United Kingdom

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United Kingdom: Venture Capital

1. Are there specific legal requirements or preferences regarding the choice of entity and/or equity structure for early-stage businesses that are seeking venture capital funding in the jurisdiction?

There are no specific legal requirements. Generally early-stage businesses will select a private limited company, given its relatively flexible structure and limited liability for shareholders. Usually a business will incorporate with ordinary shares only and will then create further classes of shares with relevant preferences when fundraising.

2. What are the principal legal documents for a venture capital equity investment in the jurisdiction and are any of them publicly filed or otherwise available to the public?

- **Articles of Association**: Sets out the rights attaching to shares in the company, including voting, capital return, dividend and redemption rights, pre-emption rights on new issue and on transfer, including permitted transfers, mandatory transfers, tag along and drag along rights. The articles also provide the framework for the appointment and removal of directors and how the directors transact the board's business and manage conflicts of interest.
- **Shareholders Agreement**: Works in parallel with the articles, usually covering investor information, investor consent rights, positive undertakings of the company, exit arrangements and restrictive covenants (see Q8).
- **Subscription Agreement**: Allows investors to subscribe for shares in the company in return for the company (and sometimes its founders) providing warranties about the business, subject to customary limitations on liability.
- The Articles are required to be publicly filed (at Companies House) but the others are private agreements.

3. Is there a venture capital industry body in the jurisdiction and, if so, does it provide template investment documents? If so, how common is it to deviate from such templates and does this evolve as companies move from seed to larger rounds?

The British Venture Capital Association (BVCA) is the UK's industry body and public policy advocate for the venture and growth capital market in the UK. It publishes standardised documents for early stage venture capital investments, which are available via its website: [link here]

The BVCA templates are used by most leading law firms for series A rounds onwards. They are sometimes used on earlier rounds, with appropriate amendments, but it is also common to see other simpler forms of documents used to simplify the process.

4. Are there any general merger control, anti-trust/competition and/or foreign direct investment regimes applicable to venture capital investments in the jurisdiction?

The UK merger control regime is managed by the Competition and Markets Authority (CMA). Filings are voluntary and are only required where an investor acquires "de facto" control or material influence. However, the CMA is likely to view a share of voting rights over 25% as conferring material influence and, conversely, rarely views a share of voting rights below 15% sufficient.

The UK does not have a foreign direct investment control regime, however the National Security and Investment Act 2021 ("NSIA") works in a similar way to foreign direct investment control regimes in other jurisdictions. A transaction will be subject to a mandatory filing requirement under the NSIA where:

- the investee company is a UK entity, or a non-UK entity that carries on activities in the UK or supplies persons in the UK;
- the transaction involves an acquisition of "control" over the investee company – generally acquiring voting rights exceeding 25%, 50% or 75% thresholds, or voting rights allowing the prevention of the passing of any class of shareholder resolution; and
- the investee company carries out activities in one of 17 sensitive sectors (for example, defence and artificial intelligence).

5. What is the process, and internal approvals needed, for a company issuing shares to investors in the jurisdiction and are there any related taxes or notary (or other fees) payable?

- **Shareholder approval** will be required to authorise the allotment of shares and waive pre-emption rights, which would otherwise require the shares to be offered to existing shareholders.
- **Board approval** is needed to approve the fundraising agreements and the resulting allotment of shares to the investor(s)
- **Process** – subject to the above approvals being obtained, the fundraising agreements are signed. The subscription monies are paid to the company and, upon receipt, the company issues share certificates, files the shareholder resolutions and SH01 at Companies House and updates its statutory registers.
- **Taxes and fees** – notarisation is not necessary and no taxes are usually payable. However if the investment includes the sale of existing shares to an investor then stamp duty will be payable – currently at 0.5% of the consideration.

6. How prevalent is participation from investors that are not venture capital funds, including angel investors, family offices, high net worth individuals, and corporate venture capital?

Angel investors and high net worth individuals commonly invest in the UK, mostly in earlier stage rounds and especially where the company is able to offer tax-advantaged EIS/SEIS shares.

Family offices are also seen in some sectors, although more commonly as sole investors rather than as co-investors alongside venture capital funds on larger rounds.

Corporate venture capital is also an important part of the UK market, often where there is a strategic fit between the corporate investor's business and the target's business. These transactions can also be coupled with staged share acquisitions (with agreed milestones and valuations), enabling the corporate investor to acquire the target over time.

7. What is the typical investment period for a venture capital fund in the jurisdiction?

The investment period will vary from investor to investor, based on its planned investment stage, sector(s) and returns strategy. However most institutional investors will target an exit within 3 – 5 years.

8. What are the key investment terms which a venture investor looks for in the jurisdiction including representations and warranties, class of share, board representation (and observers), voting and other control rights, redemption rights, anti-dilution protection and information rights?

- **Liquidation preference** usually a 1x non-participating preference allowing the investor to get its money back in priority to other shareholders if there is a shortfall.
- **Pre-emption rights** on a new allotment of shares and on the transfer of existing shares. In some cases, "major investors" (those with a sufficiently large stake or investment) have a right of first refusal ahead of smaller investors / shareholders.
- **Anti-dilution rights** to mitigate the impact of a down round, usually calculated on "broad-based weighted average".
- **Voting rights** on a pro rata basis with other voting classes. We sometimes see enhanced voting rights in the event of business underperformance, but this is rare as it can disqualify EMI option schemes (see Q12 below) and R&D tax credits.
- **Warranties** from the company (and sometimes its founders / management team) to underpin the investors' assessment of the company. The main purpose of these warranties is to encourage disclosure of information, rather than risk allocation.
- **Consent rights** over material actions of the company, including changes to the share capital or constitution, and key operational decisions. These rights may be exercised by specific investors, a specified majority of the investors, or by one or more investor directors.
- **Drag Along rights** allowing a majority of shareholders to compel all other shareholders to sell their shares to a bona fide third party buyer. This is usually subject to investor consent within an agreed time frame and / or where the exit is below a certain valuation.
- **Tag Along rights** in situations where a bona fide third party buyer is seeking to take a controlling interest in the company, ensuring the investor has the right to sell its shares too, before the transaction can proceed.
- **Undertakings and restrictive covenants** from the company and its management team about the on-going operation of the business. Founders / management will also be expected to give restrictive covenants, as described in Q11.
- **Board representation** via a right to appoint investor directors and/or observers to the company's board (and any sub-committees).

- **Information rights** to see the company's accounts, management accounts, annual budgets and other agreed KPIs on a timely basis. These rights may be limited to "major investors" (as described above). Investors will usually also have a general right to request information, to inspect the books and records of the company, and to speak with management.

9. What are the key features of the liability regime (e.g. monetary damages vs. compensatory capital increase) that apply to venture capital investments in the jurisdiction?

Monetary damages for breach of warranty is the most common form of recourse (but please note, claims are very rare). Warranty claims can also be satisfied by a compensatory equity allotment (or share transfer where a founder is liable), but such rights are rare.

Equitable remedies such as injunctions to stop a prospective breach of the shareholders' agreement or specific performance, to compel a party to comply with an undertaking in the shareholders' agreement, are also available under UK law.

10. How common are arrangement/ monitoring fees for investors in the jurisdiction?

Arrangement and monitoring fees are uncommon in venture capital transactions (probably c10%) unless the investor is a venture capital trust (VCT) or private equity investor leading what is otherwise a venture fundraising. Fees can be in the form of arrangement or monitoring fees or, in certain cases, a director's fee for an investor's nominated director.

11. Are founders and senior management typically subject to restrictive covenants following ceasing to be an employee and/or shareholder and, if so, what is their general scope and duration?

Founders and senior management are commonly subject to restrictive covenants under the shareholders' agreement (in their capacity as shareholder)s for a period of 12 – 24 months from termination of employment.

Founders and senior management are also typically subject to separate restrictive covenants under their employment contracts for a period between 6 to 12 months from termination, depending on their seniority and role.

The scope of the restrictive covenants under both regimes is similar and will typically include a non-competition obligation; an obligation not to solicit or deal with customers or suppliers in a competition with the company or otherwise to its detriment; and an obligation not to solicit key employees.

12. How are employees typically incentivised in venture capital backed companies (e.g. share options or other equity-based incentives)?

Share options: the most common form of equity incentive in VC-backed companies is share options. These are often issued under an "Enterprise Management Incentive" (EMI) option scheme, offering certain tax advantages, including:

a. no income tax for the employee when the options are exercised provided the exercise price is no less than the actual market value of the shares at the date of grant (as agreed with the UK tax authorities prior to grant); and
b. the availability of a capital gains tax and, subject to certain conditions, business asset disposal relief which reduces the rate of capital gains tax paid on the disposal of the shares.

Share options are typically subject to a 4 year vesting period, with 25% vesting on the first anniversary and 75% vesting over the next 3 years on a monthly basis. Options are often granted under "exit only" schemes, meaning they may only be exercised upon an exit.

Growth shares: Employees may also be incentivised through direct allotment of shares where the company cannot offer EMI options. The shares are often only entitled to a return on exit if the sale proceeds are above a certain threshold (or "hurdle") and may not have voting rights.

13. What are the most commonly used vesting/good and bad leaver provisions that apply to founders/ senior management in venture capital backed companies?

Time based vesting (or reverse vesting) of shares already issued is most common in early-stage fundraisings and works as follows:

a. Over 4 years, with 25% vesting on the first anniversary and 75% vesting on a monthly or quarterly basis over the next 3 years (similar to the vesting terms for an EMI option – see Q12).

b. Vesting is often accelerated on exit, so that the founder is able to sell all of their shares.

Leaver provisions are common at all stages of venture fundraising, but the equity "at risk" reduces / falls away as shareholder value is built:

a. Good leavers are often subject to events beyond their control (death or ill-heath) or leave with the consent of the board and / or investor(s) in circumstances where it would be harsh to penalise them. Good Leavers are usually entitled to retain vested shares with any unvested shares being converted into worthless, non-voting deferred shares.
b. By contrast, bad leavers have usually done something wrong (a criminal act, fraud or dishonesty). Sometimes, this can include voluntary resignation within an agreed timeframe. All or a pre-agreed proportion of a bad leavers' shares are typically converted into worthless, non-voting deferred shares.

14. What have been the main areas of negotiation between investors, founders, and the company in the investment documentation, over the last 24 months?

- **Good / Bad Leaver**: The definitions and consequences of leaving can require difficult (and emotive) negotiations between investors and founders. While there are typical vesting and leaver terms (see Q13), bespoke and negotiated terms are common.
- **Investor consents**: As well as negotiating with the company, investors must agree how investor consents will be managed between co-investors. New investors in later rounds may want more influence, particularly if they are investing bigger sums at a higher valuation.
- **Liquidation preference rights**: If there have been several fundraisings or an investor's class of share has unusual rights, the drafting of the "liquidation preference" waterfall is often negotiated in great detail.
- **Director appointment rights**: As a company grows and governance becomes more important, entrenched rights to founder board seats are often softened with a requirement for a minimum shareholding percentage and / or remaining as an employee in the business. Similarly, an investor's board appointment right is often subject to maintaining a certain shareholding.
- **Exits**: Investors and founders will negotiate exit-related provisions, including who has consent rights over an exit or the appointment of advisers and who is entitled to exercise "drag along" rights to compel all shareholders to sell their shares at the same time.

15. How prevalent is the use of convertible debt (e.g. convertible loan notes) and advance subscription agreement/ SAFEs in the jurisdiction?

- Convertible loans are regularly used for internal 'bridging' rounds, where existing investors inject funds whilst new third party investment is sought. This allows the company to get ongoing support whilst postponing negotiations about valuation and dilution, which can be difficult to assess in absence of an independent third party offer.
- SAFEs (simple agreement for future equity) is a popular way of injecting funds into a company quickly and cost effectively at early stages. This also postpones the valuation debate until a larger fundraising / external valuation. SAFEs are not loans however as the capital cannot generally be repaid.
- EIS/SEIS investors are also able to offer advance subscriptions with similar characteristics to SAFEs. This has arisen in practice because EIS/SEIS advance subscriptions cannot be repaid and the funds must convert into equity within a set time period (6 months is common).

16. What are the customary terms of convertible debt (e.g. convertible loan notes) and advance subscription agreement/ SAFEs in the jurisdiction and are there standard from documents?

- **Conversion** into equity on the next equity fundraise of the company or on an agreed maturity date. This can be at the investor's election, but is sometimes automatic – for example, on a qualifying fundraising of a certain size.
- **Discount** on conversion from the price set by the company's next funding round, usually by 10% to 30%. We sometimes see a variable discount percentage, increasing over time.
- **Valuation Cap** on the conversion price of the debt, SAFE or advance subscription on the company's next funding round, assuring investor(s) some benefit from any increase in the company's valuation between events.
- **Interest** can accrue on the capital and may convert alongside it. Interest is not permissible for EIS/SEIS advance subscriptions as these are not loans.
- **Repayment** typically on the maturity date and on an 'event of default' (insolvency, failure to pay debts as they fall due, breach of warranties). As noted above, SAFEs and EIS/SEIS advance subscription agreements do not have repayment rights.

- **Warranties & consents** to underpin an investor's assessment of the company and to give them limited consent rights.
- **Documentation** is not based on standard templates, but most convertible debt instruments are similar. SAFEs are usually based on the Y Combinator template and advance subscription agreements have evolved from them to be an EIS/SEIS compliant alternative.

17. How prevalent is the use of venture or growth debt as an alternative or supplement to equity fundraisings or other debt financing in the last 24 months?

Venture and growth debt is a popular choice for companies looking to minimise (or avoid) equity dilution for its existing shareholders. It can also be used to bridge equity funding rounds, extending cash runway and enabling founders to meet certain milestones or finance other growth strategies (e.g. M&A), particularly when valuations are under pressure.

18. What are the customary terms of venture or growth debt in the jurisdiction and are there standard form documents?

- Venture debt is mostly structured as a term loan, with a tranches available on signing and thereafter upon achievement of revenue, performance or equity fundraising milestones. For more proven business models, growth financing is available using revolving credit lines. Debt is typically provided as a multiple of revenue or recurring revenue and lenders look closely at projected profitability, levels of cash burn and gearing ratios.
- Many lenders require an equity warrant allowing them to subscribe a modest percentage of their loan commitment for equity, using the same share price paid and same class of share held by equity investors. The lifespan of a warrant is normally 10 years and the warrant will contain protections to ensure the warrant holder is treated commensurate to equity investors in certain circumstances.
- The overall cost of venture debt has several elements. In addition to interest, there will be a mix and match of upfront arrangement fees, exit fees and warrant rights to spread the cost of the loan. There may also be non-utilisation fees (for a revolving line) and prepayment fees on a term loan.
- Most lenders will require the company to comply with financial covenants, focusing on revenue and/or profitability. Like equity investors, lenders will restrict things that could distract from the business plan, soak up cash, devalue the business or create further indebtedness. Some lenders may require an observer seat on the board. All lenders will require sight of regular financial information. The loan documentation will contain customary events of default and associated remedies.
- Venture debt facilities will typically be secured against all assets of the company and lenders will usually expect to have first ranking, senior security, meaning any shareholder debt or other third-party debt must be contractually and/or structurally subordinated.
- Most lenders have their own standard templates based on English law and some of these are adapted from the Loan Market Association template loan documents.

19. What are the current market trends for venture capital in the jurisdiction (including the exits of venture backed companies) and do you see this changing in the next year?

Higher interest rates, rising inflationary costs and disruption to global supply chains have taken their toll on deal activity. Despite this, early and later-stage venture fundraising in Europe and the US appears to be back above 2020 (pre-Covid) levels, with an estimated aggregate value of >$200bn in 2024.

In 2024, artificial intelligence continued to dominate new technology investments, with the majority of tech venture fundraisings having an AI dimension. There is no sign of this changing in 2025.

The UK continues to be a leading centre of excellence for venture capital investment, due to its respected, business-friendly, tax and regulatory environment. The Government's restated commitment to the Golden Triangle, between London, Oxford and Cambridge, is also a welcomed boost to the UK's vibrant University spin out scene.

During 2024, there was a drought of VC-backed exits and a handful of public market listings in the UK, reflecting a similar picture in the US and Europe more generally. Many of our clients tell us there is significant liquidity ("dry powder") within the buyout market. It therefore seems likely that more VC-backed companies based in the UK will exit to European and US private equity-backed acquirers, instead of pursuing a public market listing or trade sale. It will also be interesting to see what impact PISCES has on exit planning (see Q20).

20. Are any developments anticipated in the next 12 months, including any proposed legislative reforms that are relevant for venture capital investor in the jurisdiction?

- **PISCES** – As part of an initiative by UK Government (HM Treasury) to improve the UK capital markets, a new trading platform called PISCES will be launched in 2025. This is intended to give founders, investors and, potentially, employees in share option schemes, liquidity prior to an IPO or sale of the company. It will also allow institutional, professional and retail investors to invest in private companies through secondary share acquisitions.
- **Agile Regulations** – The Government has announced it wants to cut unnecessary regulation, making it easier for VC funds to invest in UK businesses in innovative and emerging sectors. This is thought to be aimed particularly at FCA regulated fintech companies.
- **'Invest 2025' strategy** – Shortly after taking office, the UK Government released its green paper "Invest 2035" setting out the Government's long-term and targeted industrial strategy. It identifies eight growth-driving sectors: advanced manufacturing, clean energy industries, creative industries, defence, digital and technologies, financial services, life sciences, and professional and business services, all of which are areas of interest to the venture capital community.
- **Defence** – In its Spring 2025 statement, the UK Government confirmed plans to increase defence spending, with a minimum of 10% of the kit budget allocated to novel equipment, including drones and AI-enabled technology.
- **Digital Transformation** – The UK Government has pledged to invest £3.25bn in a "transformation fund" that aims to reduce the cost of running Government by greater utilisation of technology tools, such as AI.

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