

Financing for seed and start-up companies after JEREMIE initiative

There is noticeably less financing opportunity after the end of the allocation period of the JEREMIE initiative on the Hungarian market, at the same time it provides an occasion for the use of the resources of the private sector. However, private investors applying instead of the Jeremie funds functioning in a relatively predictable and well controlled way, contract with very different conditions, thus it is worth considering carefully what resource the company actually needs. The expert of KRS Attorneys-at-Law, dr. Attila Pintér was questioned about the contractual practice.

According to the expert of M&A, some stagnation may be experienced on the market after the end of the Jeremie initiatives, although sufficiently agile SMEs still find an investor for a well-prepared project. However immaturity of the market is a problem: SMEs raise capital from inadequate investors in many cases or do not choose the correct way of it.

It is important to stress out that depending on the stage of the undertakings, the investor or a few investors should be selected from different scope of investors, who eventually spend money, time and energy on monitoring the investments, as well as on the management of the project. According to the widespread notion, only the three Fs (friends, family, fools) finance the development of the project at the early stages of the companies, followed by VCs (namely Venture Capitals), or angel investors at an advanced stage.

The practical experience – and last but not least the increasingly widespread foreign samples too – seems to confirm that certain angel investors or even investment entities functioning professionally (business incubators) are also willing to invest at the very early stage of the undertakings, not to mention that tenders for the establishment of many business incubators have been launched recently. The right choice has a key importance among the three Fs, angel investors, business incubators and the VCs since – although all investments are different – these investments differ in their numerous elements that can be well structured. This may be mainly summarised in the rights claimed for the investment. VCs usually claim the most rights and they exercise dominant or sometimes decisive influence in the highest decision making forum but they also require greater involvement in management decisions in many cases. The business angels usually ask for less and they are satisfied with some fundamental veto rights and control rights. It should not mislead the founders that some VCs are also willing to inject greater amount of capital and their yield expectation is not much higher



than that of business angels, but it is worth keeping in mind that – tempting as it may be – if the required amount of financing is not high, it seems to be more practical to agree with a business angel.

It is not necessarily the higher VC investment that would be of real help to SMEs at the early stages but rather a businessman having professional competence and experience in the business. In most cases, although the projects generated by the domestic SME sector work at a highly professional standards, unfortunately, they do not or scarcely have sales and marketing strategy with some negligible exceptions. This may cause problems in sales, which may ultimately cause the fall of the project. It is worth selecting a business angel, who is not only experienced but also has good social capital in the business and can assist in the management decisions and provides more than just capital to the undertaking.

What rights has to be transferred to the investors at the early stage period?

There are no rules set in stone, and obviously much depends on the founders and the nature of the project too. However it can always be put down that it is unconventional to refuse at the early stage of the investment to provide the investor with information regarding all key steps of the undertaking or with reports if requested from the management periodically. It is usually unconventional to secure significant voting right neither in quantity (e.g.: majority votes of 50%, or above) nor in quality (veto rights) but the investor is always entitled to certain priority rights such as the conclusion of certain types or scale of transactions (typically loan, lease transactions, or those concluded with certain purchasers) but also such as adopting an important decision on dividend, report, and business plan. Angel investors scarcely ask for decision-making position in the management but some board is established in many cases, where the investor may share his business perceptions and proposals. These proposals are scarcely binding since the founders are usually afraid of transferring decisions over the project yet the establishment of such board or forum is necessary (even if it is informal), since the experience, opinion of the investors, or his knowledge of the sector can sometimes be of a greater value than the amount of the realised investment.

Does a “good practice” exist what rights have to be offered to the investor?

Capital investment is the final stage of negotiations without exception. It mostly should be clear what rights the founders want to preserve to themselves. The granting of certain control rights is an absolutely well-tried and common solution but, in addition, everything else basically depends on decisions. The scope of votes in the supreme body is considerably more limited, and the transfer of the effective management power is rare.



Can a lawyer be of help in the negotiation process, or his task is only limited to drafting contracts?

In the SME finance or generally in the M&A transactions, it is reasonable to consult a lawyer or other experts right from the first step. A well-prepared legal or other consultant has the necessary experience, which may provide guidance for the founders as to which requests of the investor has to be “usually” fulfilled and which requests are considered unusual to be applied, or applied but in a more favourable form, by other investors.