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A Beginner's Guide to

Growth Shares

A practical guide for founders

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Introduction

Many founders are unaware of the different ways of giving people skin in the game. Ordinary Shares are still the most commonly used method to distribute equity, but there are some great alternatives.

If you are some way into your journey and want to protect the value you have already created, then Growth Shares are ideal. They reward recipients from the point of issue, rather than from the inception of your company.

Growth Shares are also flexible and tax-efficient. They can be used to incentivise advisors, consultants, and contractors, as well as your regular employees.

This guide provides a straightforward, jargon-free introduction to Growth Shares.

Our mission at Vestd is to help as many founders as possible to share ownership with their team.

Book a **free consultation** with one of our equity experts if you'd like to discuss Growth Shares or any of the other scheme types available.

Ifty Nasir
Co-founder and CEO at Vestd

What are Growth Shares?

Growth Shares are a way of rewarding people for the growth that they help a business to achieve, without diluting the existing value of the company.

They are a special class of Ordinary Shares which have limited rights so that, when the business is sold, the holder will only receive a share in the value above a certain threshold.

In order to do this, Growth Shares are issued at a 'hurdle rate', allowing you to provide employees, contractors, advisors and consultants with a share in the capital growth of a business from the point at which they are issued forward.

For example, if they are issued at a 'hurdle' of £1 per share, recipients will share in any net sale proceeds that are over and above £1 per share.

This means that existing shareholders are only diluted for growth from that point onwards.

The advantages of Growth Shares

Growth Shares have a number of smart attributes that provide benefits for both businesses and recipients:

They have no income tax implications for recipients

As recipients only share in the growth in value of the business from the time they're issued (the hurdle), there's no Income Tax liability from receiving them.

On any eventual sale they simply pay Capital Gains Tax on any appreciation in value.

They have rights to dividends

Growth Shares have full rights to dividends after they've become unconditional (when the recipient has met the reward criteria). They can also earn dividends while they're conditional subject to board discretion.

They can either be voting or non-voting shares

Businesses can choose whether to issue Growth Shares that have full voting rights or not.

Life can be simplified by issuing non-voting shares so that the voting rights of the existing shareholders aren't diluted. This also removes the need to manage the formalities of a higher number of voting shareholders.

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The advantages of Growth Shares
[continued]

They can be conditional

As with other share schemes, such as EMI Schemes and Unapproved Options, Growth Shares enable a level of conditionality to be put in place.

This ensures that recipients meet certain **criteria** before their shares are converted to ‘unconditional’, protecting businesses from giving equity to third parties who ultimately don’t deliver on their promises.

Typical conditions include time-based or performance milestones. Goals should be tangible and measurable to avoid any misunderstandings around when equity is released.

For example, a condition of a newly hired Sales Director’s Growth Shares could be to deliver £1m in revenue during their first year. If this condition is met, they receive all of their Growth Shares, otherwise some (or all) are cancelled.

Shares are issued immediately

Unlike an options scheme, Growth Shares are issued immediately, and therefore they are a great alternative to EMI Options for businesses that are not likely to sell in the short term.

Why use Growth Shares?

Share schemes are often viewed as a tool for incentivising employees, however Growth Shares demonstrate just how much broader the benefits can reach - and not only because they can be awarded to non-employees.

So why do so many UK founders choose to use Growth Shares to reward key stakeholders?

The most common reasons that Growth Shares are used are to:

01.

Reward stakeholders' contributions to the business with equity, so that they share in the success of the company.

02.

Reward employees in situations where Ordinary Shares are too expensive for them to purchase outright.

03.

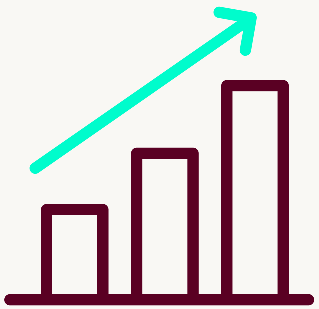
Share equity in situations where the business or recipients do not qualify for other schemes, such as EMI.

04.

Attract and retain key hires.

05.

Align stakeholders with the commercial interests of the company.



How do you issue Growth Shares?

The process of issuing Growth Shares can be very straightforward, if it's done the right way.

Here is how the process works with Vestd:

01. Adopt the Vestd standard Articles of Association

Our articles are based on the British Venture Capital Association's standard template and include additional drafting to allow you to distribute Growth Shares in a way that protects the business. Our structure is compatible with both EIS and SEIS.

02. Issue your Growth Shares

Simply enter what recipients need to do to qualify for your share award, the number of shares you're offering, and the time frame in which they'll receive them.

Then send invitations to the individuals or companies. They then individually choose whether to accept your criteria to get the shares.

Providing they accept, the Growth Shares are automatically issued and registered with Companies House. At this stage the recipient has beneficial ownership of the shares, but they remain 'conditional' until the criteria has been met. You can even choose Vestd to be the legal owner in order to reduce cap table fragmentation.

03. Take them back if the award criteria aren’t met

If circumstances change, or the recipient doesn’t meet your award criteria, companies can cancel the Growth Shares. In this case, the allocated shares are simply converted into worthless deferred shares.

04. Make them unconditional

Once you’re happy the award criteria have been met you make the Growth Shares ‘unconditional’ and they will now be dividend yielding.

What happens if a recipient leaves or doesn't meet expectations?

If the share award is still within its 'conditional period' then the shares can easily be fully or partially cancelled. It's important to set this period to be sufficient to judge if expectations are met.

Once the shares are 'unconditional' the recipient is the full owner of those shares (whether they stay with the business or leave) and you will not be able to cancel the award.

How does tax work with Growth Shares?

On sale, Growth Shares are taxed as a capital gain, so normally around 20%. In contrast, Unapproved Options normally attract a marginal tax rate of 40%, if exercised at exit.

Can Growth Shares have a vesting schedule?

Yes, you can set a vesting schedule in a similar way to options. The 'vesting' is essentially the removal of the conditionality from a proportion of the total shares at specific dates.

Are my current articles of association compatible?

Usually, we find that some additions need to be made to a company's existing articles so sufficient protections for the business are in place and to ensure dilution and exits are handled correctly. If you choose to use Vestd for your share scheme, you can use our articles for free.

These articles have been carefully configured by our legal partners to make sure that they futureproof the company (to the extent possible) to how it might develop, receive investment, and eventually be sold.

Should there be any conditionality or performance criteria?

Each Growth Share award can include a unique and specific set of qualifying criteria. This could be as simple as 'turn up each day' or more specific and linked to key project milestones or helping the business meet specific targets. What's most important is that the criteria is clear and objective.

Who does my valuation and how much does it cost?

If the valuation is carried out by Vestd it is included within the Standard or Pro plan. If your accountant conducts it then you will need to ask them for a quote.

Do I need a valuation to issue Growth Shares?

Yes, all Growth Shares are issued at a hurdle rate. This is typically a small premium above the company's value today. Unlike EMI, this value cannot be pre-approved with HMRC. However, a valuation (carried out with the support of Vestd or by your accountant) will usually provide a good degree of comfort.

Depending on the nature of the company it is normal to apply a premium of 10-40% to the market value to reflect any "hope value" of the shares, and thus further mitigate any risk of HMRC deciding at some point in the future that these shares had been undervalued at issue.

Talk to us

We specialise in helping UK founders use equity to grow their businesses (through share schemes and other equity-based agreements)

If you need any help understanding how to get the best from your equity then **book a free discovery call.**

We will explore:

- [x] Your company structure
- [x] What you are looking to achieve
- [x] The best scheme types for your needs
- [x] Setting conditions and milestones
- [x] How to protect existing shareholders
- [x] The costs and tax implications

We'll also answer any questions you have about sharing ownership. There's no obligation to use Vestd but if you'd like a demo then we'll show you the platform too.

About Vestd

Vestd is the first and only regulated share scheme platform for UK companies. Thousands of people use it to manage and monitor their equity.

The platform was specifically designed and built to help startups, scaleups and SMEs launch and manage share schemes. Customers benefit from ongoing access to our in-house team of equity specialists.

Why choose Vestd?

01. Choose from a range of share / option schemes (including: EMI schemes, Unapproved Options, Growth Shares, Ordinary Shares and Agile Partnerships™).

02. Guided setup and support from our team of specialists.

03. Full two-way Companies House integration. Issue shares and options immediately via the platform. 100% accurate real time and historic cap tables.

04. Regular company valuations from our analysts (no need for accountants) and industry standard legal docs provided (no need for lawyers).

05. A personal dashboard for all of your shareholders and share scheme participants.