

How to use Consolidated Capital Release

Gary Lowrey: *How to combine the Enterprise Investment Scheme and Entrepreneurs Relief for mutual benefit of investors and shareholders.*

There are a vast number of successful IT companies in the UK. Many of these companies, particularly smaller ones with a turnover of less than £10m, remain in the hands of their original founders and continue to be managed by them with great success. One of the questions often asked of InitioStar, is how to take a business forward and also release an owner manager's capital.

The challenge is to create an environment that is beneficial for both business owners and potential investors, be they individual investors or other businesses. At InitioStar we consider both the financial and operational perspectives of any transaction. For smaller UK IT companies (T/O <£10m), we would argue a more tax efficient environment now exists for owners and investors alike. While these tax incentives in their own right are not a reason for any transaction, they can be very effective in encouraging all parties to move forward.

Looking at the financial perspective, in April this year the UK Government created a more favourable environment for small business entrepreneurs and investors. The doubling of lifetime Entrepreneurs Relief to £10m was significant, as many small IT businesses have a corporate value less than this figure, but greater than the original £5m lifetime relief. The benefit of this tax relief for owner managers is that when they sell shares in their company (in part or in total) they can limit the capital gains tax (CGT) they pay to 10%, up to the lifetime limit of £10m.

In parallel with the change in Entrepreneurs Relief, the Government also improved tax relief for investors. For example, under the Enterprise Investment Scheme (EIS) income tax relief increased from 20% to 30%, with the tax relief amount that can be invested in any one tax year, set to double from £500,000 to £1m in 2012. With investment limits and qualifying criteria now more flexible, companies should be able to attract investment through EIS and Venture Capital Trusts (VCTs), although for smaller companies it may prove easier to obtain investment through a collective of EIS investors. InitioStar uses the term 'collective' to refer to a group of independent EIS investors who come together to support a particular investment or transaction.

While the financial perspective for smaller IT companies is now more interesting from a tax viewpoint, the challenge still remains one of connecting owner managers and investors, and of managing ownership transition thereafter. Reasons for selling a company will vary, but a common theme is one where owners are considering retirement, or have a simple desire to move on to something else. In common, they all have a wish to release capital from their business.

Of course owner managers wanting to sell still face several hurdles, indentifying a buyer, accepting a valuation for the business which in some cases may be below their original expectation, and negotiating with investors who will want to see, or participate in the development of a future business plan.

Negotiating with investors can be an interesting experience. Smaller IT companies will be aware of PE multiples obtained by some of the high-flying technology stocks and incorrectly assume they that can achieve the same multiples. The reality in practice is that PE multiples for smaller IT companies, typically with a turnover around £10m, usually achieve much lower multiples than those of larger companies. Assuming common ground exists between buyers and sellers then the merits of Entrepreneurs Relief and EIS should be considered, along with the PE multiple.

When presenting a company, owner managers need also to consider what investors are looking for: usually an established loyal customer base, strong recurring revenues, a mature product or service and a good reputation for quality and service delivery. Alternatively, they are looking for an embryonic company with a compelling and unique market proposition, likely to be a high-growth opportunity.

Capital Release is achieved by creating a tax efficient platform for both owners and investors and a business plan that investors will buy into. The combination of EIS for investors and Entrepreneurs Relief for owner managers can assist in the bridging any valuation gap.



InitioStar has considered the financial perspective of Capital Release in a single company and how the criteria for matching buyers and sellers can be supported through tax incentives. Consolidated Capital Release extends the same principles to two or more companies.

For companies operating in similar or complementary markets, consolidation can achieve economic scale, a broader customer base, product and service synergies and reduced finance and administration costs. It can be an opportunity to establish a stronger collective value proposition, to improve performance and productivity and to create a generally more attractive proposition for investors and owners. It could be that one company needs capital and the other has a surplus; it could be that both owners have a desire to realise their investment and that their combined portfolio of customers, products and services would be more attractive to potential investors.



Tax benefits from a consolidated capital release can help the financial aspects of a transaction, but they should never influence the buy/sell investment decision. The latter has to stand up on its own merits, supported by an accepted business plan and a company's ongoing operational management (i.e. how will the new team drive the company forward).

The idea of consolidated capital release might also be attractive to pan-European and global companies. These companies may wish to establish or consolidate their position in the UK and could seek investment from within the UK using for example, an EIS envelope. Potentially, this could reduce their capital requirements in the UK, freeing capital to be invested elsewhere.

In summary consolidated capital release assists the convergence of buyer and seller investment decisions through the availability of tax incentives for UK investors and owner managers.

InitioStar has a particular expertise in the SME IT sector: raising capital under EIS, creating tax efficient wrappers and managing operational transition through changes in company ownership.

About InitioStar

InitioStar provides sales and marketing services to technology and services companies. In the last decade the company has worked with 15 different technology businesses, many of whom have achieved double-digit growth and realised their stakeholder ambitions and values. The company is focused on sales and marketing, turnaround, transition and M&A in the technology and services markets. As a 'trusted advisor' and business partner InitioStar has built sustainable growth and value for business stakeholders and achieved profitable exits.