

High growth companies and how to fund them – a real driver of economic growth?

Corporate Acquisitions and Joint Ventures Commission

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The working session in Prague is entitled “*High growth companies and how to fund them – a real driver of economic growth?*” In the working session we plan to address funding alternatives for high growth companies (i.e. companies with significant annual growth over time); opportunities and challenges that both entrepreneurs and investors may encounter in your jurisdiction. The working session will also look at corporate governance issues in connection with investments in high growth companies. This questionnaire mainly concentrates on these two topics in relation to high growth companies, but will also cover commercial and regulatory opportunities and constraints.

1. CORPORATE FINANCE – FUNDING ALTERNATIVES

1.1 Which financial instruments are typically used when investing in high growth companies; ordinary shares, preference shares, convertibles, warrants, stock options, debt instruments such as bonds, hybrid instruments such as participating debentures etc.?

This differs depending on type of investors. Typically in Sweden, for seed- and angel financing, ordinary shares are used while for professional investors and later stage financing, preference shares are more common. Convertibles are typically used for bridge financing.

1.2 Please elaborate on the pros and cons of the instruments used (ref. 1.1 above) (Describe 2-3 most widely used instruments more in-depth (any combinations as well, if applicable). Also other features, i.e. typically electronically registered instruments or not? etc.)

Electronically registered instruments are typically used at later stages, e.g. in conjunction with IPO preparations. Further, they can be used also in earlier stages for smaller companies with many shareholders, in order to facilitate keeping track of the shareholders and manage the share register. However, for smaller companies with few shareholders, electronically registered instruments would normally cause unnecessary administration and costs.

1.3 Are there any regulatory constraints to the instruments used (ref. 1.1 above)?

No, there are no such general regulatory constraints in Sweden. However, please note that under certain circumstances, the Swedish prospectus rules provides for prospectus and registration requirements when securities are offered to the public.

1.4 Is crowdfunding a funding alternative in your jurisdiction? How wide is the practice? If at all, please describe pros and cons.

Yes, crowdfunding is a funding alternative in Sweden and the interest for crowdfunding has increased in recent years. Initially, crowdfunding was used only to fund projects whereby the “investor” would retain e.g. first access to the products when they had been developed etc. However, now also real funding whereby the investors are offer equity has emerged.

The pros would be that companies that are in early stages or for other reasons have problem obtaining financing can obtain such financing by turning to the public through crowdfunding. Crowdfunding is also a way for many start ups to market the company/product/service among potential customers (and not only investors).

The cons would *inter alia* be that the companies seeking funding through crowdfunding would typically be those who have tried but been rejected by more

experienced investors and through crowdfunding, they will instead turn to the wider public who have no means of conducting a proper due diligence, evaluate the target company or even negotiate the price of the shares. It has been said about crowdfunding that it is the most ventureous start-ups seeking funding from the least informed investors.

2. INVESTORS VIEWPOINT – OPPORTUNITIES AND CONSTRAINTS, LEGAL AND COMMERCIAL

2.1 Who are typical investors into a high growth company in your jurisdiction? Sources of funding (i.e founders-family-friends, angel investments, venture capital investments, private equity)

It is rather uncommon to see private equity investors invest in high growth companies in Sweden.

Further, there is a lack of early stage professional investors between approximately MSEK 20-50 investments. Up to MSEK 5 would be investments from angel investors, family and friends and above MSEK 100 you see the larger investors.

2.2 Is there a typical size of the investment into a high growth company in your jurisdiction?

Typically would be seed/angel investments of up to MSEK 5 and VC-investments of approximately MSEK 10-30.

Further, it is common to see several smaller investment rounds, i.e. the start-ups will gradually seek and receive financing and it is more uncommon with the large one-time investments, i.e. the MSEK 70-100 investments.

2.3 Describe the process of documenting the investment (Which documents are typical? Which terms need to be included in the articles to be enforceable? etc.)

Typical investment documents are: (i) investment agreement/term sheet; (ii) shareholders agreement; and (iii) corporate documentation (new share issue etc).

In distinction from many other European jurisdictions (e.g. Denmark and England), in Sweden it is not possible to include as many regulations in the articles of association (which are official). Instead, regulations which are typically included in the articles of association in other jurisdiction are in Sweden instead included in the shareholders agreement.

2.4 Are there incentive schemes for investing into high growth companies (governmental grants (including co-investment funds, state as a guarantor of loans, etc.)?)

For example ALMI, which is owned by the Swedish state, can offer both loans and investments to match/supplement other investments.

Further, Industrifonden is a foundation established by the Swedish state which invests in small and medium sized growth companies.

Another example is Fouriertransform which is a state-owned venture capital company tasked with strengthening the Swedish industrial cluster's international competitiveness on a commercial basis.

It should also be mentioned that new tax legislation admits special rights to tax deductions for venture capital investments.

2.5 Any instruments referred to in section 1 preferred from the point of view of an investor? Why? Would the answer differ if the investor is international or domestic?

Typically, preferred shares are more commonly used by professional investors. Further, the "normal" model for preferred shares is generally tougher in Sweden than in many other European jurisdictions.

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| 3. ENTREPRENEUR'S VIEWPOINT – OPPORTUNITIES AND CONSTRAINTS, LEGAL AND COMMERCIAL |
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3.1 Which company form is most popular? (Special company forms for high growth companies? Tiers of management typical for a high growth company? Liability point of view?)

Limited liability companies is by far the most popular company form used in Sweden and it is very rare to use any other form.

3.2 What sectors are most preferred by high growth companies in your jurisdiction (information and communications technologies, biotech, etc.)?

Most common high growth sectors should be IT and high tech.

3.3 Are there incentive schemes for entrepreneurs incentivising high growth companies (e.g accelerators/incubators? Other?)

There is a national network of incubators in all larger cities in Sweden. Coaching is typically provided but no other incentives.

3.4 Any instruments referred to in section 1 preferred from the point of view of an entrepreneur? Why?

Not really since entrepreneurs are normally left to accept and negotiate based on what they are offered.

4. CORPORATE GOVERNANCE – CONTROL ISSUES

4.1 In a typical investment into a high growth company, whether a loan related investment or equity investment, how much control would a typical investor take? and what is of particular importance to an entrepreneur? In particular, please elaborate on the following terms from the perspective of your jurisdiction and practice:

- a. Anti-dilution measures – This is common if it is a professional investor.
- b. Rights of first refusal, pre-emption rights, drag and tag along – Yes, common provisions.
- c. Protective provisions – Common provisions.
- d. Information rights – Common provisions.
- e. Dead-lock resolution – Rather uncommon, in particular in VC-companies where it is difficult to get rid of each other.
- f. Board seats / observer rights – Common if more than 10% ownership.
- g. Any other terms specific/important in your jurisdiction? – Potentially provisions regarding additional financing and dividends.

5. EXIT STRATEGIES AND TIME HORIZON

5.1 Type of exit which is most common (sale to venture capital/private equity firms/funds, trade sale, write-off, initial public offering)? Typical transaction length?

Trade sales have been more common for many years while the Swedish IPO-market has been weak. However, we have seen a higher activity on the IPO-market more recently, typically with respect to the smaller stock exchange lists and non-regulated markets.

Unfortunately, there are also many write-offs among these types of high growth companies.

5.2 How are new investors dealt with in your jurisdiction? How would the issues set out in section 5 above be dealt with? Are initial investment and shareholders' agreements/shareholders' agreements upheld in the next round, or new agreement is entered into?

That depends on how large the investment round is. The shareholders agreement will normally be renegotiated and rewritten if it is a larger investor while minor investors would more commonly have to adhere to the existing agreement on the terms and conditions as is.

6. REGULATORY ISSUES

6.1 Any tax implications (positive or negative) that a high growth company encounters in your jurisdiction?

It has been much criticized in Sweden that there are not more tax implications giving incentives, tax breaks, exemptions from tax and other positive discrimination with respect to start ups, incentive programs for employees etc.

6.2 In addition to any of the issues set out above, any other regulatory incentives or constraints with respect to high growth companies? Any constraints deriving from obligation for local participation in a high growth company? Co-investment obligation? etc.

The absence of special regulations and tax breaks for incentive schemes is a problem since they will be too expensive to set up for the employees.

There are no constraints on foreign investments in Sweden.

There are no general co-investment obligations unless the company chooses such financing from investors like ALMI and Industrifonden which are governmental back-funding based on co-investments (see further under Section 2.4 above).

7. OTHER

7.1 Please elaborate on any other issues relevant to your jurisdiction with respect to high growth companies which have not been discussed in responses to earlier questions (if any).

Nil.