth-stage technology and health-care companies. Mr. Georgatos is a founding member of the team that grew the PFG family of technology debt funds from $50MM under management to over $400MM. Prior to joining PFG in 2004, he was with Silicon Valley Bank and provided loans to technology and health-care companies. Mr. Georgatos holds a bachelor's degree from the University of California, Santa Barbara, and a master's degree from the University of Oxford.

Pottinger

POTTINGER

Level 13
111 Elizabeth Street
Sydney NSW 2000
Australia
Tel: +61 2 9225 8000
Web: www.pottinger.com

NIGEL LAKE

Co-Founder and Executive Chair
Email: Exec.Chair@Pottinger.com
Twitter: @Nigel_Lake

Mr. Lake is Co-Founder and Executive Chair of global advisory firm Pottinger, and Co-Founder and Chief Executive Officer of programmatic analytics business Atomli Inc. An entrepreneur with a passion for diversity, innovation, environment and action, he is the author of *The Long Term Starts Tomorrow.*

PRINCIPALS

PRINCIPALS

58 Lower Fort Street
Dawes Point
Sydney NSW 2000
Australia
Tel: +61 2 9251 3833
Web: www.principals.com.au

WAYDE BULL

Planning Director
Email: wayde@principals.com.au

Wayde is a founder of Principals, Australia's largest independent branding agency. For more than 25 years, he has worked with leaders of corporate, government and startup organisations to help answer what makes them different and to create brand identities and communications programs that build competitive advantage. Wayde has led branding projects for businesses listed on the Australian Securities Exchange, such as Brambles, Coca-Cola Amatil, Lendlease, National Australia Bank, News Corp, QBE and Telstra; national icons such as Austrade, Australia Post, the Bionics Institute and Commonwealth Scientific and Industrial Research Organisation; and ambitious startups like Everlight Radiology, Genome.One, James Squire Beer and the Australian Football League's Greater Western Sydney Giants.

SILICON VALLEY FOUNDRY

Pier 26, Suite 5, The Embarcadero

San Francisco, California 94105

Web: www.svfoundry.com

ELIAS BIZANNES

Chief Executive Officer and Founder

Email: elias@svfoundry.com

Mr. Bizannes is an Australian entrepreneur who is based in Silicon Valley. Under Silicon Valley Foundry LLC, he developed several business concepts: the incubator 'StartupHouse', the international bootcamp 'StartupBus', and the Aussie Founders Network. He also created Australia's 'silicon beach'. He currently sits on the Board of ZoomSystems, an automated retail company with close to $100 million in sales. He is also working on the health care startup Utmost. He previously worked at venture capital firm CRV, search engine startup Vast.com, and professional services firm PwC. He is licensed as a Chartered Accountant.

SPRUSON & FERGUSON
INTELLECTUAL PROPERTY

SPRUSON & FERGUSON

Level 24, Tower 2, Darling Park

201 Sussex Street

Sydney NSW 2000

Australia

Tel: +61 2 9393 0100

Web: www.spruson.com

SYLVIE TSO

Principal

Email: sylvie.tso@spruson.com

Ms. Tso is a Principal of Spruson & Ferguson—a leading intellectual property firm with nine offices across the Asia-Pacific region. Ms. Tso leads the Spruson & Ferguson Lawyers' Commercial Transactions and Advice team. She is a lawyer and registered Australian Patent and Trade Mark Attorney, with more than 15 years' experience in the intellectual property (IP) field. Ms. Tso advises clients on a range of IP issues, including IP ownership, licensing, IP protection, non-disclosure, material transfer and collaborative R&D. She is experienced in delivering IP services to many sectors of the technology-based community, including inventors, startup and established companies, universities, cooperative research centres and research institutions. Ms. Tso was a principal author of the *IP Manual for Australian Government Agencies* and has assisted major Government departments with their IP audits and advised on the establishment of appropriate IP management frameworks. She has also authored three other IP management manuals tailored to the biotech, electronics and engineering industries, and has delivered numerous presentations and workshops to the public and private sectors on this topic. Ms. Tso is a member of the Licensing Executives Society and the Intellectual Property Society of Australia and New Zealand.

NATALIA BLECHER

Senior Associate
Email: natalia.blecher@spruson.com

Ms. Blecher is a Senior Associate in Spruson & Ferguson's trade marks team, based in the firm's Melbourne office. She represents public and private sector clients in a wide range of industries, including fast-moving consumer goods, fashion, consumer technology, automotive, financial services, communications and health. Her practice spans the full scope of trade mark and registered designs services. She undertakes prosecution and clearance work and represents market-leading brands in contested proceedings. Ms. Blecher advises clients in relation to risks arising under the laws of infringement, passing off and the Competition and Consumer Act in matters concerning trade marks, designs and copyright. She is admitted as a Solicitor in the Supreme Court of Victoria, is a Registered Australian Trade Mark Attorney and a member of the International Trademark Association and the Intellectual Property Society of Australia and New Zealand.

DAVID MÜLLER-WIESNER

Patent Attorney
Email: david.mueller-wiesner@spruson.com

Mr. Müller-Wiesner works in the field of mechanical engineering patents and registered designs and is a Registered Australian and New Zealand Patent Attorney and Registered Australian Trade Mark Attorney. He specialises in delivering incisive, cost-effective IP strategies to early-stage and scaling startups, supported by broad experience in handling patent and design matters for clients in fast-moving consumer goods, agritech, food packaging technology, drone technology and data processing sectors. Prior to joining Spruson & Ferguson in 2016, he founded a startup business in the field of carbon composite materials and worked in the Methods of Analysis Team for a Tier 1 aerospace supplier. He has also completed internships for an airframe manufacturer in Germany and in various research roles at European universities.

SQUARE PEG CAPITAL

Level 1
28 Claremont Street
South Yarra VIC 3141
Australia
Tel: +61 3 9863 5000
Web: www.squarepegcap.com

PAUL BASSAT

Co-Founder and Partner
Email: paul@squarepegcap.com

Mr. Bassat is a co-founder of Square Peg Capital. Prior to founding Square Peg, he co-founded SEEK in 1997 and served as Joint CEO from 1997 to 2011. SEEK is the world's largest online employment business and has market-leading businesses in Australia, China, Brazil, Mexico and throughout Southeast Asia. Mr. Bassat is a director of Wesfarmers Ltd. and a Commissioner of the Australian Football League. He is also on the board of Innovation Australia, the Peter MacCallum Cancer Foundation and the P&S Bassat Foundation. Mr. Bassat started his career as a lawyer and practised for six years. He holds a Bachelor of Laws and a Bachelor of Commerce from the University of Melbourne.

STARTUPAUS

Level 2
11 York Street
Sydney NSW 2000
Australia
Web: www.startupaus.org

ALEX McCAULEY

Chief Executive Officer
Email: alex@startupaus.org

Mr. McCauley is a former lawyer, diplomat and startup founder who, for the last few years, has been CEO of Australia's national startup advocacy organisation, StartupAUS. StartupAUS's mission is to help Australia become one of the best places in the world to build and grow a startup.

STARTUP ONRAMP

315 Brunswick St
Fortitude Valley QLD 4006
Australia
Tel: +61 411 122 976
Web: www.startuponramp.com

COLIN KINNER

Founder
Email: colin@startuponramp.com

Colin is the Founder of Startup Onramp, a training and mentoring program for first-time startup founders. Having worked with several hundred startup teams over two decades, he has a depth of experience that is rare in the Australian startup ecosystem. Colin has also served on the boards of several venture-backed technology companies and managed early-stage venture funds in Australia and the U.K. He is a strong advocate for growth of the Australian startup ecosystem, having authored the *StartupAUS Crossroads Report* for three years running and advised on a wide range of projects to develop the Australian startup ecosystem.

STONE & CHALK

Level 4
11 York Street
Sydney NSW 2000
Australia
Web: www.stoneandchalk.com.au

ALEX SCANDURRA

Chief Executive Officer
Email: alex@stoneandchalk.com.au

Mr. Scandurra is the founding CEO of Stone & Chalk, Asia's leading FinTech Innovation Hub in Sydney and Melbourne, which supports 450 full-time residents in 100 high-growth ventures across Sydney and Melbourne to commercialise and scale. With 25 Corporate Partners, Stone & Chalk has helped startups secure $210 million in direct investment and create 500 jobs in FinTech since August 2015. Mr. Scandurra is a founding director of FinTech Australia and co-founder of Spark Festival, Australia's largest innovation festival. He serves on the Australian Securities & Investment Commissions Digital Finance Advisory Committee, the NSW Government's Advisory Board for its Digital Analytics Centre, and is a director of children's cancer charity Redkite. He is the former Head of Strategy & Business Development for Barclays in London, where he was Head of the Barclays Accelerator program. He launched startup hubs in London and Manchester and led a major Open Innovation Program. He also worked for Nokia Networks across MEA and APAC, managed projects for LendLease and was an officer in the Australian Army.

Sydney Angels

SYDNEY ANGELS

Web: www.sydneyangels.net.au

VIVIAN STEWART

Committee Member

Email: admin@sydneyangels.net.au

Mr. Stewart has an extensive background in the technology and telecommunications sectors, venture capital and corporate advisory services. He co-founded ISP Magna Data, venture firm Tinshed, corporate advisory firm Callafin and angel investment group Sydney Angels and the Sydney Angels Sidecar Funds I & II. He has many years as an independent corporate advisor specialising in sale, merger and acquisition transactions and related capital strategy for public and private companies. Mr. Stewart serves on the board of ASX-listed telecommunications carrier Superloop.

tdm. asset management

TDM ASSET MANAGEMENT

Sydney Office
Level 9, Hudson House,
131 Macquarie Street,
Sydney NSW 2000

Australia

Tel: +61 2 8999 8810
Web: www.tdmam.com

HAMISH CORLETT

Email: hamishcorlett@tdmam.com

Mr. Corlett is a Partner at TDM. Prior to joining TDM, he worked as an Investment Manager at Caledonia Investments, a global investment management firm. He holds a Bachelor of Commerce with Honours Class 1 (Accounting and Finance) from the University of Sydney and a Graduate Diploma of Counselling from the Australian College of Applied Psychologists.

ED COWAN

Email: edcowan@tdmam.com.au

Mr. Cowan has a master's degree in Applied Finance from Macquarie University, Sydney, as well as a Commerce degree (Accounting and Finance) from Sydney University. He is the author of a best-selling book, and has been a contributor to newspapers around the world, including *The Australian* and *The Times of London*.

TDM is a private investment firm founded in 2004 with offices in Sydney and New York. They invest in companies with attractive growth profiles run by outstanding management teams. Their flexible mandate allows them to invest in public companies globally, as well as Australia- and New Zealand-based private companies. TDM has a highly focused approach to investing, with a portfolio of no more than 15 investments globally. They typically deploy between $20 million to $75 million (maximum $100 million) per investment.

TRANSITION LEVEL INVESTMENTS

PO Box 906

Fortitude Valley QLD 4006

Australia

Tel: +61 7 3054 6000

Web: www.transitionlevel.com

STEPHEN BAXTER

Tech Investor

Email: contact@transitionlevel.com

Mr. Baxter is Queensland's second Chief Entrepreneur and an early-stage investor in Australian startups, and has been a Shark on Shark Tank Australia since 2015. His first startup, Internet Service Provider SE Net, was acquired by Ozemail/UUNet under Malcolm Turnbull. Mr. Baxter co-founded PIPE Networks, a provider of wholesale telecoms infrastructure that listed on the Australian Securities Exchange in 2005 and was acquired by the TPG Group for $373 million in 2013. He led a Google project delivering high-speed networks across North America. Mr. Baxter founded Brisbane tech startup hub River City Labs, Startup Catalyst and River Pitch. He has been on the boards or listed boards of PIPE Networks, Vocus, Indoor Skydive Australia and OtherLevels and Commercialisation Australia. Mr. Baxter helped to found or was heavily involved with the South Australian Internet Association, South Australian Internet Exchange, Australian Domain Name Authority, AuDA, INTIAA, IIA, AusBone and AusNOG. His awards include the Ernst & Young Entrepreneur of the Year (Northern Region, 2006) and the Pearcey Medal for Lifetime Achievement for contributions to the ICT industry (2016).

UNIVERSITY OF SOUTH AUSTRALIA

Australian Centre for Business Growth

University of South Australia

City West Campus

Adelaide SA 5000

Australia

Tel: +61 8 8302 0484

Web: www.centreforbusinessgrowth.com

DR. JANA B. MATTHEWS

Director, Australian Centre for Business Growth

Email: jana.matthews@unisa.edu.au

Dr. Jana Matthews is an international expert on entrepreneurial leadership and business growth. As the Director of the Australian Centre for Business Growth at UniSA's Business School, she has worked with hundreds of Australian CEOs and executives, teaching them how to achieve their company's growth potential. The Centre has won several international awards for its innovative programs and the growth its companies are achieving. Jana was on the founding team of the Kauffman Foundation's Centre for Entrepreneurial Leadership, has founded five companies and has worked with CEOs and executives all over the world, helping several of them grow billion-dollar companies. She has a doctorate from Harvard University, has written seven books and 150 articles, was Global Thought Leader for SAP and was named one of 18 Women Business Gurus in the world and one of the leading women in Australia's innovation ecosystem.

UpGuard

UPGUARD

909 San Rafael Avenue

Mountain View, California 94043

Tel: +1 650 437 0397

Web: www.upguard.com

HAMISH HAWTHORN

Chief Operating Officer

Email: hamish.hawthorn@upguard.com

Hamish has been involved in the commercialisation of new technologies for over 20 years, and his experience spans the software, biotechnology and advanced manufacturing sectors. Since 2016, he has served as UpGuard's Chief Operating Officer, driving operations and corporate development activities, overseeing partnerships with the cyber insurance sector and working on technology collaborations. UpGuard is the world's first cyber resilience platform, designed to proactively assess cyber risk for every organization. UpGuard monitors the digital footprints of millions of organizations, automates assessment questionnaires and synthesizes those factors into the most accurate cyber risk score. In his previous role as Chief Executive Officer of Australia's leading technology company incubator Cicada Innovations, Hamish was part of the growth and success of a portfolio of over 150 companies. He has a passion for sharing his experience with entrepreneurs who are starting their journey and has taught extensively at Australia's leading universities.

WATSON MANGIONI

WATSON MANGIONI LAWYERS

Level 23

85 Castlereagh Street

Sydney NSW 2000

Australia

Tel: +61 2 9262 6666

Web: www.wmlaw.com.au

CHRIS CLARKE

Director

Email: cclarke@wmlaw.com.au

Chris leads the Corporate and Capital Markets practice group at Watson Mangioni where he has top-tier experience preparing and leading companies through public offerings, as well as counselling companies and boards of directors on complex public company matters. Chris specialises in mergers and acquisitions, capital raisings, corporate restructuring and corporate advisory matters. He has more than 16 years' experience advising significant listed and unlisted clients in a broad range of industries, including technology, professional services, logistics, funds management, communications, entertainment, retail and energy. He also provides strategic advice on general corporate and commercial matters, including corporate governance, disclosure, fiduciary duties and other general corporate and securities law issues, and has extensive experience in liaising with regulatory bodies, including the Australian Securities Exchange and the Australian Securities & Investments Commission. He holds a Masters of Applied Finance and an LLB and BA from the University of Technology Sydney.

ROBERT MANGIONI

Director
Email: rmangioni@wmlaw.com.au

Robert is one of the founders of Watson Mangioni Lawyers and is a corporate and regulatory lawyer with over 30 years' experience. His corporate practice embraces a wide range of financial institutions, listed public companies and high-net-worth families, providing high-level strategic and transactional advice around complex corporate deals, shareholder activism and disputes, solvent reconstructions, mergers and acquisitions, capital raisings, corporate advice, board and shareholder disputes and governance and compliance. Robert's regulatory practice includes all facets of white-collar crime, regulatory investigations and enforcement proceedings, including criminal prosecutions, with emphasis on securities markets regulation, insider trading and market-rigging, continuous disclosure and whistleblower actions. Robert is recognised as a leading Australian legal practitioner in multiple categories in *Best Lawyers* and *Doyle's Guide*. Robert holds a BA and LLB from the University of New South Wales.

ASHLEY ROSE

Director
Email: arose@wmlaw.com.au

Dealing with complex and sensitive transactions is Ashley's bread and butter. He has practised in leading Australian and global law firms in Sydney and London for over a decade and has acted counsel for several international financial and corporate institutions, including J.P. Morgan, British Telecom and Colgate-Palmolive. Ashley specialises in mergers and acquisitions for public listed companies and private companies, capital raisings and initial public offerings, corporate restructures and disposals, company takeovers and corporate governance. His work with companies spans the entire corporate life cycle, including company formation and entity selection, general corporate representation and counselling, financings of equity and debt securities and restructures. He received his LLM (Hons) from the University of Cambridge, LLB (Hons) from the University of New South Wales and BSc from Murdoch University. Ashley also holds additional qualifications in applied finance.

XERO

1/6 Elizabeth Street
Hawthorne, Melbourne VIC 3122
Australia
Web: www.xero.com

ROD DRURY

Founder
Email: aupress@xero.com

Rod Drury is the founder and CEO of Xero, a global small-business platform with hubs throughout Australia, New Zealand, the U.K., North America and Asia. With more than 1.2 million subscribers worldwide, Xero is one of the fastest growing SaaS businesses in the world, ranked No.1 by Forbes as the World's Most Innovative Growth Company two years running, rated Australia's Best Accounting Software in 2017, 2016 and 2015 by Canstar Blue, and Technology Provider of the Year for the British Small Business Awards.

CONTRIBUTORS FROM:

- Addisons
- Alphastation
- Ashurst Australia
- Australian Securities Exchange
- BoardRoom
- CBRE
- Cicada Innovations
- Clyde & Co.
- DLA Piper Australia
- Employsure
- Gilbert + Tobin
- Glasshouse Advisory
- Google Australia
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- Kain Lawyers
- KPMG
- Legalvision
- Link Market Services
- Main Sequence Ventures
- muru-D
- National Australia Bank
- Partners for Growth Australia
- Pottinger
- Principals
- Silicon Valley Foundry
- Spruson & Ferguson
- Square Peg Capital
- StartupAUS
- Startup Onramp
- Stone & Chalk
- Sydney Angels
- TDM Asset Management
- Transition Level Investments
- University of South Australia
- Upguard
- Watson Mangioni Lawyers
- Xero