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Good practice

Guidance for governors and senior managers

Higher education institutions set up related companies for a variety of reasons to help them manage their activities efficiently and flexibly. This guide outlines the issues and risks associated with assurance, compliance and accountability that are faced by institutions when using related companies. The guidance is not prescriptive, but a tool for institutions to use as they think fit.

Related companies: guidance for higher education institutions

Produced for the UK funding bodies by RSM Robson Rhodes

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND
hefce

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1 Executive summary

Introduction

1. Institutions set up related companies for a variety of reasons: for example to carry out commercial activities, to provide a focus for commercial enterprise in a culture different from that of the institution itself, or to protect the institution's charitable status and/or provide advantageous tax or estate planning. Increasingly, related companies are also being used to commercially exploit intellectual property.

2. Related companies provide institutions with opportunities to manage their business efficiently and with a degree of flexibility and varying involvement. However, the use of related companies also exposes institutions to a number of risks.

3. This guidance has been produced by RSM Robson Rhodes for HEFCE, on behalf of the UK higher education funding bodies, to outline the assurance, compliance and accountability issues and risks faced by institutions in the use of related companies.

4. In line with the principles of better regulation, the guidance is not prescriptive. It is a tool for each institution to choose to use and adapt, as it feels appropriate, in accordance with its own objectives, priorities and assessment of risk.

Background

5. In 1995 HEFCE commissioned RSM Robson Rhodes to conduct a study of related companies operating within the higher education sector, and to produce guidance for the sector in the form of recommended practice guidelines. In 1999 HEFCE commissioned RSM Robson Rhodes to review how the guidelines had been used and whether they could be improved. Updated guidelines (HEFCE 00/58) were subsequently published in December 2000 (available on the web at www.hefce.ac.uk under Publications).

6. Against a background of a fast-changing environment for related companies in higher education, HEFCE commissioned RSM Robson Rhodes to update the guidance. In particular, the guidelines now take into account new and emerging risks, the differing objectives and activities of related companies, and consider a wider definition of related company (body). The legal content of these guidelines has been reviewed by Eversheds LLP.

7. A consultative approach was adopted to develop the guidance: RSM Robson Rhodes held telephone interviews with 23 higher education institutions to ascertain the sector's views on the usefulness of previous guidance and requirements from the updated guidance. Site visits to six of these institutions were subsequently conducted to explore in more detail the institution's approach to related company activity.

8. The development of the guidance was overseen by a steering committee of representatives from the sector and from each of the funding bodies.

Key elements of the new guidance

Risk assessment guidance

9. The key objective was to assist institutions in identifying risks and opportunities that are specific to related companies in achieving the institution's strategic objectives.

10. Central to this new risk-based approach, and where the guidance differs significantly from previous versions, is the risk assessment guidance (Section 3).

11. It is important that institutions are able to define, evaluate, monitor and where necessary take action to ensure that opportunities are maximised whilst risks are mitigated to an acceptable level. Each institution will have its own risk management framework and processes.

12. The risk assessment guidance seeks to provide a working tool for managers in mapping key related company risks, to supplement institutions' own risk management processes. The guidance addresses the most likely strategic risks, which should be considered and understood by all senior management of the institution; and the most likely operational risks relating to each strategic risk, which should be considered and used by operational management as needed.

Activities and entities for related company activity

13. Consultation with the sector provided evidence that knowledge of the types of related companies available to institutions was varied. It also showed that some institutions were undertaking related company activities without consulting the guidance, because they believed that the type of activity or organisation was not covered by the guidance.

14. Whilst the guidance cannot provide an exhaustive list of activities which should be deemed related company activity, Section 4 does define a number of entities which may be considered to be related companies or whose attributes are similar to those of related companies. This section also details the key advantages, disadvantages and risks associated with each of these entities.

Checklists

15. The related company checklists have been a feature of these guidelines from the start. Consultation with the sector in 2000 and again during 2004 found that institutions were using the checklists to varying extents. Some used the checklists in full, some incorporated elements within their own procedures, and some used the checklists for reference only. However, it was widely felt that the checklists were a useful tool in the management of related company activity.

16. The guidelines are now risk based, and their use should be driven by the risk assessment guidance. However the checklists have been retained in order to provide additional information and best practice once institutions have determined their key risks.

Using the new guidelines

17. These guidelines will be relevant, at least in part, to all members of the board and management of each institution and of its related companies: their implications should be considered at all relevant committee and management meetings.

18. As a minimum the following key strategic risks identified within these guidelines should be considered by all institutions:

- the institution may not have a clear strategy for the use and development of related companies and/or other entities;
- the institution may not have due regard for the issue of public accountability;
- institutional governance structures do not reflect the appropriate level of influence over related companies;
- the institution does not identify and evaluate all potential commercial opportunities in line with an agreed strategy;
- the formation of a related company (or other commercial entity) may not be properly planned and controlled; and
- the related company's performance may not meet its budget and objectives.

19. The guidelines are layered in structure. Those responsible for the strategic direction of the institution as a whole, for example the Vice Chancellor, may read only the executive summary and the introduction to gain an understanding of the key strategic risks and considerations; whilst the entire guidelines may be relevant to those involved in the day to day operation of the related company activity.

20. The implementation of the guidelines should be through each institution's own risk management framework. This should ensure that the guidelines are introduced at an appropriately senior and diverse level to ensure sufficient ownership and accountability.

2 Introduction

Introduction

The higher education funding bodies

21. In 1992 Funding Councils were established in England (HEFCE), Scotland (SHEFC) and Wales (HEFCW) to administer public funds for the provision of teaching, research and related activities in higher education institutions (HEIs). In Northern Ireland there is no funding council and institutions are directly funded by DELNI.

22. One of the funding bodies' key objectives is to promote the efficient use of institutional assets and effective accountability for public funds, whilst recognising the autonomy of institutions.

23. Accordingly in 1995 HEFCE commissioned RSM Robson Rhodes to conduct a study of related companies operating within the higher education sector, and to produce guidance for the sector in the form of recommended practice guidelines. These guidelines were updated in 2000 (see HEFCE 00/58) and now in 2005.

24. All four funding bodies have participated in the original and/or follow-up studies, and are partners on the steering committee for developing this updated guidance. The guidelines are therefore intended to be of use to all publicly-funded HEIs, and reference to HEFCE within these guidelines should be taken to refer to any of the higher education funding bodies.

Institutions

25. HEIs are legally independent bodies (usually corporate), which have a common charitable purpose of providing education and, in most cases, undertaking research. They are accountable through their governing bodies, which carry ultimate responsibility for all the affairs of the institution.

26. The constitutions and powers of HEIs are extremely diverse and may (depending upon the type of institution) be laid down in, for example, the Royal Charter and statutes of the institution, or in the Education Reform Act 1988 (as amended by the Further and Higher Education Act 1992), together with the instruments and articles of government.

27. Members of governing bodies (governors) act in a fiduciary capacity and must act in the best interests of the institutions they govern. In certain circumstances, for example if they act negligently, they may face personal liability for loss.

28. Not all institutions have the power to set up related companies or the power to set up all types of related company; in addition, some of the proposed activities of such companies may not be directly in accordance with the institution's constitution. Governors should seek proper advice on all aspects of proposed projects.

29. More detail on the responsibilities of institutions may be found in the 'Guide for members of higher education governing bodies in the UK' (Committee of University Chairmen, HEFCE 2004/40).

Related companies

30. Institutions set up related companies for a variety of reasons. Historically, most related companies were set up to carry out commercial activities, which may protect the institution's charitable status and incidentally provide advantageous tax or estate planning; to provide a focus for commercial enterprise in a culture different from that of the institution itself; or as a means of conducting joint ventures.

31. Increasingly, however, related companies are being established to commercially exploit intellectual property. The activities of related companies can vary considerably. Some take advantage of specialist skills by selling training and consultancy expertise; others exploit the commercial potential of research and intellectual property. Some retain ownership of activity and intellectual property, whilst others attract private funders to share in the risks and rewards of ventures which institutions may not otherwise be able to fund.

32. Some institutions are now experienced in generating commercial income from spin-out companies or the licensing of intellectual property, whilst many others are actively developing mechanisms for this purpose.

33. UK HEIs are making a growing contribution to the number of companies being spun-out for commercial purposes worldwide; however, to date only a small proportion of these companies have become profitable. Work by the Economic and Social Research Council[1] suggests that the poor success rate is a symptom of a lack of academic commitment to spin-outs, a lack of clear structure to spinning-out the company, and a lack of seed funding to conceptualise inventions.

34. The Government has a clear agenda to promote UK science and technology through HEIs, and has highlighted the successes of several institutions and centres of excellence. Regional Development Agencies have played a role by providing funding for science and technology incubator centres. However, the Government is also conscious of the lack of consistent control and regulation of spin-outs and poor success rates. It has recently been criticised from within the sector for demanding more detailed business plans from academics applying for commercial funding.

35. By establishing a related company to undertake a commercial activity, an institution may be able to ensure that its powers are not exceeded, that its legal duties (specifically under the law relating to charities) are not breached, and that its governors reduce the risk of personal liability.

36. By carrying out activities through a company it may be possible to limit liabilities which may arise, for example, through negligence or breach of contract. However, in certain circumstances (particularly where the institutional "parent" exercises a high degree of control), limited liability may not fully protect the institution. In those circumstances, individual directors of the related company who are also institutional employees or governors (or individuals who may be deemed to be performing or instructing the role of a director i.e. shadow directors) may face personal liability. This may occur where an institution continues to nurture a related company beyond the point of failure. Likewise the institution may be at risk of reputational damage by virtue of its association with the related company (regardless of ownership). In each case, proper professional advice should be sought and risk management

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[1] The Economic and Social Research Council is the UK's leading research funding and training agency addressing economic and social concerns, and providing research on issues of importance to business, the public sector and government.

processes invoked, both at the preliminary consideration stage and at subsequent stages where problems may arise.

Background

A changing environment

37. As a consequence of the changes occurring within the sector and in particular the changing face of related company activity, these guidelines have been updated to take into account new and emerging risks, the differing objectives and activities of related companies, and to consider a wider definition of related company (body) than hitherto. For example they take account of joint venture arrangements, new forms of legal entity, private provision and connected institutions, where a different entity is used but the risks are similar to those of related companies (defined as any legal entity over which the institution has control or exercises a substantial degree of influence in relation to that company's activities).

38. The way institutions choose to use related companies will result in a number of different issues and risks arising. The purpose of related companies or similar entities, the method of regulation and control, and the use of institutions' officials as directors or shadow directors are all matters deserving careful consideration.

39. This guidance therefore focuses on the assurance, compliance and accountability issues and risks faced by institutions. In particular it addresses:

- the differing purpose/objectives of related companies, for example protection of charitable status, tax planning, income generation, knowledge transfer, or educational provision;
- the degree of influence and control and accountability exercised by the institution, and the degree of decentralisation/autonomy enjoyed by the related company;
- the complexity of legal status structures, arrangements, and shareholdings;
- audit access;
- consolidation within the institution's accounts;
- intellectual property (licensing);
- managing conflicts of interest;
- degree of risk to institutions (significant losses or reputational impact); and
- ensuring proper accountability.

Review of current related company activity

40. Best practice guidance can only be effective in the management of an institution's activities if it is derived from a thorough understanding of the issues involved, and the current level and nature of activity in the sector.

41. The approach taken by RSM Robson Rhodes in conducting a review of current activity included:

- an initial desktop review of all reported activity by related companies within the sector;
- interviews with representatives of 23 HEIs, based on a short and focussed questionnaire. The purpose of these interviews was to gain a greater understanding of the level and nature of related

company activity, how this is managed by the institution, and how previous guidance has been applied (participating institutions are listed in the Acknowledgements); and

- site visits to six of these HEIs to explore in detail the institution's approach to related company activity, the management of this activity, and the risks and concerns encountered by both the institution and the related company.

42. The findings of this work informed the update of this guidance, and were instrumental in enabling the production of the risk assessment guidance (Section 3) and the analysis of activities and entities for related company activity (Section 4).

43. The risk assessment guidance should be used as the starting point for applying the guidelines. It comprises two tables, and advice on how to use them. Table 1 details possible strategic risks to the organisation and will be most useful to governors and senior management. Table 2 provides a more detailed mapping of possible operational risks relating to each of the strategic risks mentioned in Table 1.

Entity considerations

44. New activities undertaken by institutions can be packaged, monitored and controlled in a number of different ways by using different types of entity, each with their own set of risks and opportunities. Institutions should give careful consideration to choosing the most appropriate entity for the activity they are undertaking.

45. The activities considered within these guidelines (although not an exhaustive list) are as follows:

- subsidiary company;
- associated company;
- spin out company;
- joint venture; and
- licensing.

46. The types of legal entity which could be a related company under these guidelines include:

- private company limited by shares;
- public company limited by shares;
- company limited by guarantee;
- unlimited company limited by shares;
- limited partnership;
- limited liability partnership;
- European Economic Interest Grouping (and other legal entities current or proposed by the EU);
- industrial and provident society;
- community interest company;
- charitable incorporated organisation (if enacted in the Charities Bill currently before Parliament); and
- interests in foreign legal entities.

47. They could also encompass unincorporated arrangements such as trusts, partnerships and unincorporated associations.

48. Section 4 gives further guidance on the use of the most commonly used entities and the typical risks and opportunities associated with each. However the institution's unique activities will be the key driver of the level of risk and opportunity offered by any particular entity. An unlimited company limited by shares is only rarely used and is not considered further in these guidelines. Institutions should always seek professional advice in choosing the most appropriate entity.

Risk/opportunity considerations

49. Activities undertaken through related companies or similar entities will carry with them a number of risks and opportunities relevant to the achievement of the institution's strategic objectives. It is important that institutions are able to define, evaluate, monitor and where necessary take action to ensure that opportunities are maximised whilst risks are mitigated to an acceptable level.

50. The risk assessment guidance in Section 3 aims to assist institutions in identifying and mapping these key risks and opportunities.

3 Risk assessment guidance

Introduction

51. Activities undertaken through related companies or similar entities will carry with them a number of opportunities as well as risks to achieving the institution's strategic objectives. It is therefore important that institutions are able to define, evaluate, monitor and where necessary take action to ensure that opportunities are maximised whilst risks are mitigated to an acceptable level.

52. Each institution will have its own risk management framework and processes. It should ensure that these processes cover all risks and opportunities (not just financial), and cover all the institution's activities (including those by related companies). Guidance to institutions on general risk management has been produced by HEFCE (HEFCE 2005/11).

53. The tables in this section therefore seeks to assist institutions in identifying and mapping the key risks and opportunities that typical of related companies and similar ventures.

Using the tables

54. Each institution will be operating in a different risk environment and with differing objectives, so the risks to each institution achieving their objectives will not be the same. The common key risks in this guidance should therefore not be taken to be an exhaustive list of potential risks.

55. Table 1, the strategic risk matrix, outlines the common key strategic risks associated with related company activity, based upon examples of objectives from the sector. A risk assessment should in all cases begin with mapping the risks against an institution's agreed corporate objectives. Against each illustrated risk are the potential consequences, key risk activities and controls, and the typical risk owners and stakeholders. (Note that the stakeholders' job titles and role may differ from those used in your institution.)

56. For each of the strategic risks listed in Table 1, there is a more detailed operational risk matrix in Table 2. This details sub-risks and triggers to each strategic risk, and key controls, activities and assurances in place. Table 2 also supplies a checklist reference , cross-referencing risks to particularly relevant checklists in Section 5 or to the Appendices.

3 Table 1 - Strategic risk matrix

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
1. The institution may not have a clear strategy for the use and development of related companies and/or other entities.	Institution strategies and policies support the achievement of the institution's corporate plan	a) Corporate plan objectives are not delivered. b) Commercial opportunities are not developed in line with institution's agreed strategy. c) Resources are not efficiently and effectively directed towards the achievement of the strategy.	Strategic planning process ensures the alignment of supporting strategies to the corporate plan objectives through annual monitoring and periodic 'fit for purpose' review. Process of venture identification includes confirmation of alignment to strategy. Institutional strategy includes an assessment of resource mix and skills required to achieve identified objectives.	Head of institution	Governing body; finance committee; and senior management team.

Table 1 Strategic risk matrix (continued)

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
2. The institution may not have due regard for the issue of public accountability.	The institution complies with the regulatory framework.	a) Non-compliance with regulatory framework, e.g. funding body, employment, tax, health and safety or other legal obligations. b) Inappropriate selection of entity leads to ineffective or inefficient exploitation of identified commercial or other opportunity. c) Inadequate audit and assurance framework to support the draw-down of agreed funding streams. (d) As a result of (a) or (c), unplanned or unknown financial and/or non-financial liability, including reputational damage, accrues to the institution.	a) Development process for the commercial venture includes consultation with regulatory advisors. b) Development process for the commercial venture includes evaluation of exploitation of opportunities. c) Process for company formation includes: (i) agreement of contract and service levels; and (ii) identification and agreement of audit and assurance framework.	Institution's secretary	Governing body; finance committee; audit committee; head of institution; and director of finance.

Table 1 Strategic risk matrix (continued)

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
3. Institutional governance structures do not reflect the appropriate level of influence over related companies.	The institution complies with the regulatory framework.	a) Inefficient/ineffective commercial activity planning and review framework. b) Undue or insufficient influence, including through shadow directorships. c) Inefficient or ineffective use of resources.	(a) Institution's governance structure supports a balanced assessment of each commercial opportunity, which informs investment decisions. (b) Process of venture development includes the appointment, where appropriate, of Nominated Officer and company board. (c) Process for venture formation identifies company governance framework and investment by the institution.	Institution's secretary	Governing Body; audit committee; head of institution; nominated officer; and company chief executive.
4. The institution does not identify and evaluate all potential commercial opportunities in line with its agreed strategy.	The institution's related company strategy supports the achievement of the institution's corporate plan.	Commercial opportunities are not optimised based upon the institution's agreed strategy. Resources are not efficiently and effectively directed towards the achievement of the strategy. Unviable or high risk investments are progressed at unnecessary financial or reputation cost to the institution.	(a) Operational arrangements within the institution ensure the identification and balanced evaluation of commercial opportunities within the context of the agreed strategy. (b) Institutional strategy includes an assessment of the resource mix and skills required to achieve identified objectives. (c) Evaluation process for the commercial venture includes assessment of a possible exit strategy.	Head of commercial activities	Governing body; finance committee; and head of institution.

Table 1 Strategic risk matrix (continued)

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk Owner	Stakeholders
5. Formation of the related company (or other commercial entity) formation may not be properly planned and controlled.	The institution complies with the regulatory framework.	a) Poor selection of investment opportunity. b) Inappropriate choice of commercial entity. c) Poor governance structures leading to: regulatory non-compliance; and/or professional or commercial conflicts of interest. (d) Unviable investments are sustained and/or exit strategies are not implemented on a timely basis.	(a) Operational arrangements within the institution ensure the identification and balanced evaluation of commercial opportunities within the context of the agreed strategy. (b) Development process for the commercial venture includes evaluation of choice of entity. (c) Commercial venture development process includes: consultation with regulatory advisors; and appointment, where appropriate, of Nominated Officer and company board. (d) Process for formation of commercial venture includes agreement of exit strategy.	Head of institution	Governing body; finance committee; head of institution; nominated officer; company secretary; and company chief executive.

Table 1 Strategic risk matrix (continued)

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
6. The related company's performance may not meet its budget and objectives.	The institution achieves its planned financial performance.	a) Corporate plan objectives are not delivered. b) Planned financial contributions to the institution are not achieved. *c)* Ineffective use of institution's resources.	a) Process for forming the commercial venture includes agreement of: financial and non-financial performance targets; performance reporting methods; timetable for deliverables; and non-performance exit strategy.	Company chief executive	Governing body; finance committee; head of institution; nominated officer; and head of commercial activities/director of finance.

Table 2 - Operational Risk Matrix

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 1: The institution may not have a clear strategy for the use and development of related companies and/or other commercial entities.			
Strategy has not been produced and approved by the governing body.	Strategic lead appointed to drive the development of the strategy. Strategic planning process includes production and review of supporting strategies to the corporate plan. Board and committee annual timetable includes agenda items for the approval of the commercial development strategy.	Management structures, job descriptions, annual objectives and appraisals. Presentation of strategy to board. Timetable of board and committee business.	A
Poor awareness of the strategy amongst relevant staff.	Communication arrangements may include: dedicated resource embedding consideration of commercial opportunities into the planning cycle internal marketing intranet site training for relevant staff.	Staff feedback at planning cycle evidences awareness. Evidence of marketing material. Levels of use of intranet site. Training records. Annual commercial activity report to the governing body and the head of institution. Independent assurance reports.	C
Resources are not available to support the implementation and achievement of the strategy.	Institutional strategy includes an assessment of resource mix and skills required to achieve identified objectives	Presentation of strategy to board.	A
The governing body does not periodically review, challenge or approve an institutional strategy for commercial opportunities.	Periodic management or independent review.	Annual commercial activity report to the governing body and the head of institution. Independent assurance reports.	C, D

Table 2 - Operational risk matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 2: The institution may not have due regard for the issue of public accountability.			
The institution is not aware of public accountability issues through a poor understanding of the regulatory framework, including funding council legislation, taxation, legal and other audit requirements.	Specialist advisors held on retainer. Relevant officers, for example Nominated Officer, are empowered to obtain necessary advice.	Outline and detailed business plans include consideration of public accountability issues and confirmation of consultations.	B Appendix VI
Policies and procedures do not support compliance with regulatory framework.	Responsibility for production and control of policies and procedures clearly delegated to a named officer.	Ongoing review by management to the governing body. Periodic independent assurance to the audit committee.	B, C, D Appendix I
Insufficient skills are available to the institution to identify and evaluate identified opportunities in the context of: ethical responsibilities corporate and social responsibility issues statutes and other regulations, related to for example: – funding body – taxation – employment financial issues other academic priorities, for example research.	Institution policies and procedures require the need to consider these issues. Relevant officers, for example Nominated Officer, are empowered to obtain necessary advice.	Outline and detailed business plans include consideration of public accountability issues and confirmation of consultations.	B Appendices I, VI

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 2: The institution may not have due regard for the issue of public accountability (continued).			
There is a poor understanding of the commercial entity options available, for example: related company joint venture partnership internal development spin out etc.	Training and guidance is available for relevant staff. Access to and membership of relevant peer groups and working parties. Institution policies and procedures require assessment of entity options.	Training records. Communication of outcomes and evidence of inclusion of issues on board and other reports. Outline and detailed business plans include evaluation of entity options.	A Appendix VI Section 2
The framework for decision making is unclear or inconsistently applied.	All opportunities are logged with the strategic lead. The evaluation process is clearly documented and predicated on key indicators, for example investment need, time to realisation, likely outcome, availability of funding, other potential uses. Evaluation reports and business cases must include key evaluation material to provide for balanced assessment. Decisions are documented and include the assumptions upon which the decision has been made.	Central tracker of options. Documented procedures. Evaluation reports and business case documents. Decision forms or other meeting minutes.	B, C
Arrangements are not in place to subcontract the provision of services back to the institution from the related company where appropriate, for example research deriving from consultancy work.	Policies and procedures detail the process for decision making. A cost benefit analysis is carried out. Appropriate contractual documentation is produced and signed by all relevant parties.	Decision forms or other meeting minutes. Completed documentation.	B

Table 2 - Operational risk matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic Risk 2: The institution may not have due regard for the issue of public accountability (continued).			
Lack of control and monitoring of related company liabilities to the institution, for example: • profits not routed back on an effective basis possible tax or repayment exposure to the institution as a result of funding arrangements • other liabilities in respect of employees in related companies • related company compliance with the requirements of the taxation authorities.	Formation process requires identification of initial liabilities. Memorandum of agreement requires periodic management reports to be provided to the institution and, based on the level of investment and influence held, allows for institutional representation to review the company's accounts and financial records.	Nominated Officer and director of finance assurance at creation. Periodic Nominated Officer review. Director of finance confirmation.	B, C Appendices IV, V

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 3: Governance structures do not reflect the appropriate level of influence over related companies.			
The institution has not implemented a group framework to support commercial development in light of the potential mix of developments. Relevant to, for example: • governor forums • management structures • group structure.	Periodic review of governance structures to ensure they are fit for purpose.	Institution's company secretary; independent assurance reports.	B, C, D
Related company structure including board membership.	Institution policy defines board allocations.	Nominated Officer at creation.	A Appendix I
Inappropriate board membership creates: • conflicts of interest • shadow directorship.	Nominations and appointment process. Training for all company directors. Declaration of interest processes include declarations for related company interests. Nominated Officer.	Board reporting. Training records. External auditor. Nominated Officer at creation and periodic review.	A, C Appendix I
Inappropriate evaluation phase does not include robust assessment of institution's investment and its impact on the governance structure.	Evaluation procedures include consideration of investment level and consequential impact on board allocations.	Outline business case includes assessment. Nominated Officer at creation.	A, B Appendices I, VI

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 3: Governance structures do not reflect the appropriate level of influence over related companies (continued).			
Contractual or other service level agreement poorly defined	Memorandum and Articles and/or memorandum of understanding in place for all related companies and other relevant ventures.	Company secretary /Nominated Officer. Periodic independent review.	Appendices IV, V
Lack of awareness of audit and code of practice requirements.	Evaluation procedures require consultation with relevant officers and advisors to clarify audit and other assurance requirements.	Nominated Officer confirmation at creation. Periodic review by: external audit; internal audit; or other independent assurance reports (e.g. by funding council).	A, D Appendix VI
The review of the institution's investment is inadequate by: • external auditors • internal auditors.	Funding body review. External auditor's annual plan and audit committee review of external auditor performance Internal auditor's annual plan and external auditor's review of internal auditor performance.	External audit management letter. Internal auditor reports and annual report. Audit committee annual report. Other independent assurance reports (e.g. by funding council).	D
The related company does not operate with due regard to the requirements of the shareholders.	Training. Nominated Officer. Periodic management reports, including performance reports. Operational issue escalation arrangements, including whistle-blowing procedures.	Training records. Nominated Officer periodic reports.	C Appendices I, II, III

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy.			
Academic staff are unaware or unable to identify opportunities available.	Business development manager or other dedicated support. Annual planning process. Intranet site and other marketing material provide: • clear guidance; and • live examples of opportunities. Enshrined within performance objectives and annual appraisal cycle.	Staff feedback at planning cycle evidences awareness. Evidence of marketing material. Levels of use of intranet site. Training records. Annual commercial activity report to the governing body and the head of institution. Independent assurance reports.	C, D
Business development staff are not in place or used effectively to facilitate the identification of opportunities.	Commercial development strategy identified specialist resource need. Effective recruitment and retention arrangements or development training. Management reporting arrangements support the alignment of business developers into academic areas. Job descriptions define roles and responsibilities. Periodic review of documented management structures and job descriptions.	Commercial strategy approved by the governing body. Vacancy levels reported in head of commercial activities' annual report. Ongoing review by management to the governing body.	A, B, C, D Appendix III

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy (continued).			
The culture of the institution does not support academic staff in the development of opportunities (for example in terms of time and seed corn investment).	Corporate strategy defines institutional objectives. Annual planning cycle enables re-alignment of roles and responsibilities where appropriate. Budget allocations provide for development of identified opportunities. Skills sets are available to effectively leverage seed-corn and other funding to support commercial development opportunities.	Corporate plan approved by the governing body. Annual plan approved by senior management team and the governing body. Financial budget agreed between the head of commercial activities and the senior management team and approved by the finance committee. Commercial strategy approved the head of commercial activities before presentation to the governing body.	C, D
The identification and evaluation process is unclear or is not 'user friendly' to facilitate the decision making process.	Procedures are clearly documented and include reference to key responsibilities, deliverables and timescales. Business development or other support is available to academic staff identifying opportunities and developing business plans.	Procedures approved by the head of commercial activities and periodically reviewed by internal audit. Commercial strategy, including required resources, developed by head of commercial activities before approval by the governing body.	B, D
Undue influence over the prioritisation of opportunities, for example: • where a related company is used for the initial identification and assessment of commercial opportunities, its assessment may be biased as a result of overarching targets set for it by the institution, or • where an institution is developing commercial activity in-house one academic area may dominate over another because of existing skills and experience.	Procedures are clearly documented and include reference to key responsibilities, deliverables and timescales. All opportunities are logged with the strategic lead. The evaluation process is clearly documented and predicated on agreed indicators, for example investment need, time to realisation, likely outcome, availability of funding, other potential uses.	Procedures approved by the head of commercial activities and periodically reviewed by internal audit. Approval of evaluation process approved by strategic lead and summarised to the governing body annually.	B, D

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy (continued).			
Ineffective outline business planning	Business development or other specialist support. Procedures are clearly documented and include: • reference to key responsibilities, deliverables and timescales; • minimum content standards for the business case, for example: – summary of the opportunity – SWOT analysis – indicative resource requirements – outcomes from initial consultation with regulatory and other advisors – initial commercial entity assessment.	Outline business case is approved by strategic lead before presentation to governors where appropriate.	B

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy (continued).			
Inefficient initial evaluation.	Business development or other specialist support. Procedures are clearly documented and include: • delegated powers evaluation criteria and • an assessment of the availability of funds. Outcomes of evaluation are documented.	Evaluation is confirmed and approved by strategic lead. Periodic independent review by internal audit.	B, D
Assessment of commercial venture entity options.	Documented guidance is available for informed assessment. Specialist advice is available in-house or obtained by sub-contract.	Outcomes documented in outline business case, which requires strategic lead authorisation.	A, B Appendix VII Section 2

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 5: The establishment of each related company (or other commercial entity) may not have been properly planned and controlled.			
A full business case is not developed and scrutinised to ensure a robust decision-making process.	Nominated Officer allocated. Business development or other specialist support. Procedures are clearly documented and include: • reference to key responsibilities, deliverables and timescales; • minimum content standards for the business case, for example: – summary of the opportunity – SWOT analysis – full resource requirements – impact on other areas of the institution (opportunity cost of progression), e.g. impact of teaching and learning resources, RAE submissions. – full outcomes from consultation with regulatory and other advisors – final commercial entity assessment – exit/realisation strategy including timescales. Clearly documented evaluation criteria based on institutional strategy and priorities.	Documented evaluation assessment forms. Detailed business case is approved by strategic lead before presentation to governors where appropriate. Nominated Officer formation approval.	B, E Appendices I, II

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 5: The establishment of each related company (or other commercial entity) may not have been properly planned and controlled (continued).			
Adequate resource is not allocated to ensuring the effective and timely planning and establishment of related companies.	Nominated Officer allocated. Commercial development strategy includes assessment of specialist skills requirements, and these are recruited. Business development or other specialist support. Resource modelling is carried based upon an agreed structure, to establish: • human resources • IT/IS • accommodation • financing • other specialist equipment needs etc. Procedures are clearly documented.	Nominated Officer annual report. Strategic lead annual report to governors. Director of finance approves resource modelling tool. Periodic management review of policies and procedures, the findings from which are reported via the strategic lead to governors. Periodic internal and external audit assurance.	A, C, D Appendices I, II
Appropriate specialist advice is not taken: for example legal, tax, regulatory or commercial.	Business case methods require full consultation.	Detailed business case is approved by strategic lead before presentation to governors where appropriate.	B Appendix VI

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
Strategic risk 5: The establishment of each related company (or other commercial entity) may not have been properly planned and controlled (continued).			
Inappropriate choice of commercial entity.	Documented guidance is available for informed assessment. Specialist advice is available in-house or obtained by sub-contract. Where relevant and appropriate, arrangements ensure effective subcontracting of the provision of services back to the institution from the related company, for example research deriving from consultancy work.	Outcomes documented in outline business case, which requires strategic lead authorisation.	B Section 2
The assignment of intellectual property is not appropriate or is not effectively carried out.	Specialist advice is available in-house or obtained by sub-contract. Standard contract clauses are applied.	Outcomes documented in outline business case, which requires strategic lead authorisation. Use of standard contracts approved and periodically reviewed by the institution's company secretary.	B, C Appendix VII
Poorly defined realisation and/or exit strategy.	Requirement of business plan. Annual planning cycle.	Outcomes documented in outline business case, which requires strategic lead authorisation. Nominated Officer creation and periodic review of performance management information.	A, B, C, E Appendix VI

Table 2 – Operational Risk Matrix (continued)

Trigger	Risk Management Activities and Controls	Sources of Assurance	Checklist Ref
Strategic risk 6: The related company's performance may not meet its budget and objectives.			
Management structures, for example boards and committees, do not effectively control the development process.	Board nomination and training. Policies and procedures.	Nominated Officer creation and periodic review. Completed nominations forms. Nominations Committee minutes. Training records. Completed declaration of interest forms.	A, B, C Appendices I, III
Unclear targets and objectives for performance management purposes.	Requirement of business plan. Memorandum of understanding. Annual planning cycle. Documented guidance is available detailing minimum standards, suggested formats and timetable for reporting, for: • financial reporting • non-financial targets, e.g. performance reporting arrangements.	Outcomes documented in outline business case, which requires strategic lead authorisation. Use of standard memorandum of understanding and contracts approved and periodically reviewed by the institution's company secretary. Nominated Officer creation and periodic review of performance management information.	A, B, C Appendices IV, V, VI
Inadequate audit arrangements	Funding body review. External auditor's annual plan and audit committee review of external auditor performance. Internal auditor's annual plan and external auditor review of internal auditor performance.	External audit management letter. Internal auditor reports and annual report. Audit committee annual report. Independent assurance reports (e.g. by funding council). Funding body reports.	D

4 Activities and entities for related company activity

Activities

Subsidiary company	
Definition	**HEI controls the company. Subsidiary generally has the same policy-making powers as any majority owner and can do such things as appoint directors and hire officers.** **Subsidiary is controlled by the parent through these powers.**
Advantages	• Scope to readjust the level of limited liability afforded to the group as a whole. • Can provide a distinct focus to the activities undertaken.
Disadvantages	• Parent may be held liable for the acts of the subsidiary if the subsidiary is found to be an instrument of the parent. • HEI is not permitted to exempt a director from any liability attaching to him/her in connection with any negligence, default, breach of duty or breach of trust by him/her in relation to the associated company (but can be insured against).
Other comments	• Used most commonly for tax efficiency purposes or for distinct trading activities.

Spin out company	
Definition	**A business set up by staff at an HEI to make use of the commercial applications of research.**
Advantages	• A mechanism to enable institutions to realise the value of research activity and generate additional income. • Can enable third party investment to be obtained. • Limited liability can protect owners from creditors.
Disadvantages	• Directors may be personally liable for the activities of the spin-out. • Distraction from research activities. • Business and management skills may not be readily available. • Consent from the HEI may be required for a researcher to participate in the spin-out. • HEI may not give permission to its employees to take executive directorships in spin-out companies. • Onerous legal responsibilities attached to being a director of a limited company.
Other comments	• The approach to spin-outs and the success levels of spin-outs varies significantly from organisation to organisation.

Joint venture	
Definition	**A joint venture is a venture by a partnership or conglomerate designed to share risk or expertise, created with a specific project in mind.** **It may not be a limited liability company.** **It generally dissolves once the project has been completed.**
Advantages	• All parties agree to share in the profits and losses of the venture. • A joint venture is a good way for organisations to partner without merging.
Disadvantages	• Members of the joint venture are exposed to full legal liability, i.e. the liability extends to all liabilities of the venture and not only in proportion to the contributions by the joint venture parties.
Other comments	• Joint ventures can be a particularly complex entity, fraught with difficulties. Problems are most commonly encountered where the different parties have not fully considered the risks and rewards associated with the proposed partnership, or where there is no clear and transparent objective or exit strategy.

Licensing	
Definition	**A contract involving the granting of permission, giving someone the legal right to use a patent, trademark or technology under defined conditions.**
Advantages	• Licensing enables the retention of ownership, and therefore control, of intellectual property (IP) whilst at the same time generating royalty income from the use of IP by industry. • Licensing can be a source of significant income. • Offers risk-free income to an inventor, who does not need to devote further financial resources to its exploitation
Disadvantages	• Reduction of direct control. • Need for high tolerance level. • The inventor and/or HEI may have onerous obligations under the licensing arrangement (e.g. marketing, transferring updated research results etc).
Other comments	• Licensing can be an effective and efficient entity for releasing the potential of intellectual property.

Entities

57. The available legal entities for both a subsidiary and an associated company are a private company limited by shares, public company limited by shares, company limited by guarantee, an industrial and provident society, or a community interest company.

58. The most common entity used is a private company limited by shares or a company limited by guarantee. Sometimes a public company limited by shares is used.

59. A spin-out company is invariably a private or public company limited by shares although it is possible to use another legal form.

60. A joint venture can be any of the legal forms listed earlier, or could be an unincorporated arrangement (evidenced by contract).

61. A licensing deal is almost invariably by contractual arrangement only.

62. The main drivers behind the use of different forms of legal entity are the tax status, minimisation of risk, the exit route, funding, whether any aspects are overseas, third party interaction and other commercial factors, and the degree of management control. These are discussed in more detail below.

- **Tax status**

  The tax status of the parties to the venture often drives its legal form. Some legal forms are fiscally transparent, which means that the underlying owners are taxed directly on any profits received and the legal entity itself does not pay tax. This is particularly true of limited partnerships, limited liability partnerships and European economic interest groupings. An industrial and provident society is automatically an exempt charity and is less constrained in some instances in what it can do, compared to other charities.

- **Minimisation of risk**

  The parties always need to understand the nature of the risks they face in a venture and to put into place appropriate risk minimisation strategies consistent with relevant risk/reward ratios. For example, in a limited partnership structure, the limited partner is not allowed to take part in the management of the limited partnership and, therefore, that lowers the risk of a claim being made against a limited partner by an aggrieved third party. This is balanced against the lack of control that such an interest would have. A limited liability partnership gives both limited liability and an ability to take part in management.

  Contracts can be used to minimise liability but their effectiveness can depend on the nature of the entity being used.

- **Exit route**

  The method by which the institution seeks a return (i.e. by income, capital gain or both) dictates the legal form to be used. If one is looking for an exit route for a commercial venture on a public stock market then only a company limited by shares would normally be used in the early stages as the entity. This is because it is difficult to convert one legal form to another, and usually only companies limited by shares are listed on UK stock exchanges.

Institutions should also consider in advance their possible exit routes in the event of failure of the related company activity, whether it be failure to achieve its corporate objectives or financial failure.

- **Funding**

  Sometimes funding is required in order to move the project forward. If substantial external funding is required then it is usually from venture capitalists or a bank. They generally fund a company limited by shares. The more unusual the legal entity, the more difficult and time consuming (and possibly expensive) it could be to raise the finance.

  If the institution is seeking to raise funds to be used for a range of ventures (for example as a venture capital fund) then external funders will want to invest in a fiscally transparent entity such as a limited partnership or a limited liability partnership. This is the common method used for venture capital funds to be formed.

  The availability of grants and other finance sometimes dictates the form of the legal entity. European economic interest groupings are often used to access EU funding (where there are participants from more than one EU member state).

- **Overseas**

  Overseas legal entities are used where a partner of the HEI is based overseas or there is the possibility of an exit route on an overseas stock exchange. Numbers of British investors have invested in spin-out companies who are (normally Delaware) corporations which have gone onto a listing on the US Nasdaq or New York Stock Exchange.

- **Third party interaction and other commercial factors**

  The method by which the related company will interact with commercial and other partners can be relevant to its legal form (e.g. if it needs to give a charge or mortgage or debenture). If it is operating in EU markets then there is likely to be increasing use of European companies (because of their common laws throughout the European Union.)

- **Management control**

  The nature of management control dictates the legal form to be used. Limited partnerships do not allow limited partners to control them. Industrial and provident societies require at least seven members although they can be differing membership interests.

  Expert advice should be taken on which type of legal entity to be used for a related company activity.

5 Checklists

Introduction

63. The following checklists should be studied and completed by officers of the institution and the company as appropriate. We recommend that the Nominated Officer should prepare a report for submission to the institution. We set out a suggested report structure at Appendix II.

Completion cycle

64. The checklists are set out in five parts, each broadly corresponding to a stage in the life cycle of a company. We recommend that these checklists should be reviewed as follows:

A - Preliminary considerations	Before formation
B - Company formation	On formation
C - Management	To be completed at the formation stage and on a regular basis thereafter (we recommend at least annually)
D – Review	To be completed on a regular basis (we recommend at least annually)
E - Exit/realisation of investment	Pre-disposal/closure

65. Every institution that is considering creating a company should examine the issues in Checklist A.

66. Once it has been decided to proceed, every institution should consider the formation, management and review issues outlined in Checklists B, C and D respectively before taking a decision to implement.

67. Checklists C and D should be reviewed at regular predetermined points (or an ad hoc review if required by performance) by the institution or by the holding company (when different people may have responsibility). This should be agreed by the institution's Nominated Officer.

68. Checklist E should only be completed once the decision has been taken by the institution to dispose of its investment or wind up the company.

69. The checklists have been designed to allow the addition of relevant comments, or references to supplementary documents as appropriate.

CHECKLIST A: PRELIMINARY CONSIDERATIONS

Checklist A should be considered and, where relevant, completed before a related company is established. It is intended to determine that a company is appropriate for the purpose and that the reason for formation is valid.

		Yes, No or N/A	Comments
A1	Have the governors approved the project? In particular, have they satisfied themselves as to the objectives in drawing up the business plan?		
A2	Has a Nominated Officer been appointed by the governors to oversee the formation of the company?		
A3	Has a preliminary business plan been prepared? Does it include: i. consideration of the feasibility of the project; ii. the proposed objectives of the company; iii. details of the proposed management structure of the project and the company; iv. details of the proposed shareholding/ownership of the company; v. constraints (e.g. is the institution prepared to allow the proposed subsidiary to use its name and reputation?); vi. financing (from non-earmarked sources) and the need for guarantees; vii. assessment of risks and sensitivities; viii. exit strategy; ix. formation timetable?		

		Yes, No or N/A	Comments
A4	Has the form of legal entity to be used for the activity been considered? Is a company the most suitable entity for the proposed activity? Have alternatives been considered, including: (i) straightforward contractual agreement by the institution; (ii) joint venture not involving the formation of a company; (iii) partnership; (iv) franchising/licensing arrangements?		
A5	Has professional advice been taken as to whether a company is appropriate for the purposes and objectives of the proposed activity (and as to its proposed legal form)? In particular: (i) is the activity within the powers of the institution? What steps must be followed to ensure the validity of the arrangements? (ii) are there any implications in respect of the charitable status of the institution? (iii) what are the implications in respect of taxation (both direct and indirect) ? (iv) what are the legal implications of the proposed activity?		
A7	Have any restrictions within the constitution of the institution been considered and resolved in respect of the formation of a company? Have any legal or tax obstacles been resolved?		
A8	Is the company being set up to exploit the commercial potential of technology and/or intellectual property? If so, have the matters set out in Appendix VII been considered?		

CHECKLIST B: COMPANY FORMATION

Checklist B should be completed once the decision to set up a company has been approved by the governors. It is intended to ensure that the formation of the company has been properly planned and controlled.

		Yes, No or N/A	Comments
B1	Has a comprehensive business plan been prepared by the proposed directors of the company? The following should be included: (i) the objectives of the company; (ii) management structure; (iii) management teams; (iv) detailed financial projections, including key assumptions and the working capital requirement; (v) risks and sensitivity analysis; (vi) the permanent capital required; (vii) an understanding of the true costs, contribution to overheads, and rates of return required; (viii) the return of profits to the institution; (ix) the intended exit; (x) the expectations of the institution in the event of any unexpected losses.		
B2	Has the institution validated the business plan? (This may be through independent professional advice or by suitably qualified personnel within the institution.)		
B3	Has the comprehensive business plan, together with the financial backing required (for example in equity, loan and guarantees), been approved by the governors?		

		Yes, No or N/A	Comments
B4	Has independent professional advice been taken on: (i) the company's constitution; (ii) the impact of the proposed company on the charitable status of the institution; (iii) the impact of taxation on the company and on the institution; (iv) loan agreements; (v) the impact of the proposed company on the financial position of the institution; (vi) the protection of assets, including intellectual property and copyright; (vii) potential risks to the institution and others for which the institution may become liable; (viii) the potential impact of product liability or other possible litigation, where the impact or cost of such litigation could flow through to the institution itself; (ix) the impact of any guarantees?		
B5	Are there formal loan agreements covering the following: (i) security of loans; (ii) rate of interest (which should be at a commercial rate); (iii) payment of interest; (iv) repayment of capital?		
B6	Has the appointment of the directors or other senior managers been ratified by the governors?		
B7	Has a chairman of the board of directors or equivalent been appointed?		
B8	Has a company secretary been appointed?		
B9	Have external (and if appropriate) internal auditors been appointed?		

		Yes, No or N/A	Comments
B10	Has the year-end of the company been established and (if relevant) Companies House notified?		
B11	Has a memorandum of understanding been prepared, setting out clearly defined and understood responsibilities and the scope within which the activities of the company can be carried out? Does the memorandum of understanding include the items set out in Appendix IV? Is the memorandum binding or non-binding?		
B12	Is the constitution of the board fit for purpose? Has it been well constituted, with an appropriate balance of executive directors, governors, executive officers of the institution and non-executive officers?		
B13	Has the board of directors or equivalent set down written procedures and management structures for the conduct of its business?		
B14	Is there a need for appropriate written operating procedures?		
B15	Are the directors or equivalent aware of their legal responsibility to act in the best interests of the company? Are any directors or equivalent of the company also officers of the institution? If so, is there a written requirement for the directors and other senior officials to report to the governors any conflicts which may arise from their duties to the board or to the institution? Is there a register of interests set up by the company to record any conflicts which may arise? Is this register of interests reviewed from time to time by the internal auditors? Has legal advice been taken in respect of any situation (such as the conflicts set out above) which may put at risk the institution's charitable status or directors as individuals?		

		Yes, No or N/A	Comments
B15	Are there any other people attached to the company who are so closely involved that they might be considered shadow directors?		
B16	Is there a suitable mechanism in place to remove directors or equivalent from office? If relevant is there a requirement in the articles for the directors to retire by rotation? Are there any other restrictions which should be imposed on the directors or equivalent? (For example, it may be appropriate for the institution to have a right to appoint and remove directors at will.)		
B17	Has the issue of remuneration for directors or equivalents been considered?		
B18	Are there laid down instructions in respect of the management information to be produced by the company? Does this management information include instructions to produce: (i) budgets and forecasts; (ii) management accounts?		
B19	Are there clearly defined approval procedures for the following: (i) strategic decisions; (ii) contracts of employment; (iii) subsidiary companies (of the company)?		
B20	Are the respective responsibilities of the following clearly defined: i) the board of directors or equivalent; ii) the institution's finance committee; iii) the institution's audit committee or equivalent; iv) the governors? These responsibilities should be clearly set out in the memorandum of understanding between the institution and the company.		

		Yes, No or N/A	Comments
B21	Is there a mechanism in place for holding accountable key related company executives?		
B22	Are there suitable indemnities in favour of institutional officers or employees acting as directors of related companies?		
B23	Are maximum authority limits set down in the memorandum of understanding, and clearly understood by officials both at the company and at the institution? Do these limits cover the following: (i) capital expenditure; (ii) resource planning; (iii) employment decisions; (iv) investment decisions; (v) sale of assets; (vi) external financing (involvement of third parties); (vii) alterations to the proposed activities of the company?		
B24	Are the directors satisfied that there are no arrangements which may prevent the company carrying out its planned activity or proposed exit?		
B25	Has suitable liability insurance for directors and officers been taken out by the institution and by the company?		
B26	Has the company arranged suitable insurance cover?		
B27	Has an appropriate timetable of board meetings been established (including the annual general meeting)?		
B28	Has the company been given authority to disclose information to the institution's audit committee (i.e. has the institution right of access to the company's records)?		

		Yes, No or N/A	Comments
B29	Have the internal auditors been given instruction as to their responsibilities in respect of the company and given rights of access?		
B30	Has the institution considered whether it is appropriate for the company to adopt the recommendations of the Cadbury Committee, the Greenbury Committee on Corporate Governance, the Combined Code and Turnbull?		
B31	Has Checklist C in respect of management issues been reviewed and completed where appropriate?		
B32	Is the company a joint venture company? If so, have a shareholders' agreement and articles of association been prepared setting out the obligations and liabilities of the shareholders and the company to each other? Do the shareholders' agreement and articles of association address the issues set out in Appendix V?		
B33	Is the company being set up to exploit the commercial potential of technology and intellectual property? If so, have the matters set out in Appendix VII been addressed?		

CHECKLIST C: MANAGEMENT

Checklist C should be completed once the company has been set up and has commenced trading. It is intended to ensure that management procedures are being adequately maintained, and that the business issues arising out of the performance of the company are understood by the institution.

		Yes, No or N/A	Comments
C1	Has Checklist B in respect of formation issues been completed and reviewed?		
C2	Have any profits arising been passed back to the institution in accordance with agreed procedure?		
C3	Are the protocols by which the directors conduct the business of the company in line with the law? In particular has each director, on appointment, been given sufficient information by the board to enable him/her to perform his/her duties?		
C4	Has the company suitable procedures in place to ensure that there are regular board meetings and that formal minutes are prepared and approved by the board which clearly detail: (i) business which can only be conducted at board meetings by company law; (ii) other relevant business issues?		
C5	Are decisions regarding the content of the agenda for individual meetings of the board, and the presentation of agenda items, taken by the chairman in consultation with the company secretary?		
C6	Do the directors monitor the executive management of the company? Is this procedure subject to internal audit review?		
C7	Does the board of directors formally record its compliance with the written procedure for the conduct of its business?		

		Yes, No or N/A	Comments
C8	Is appropriate financial and non-financial motivation given to key company personnel, to ensure that the performance of the company is optimised, where this is relevant? Advice on the use of the following might be sought: (i) remuneration packages; (ii) bonus schemes; (iii) share ownership schemes.		

CHECKLIST D: REVIEW

Checklist D should be completed at regular predetermined times once the company has been set up and has commenced trading and thereafter. It is intended to ensure that the performance of the company is subject to appropriate review procedures.

		Yes, No or N/A	Comment
D1	Has the Nominated Officer reviewed Checklist C in respect of management?		
D2	Has the institution (the Nominated Officer in the first instance) reviewed on a regular basis the performance of the company and understood the results? In particular, the following factors should be included in this review: (i) the sharing of resources between the institution and the company, for example staff and premises; (ii) the contribution by the company to the institution's overheads; (iii) whether transactions between the institution and the company are carried out on a full cost basis; (iv) whether the level of profitability of the company and other performance criteria are meeting the agreed targets. The frequency of this review will depend on the specific circumstances of the company and the scale of its operations. In most cases a review of performance against budget at least quarterly would be appropriate.		
D3	Has the lifespan of the company been predetermined in any formal documentation or contract? If so, consider the appropriate course of action, for example completion of Checklist E.		

		Yes, No or N/A	Comment
D4	Does the institution's assessment of the company's performance give a clear understanding of its current and future financial exposure? In particular: (i) is there an approved business plan which is still appropriate to the operations and environment of the company? (ii) do the management accounts show that the company has operated in accordance with the approved business plan? (iii) is the risk exposure of the institution clearly defined and reported? (iv) has the value of the underlying net assets been ascertained? (v) what are the future financing requirements? (vi) will these future financing requirements be met? (vii) has the impact of the company's activities and performance on the institution been considered?		
D5	Are sufficient reserves earmarked by the institution to cover any contingent liabilities which may exist?		
D6	Does the audit committee have clear terms of reference in respect of the company?		
D7	Do the external auditors formally report to the audit committee in respect of the company?		
D8	Do the internal auditors include the company in their cycle of work, and formally report to the audit committee?		

		Yes, No or N/A	Comment
D9	Is there adequate disclosure in the institution's accounts of the following: (i) company activities; (ii) company performance; (iii) the financial position of the company; (iv) institutional liability for company debts; (v) related party transactions; (vi) any material relationships which may exist?		
D10	Has the company been consolidated into the institutional accounts? If not, have the governors received summary information on the company and the reason for non-consolidation?		
D11	Does the institution maintain a record of the related company profits to date, and contributions to the institution since formation? Note: a record may be maintained for internal purposes only - it will enable the institution to determine the level of reserves generated from commercial investment.		
D12	Do the institution and its related companies maintain adequate records of transactions with related parties, as required by Financial Reporting Standard 8 'Related Party Disclosures'?		
D13	Has the institution satisfied itself that the company has taken appropriate steps in respect of the following: (i) health and safety procedures; (ii) quality control procedures; (iii) environmental impacts?		

		Yes, No or N/A	Comment
D14	Has a review of the company been carried out by the institution to consider the: (i) financial performance; (ii) performance of management; (iii) future working capital requirements; (iv) assessment of risks? Has the institution committed to its ownership of the company for a further year? If not, then Checklist E should be completed.		
D15	Where the company is a joint venture company, have the provisions of the shareholders' agreement and articles of association been complied with by all relevant parties?		

CHECKLIST E: EXIT/REALISATION OF INVESTMENT

Checklist E should be completed once the decision has been taken by the institution to dispose of its investment or wind up the company.

		Yes, No or N/A	Comments
E1	Has the institution's decision to dispose of its investment in a related company been ratified by the governors?		
E2	Has the institution considered the potential costs in respect of: (i) closure; (ii) redundancies; (iii) contingent liabilities; (iv) guarantees; (v) product liability?		
E3	Has suitable independent professional advice been taken? Such advice should cover: (i) tax planning (both corporate and capital taxes); (ii) valuation of the company; (iii) the terms of the disposal and any warranties or guarantees given; (iv) contractual matters, including rights of employees; (v) public relations/announcements.		
E4	Is the institution satisfied that it has obtained the best price possible (in the context of its goals) for its investment?		
E5	In the event that the institution has determined to withdraw its financial support from a company, has this information been formally passed to the board of directors of the company?		

		Yes, No or N/A	Comments
E6	Where the company is a joint venture company the disposal of a shareholders' investment or the winding up of the company will depend upon the terms of the joint venture, and in particular any shareholder agreement between the parties. Have these been considered and independent professional advice taken on them?		

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- University of Leeds;
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Our thanks also to Eversheds LLP who have reviewed the legal content of this guidance. They stress that institutions should take appropriate professional advice before proceeding with any related company activity or proceeding to act on this guidance. The law has been checked to 31 July 2005.

Glossary of terms

Term		Definition
HEFCE	-	The Higher Education Funding Council for England
SHEFC	-	Scottish Higher Education Funding Council, now the Scottish Funding Council
HEFCW	-	Higher Education Funding Council for Wales
DELNI	-	Department for Employment & Learning Northern Ireland
Institution or HEI	-	University or higher education institution or college in England, Wales, Scotland or Northern Ireland
Governor	-	Member of council, board, governing body or other body ultimately responsible for the affairs of the institution
Related company or company	-	Any legal entity where the institution has control over, or exercises a substantial degree of influence over, that company's activities*
Guidelines	-	Recommended practice guidelines issued to institutions from time to time by the relevant funding council
Shadow director	-	A person (or a body corporate) in accordance with whose directions or instructions the directors are accustomed to act
Risk	-	A potential event which may support or hinder an institution in the achievement of its strategic objectives

* Under this definition the institution would in most cases have a controlling or majority interest in the company. However, there may be situations where a related company is not a subsidiary undertaking, as defined by accounting standards, but where the relationship between the institution and that company is such that the guidelines may still be applicable.

December 2005/**48**

Related companies: guidance for higher education institutions

Appendices

Produced for the UK funding bodies by RSM Robson Rhodes

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

Contents

Appendix I: Duties of the Nominated Officer

The duties of the Nominated Officer may include the following:

- On behalf of the institution, to set up the company and ensure the matters contained in the Recommended Practice Guidelines on preliminary considerations and company formation (Checklists A and B) are satisfactorily addressed.
- To ensure that the constitution of the company is properly drafted and implemented and that the memorandum of understanding (and shareholders' agreement where applicable) are agreed between the directors of the company and the institution (and the joint venture partner(s) where the company is a joint venture company).
- To ensure that the memorandum of understanding is applied and any relevant matters satisfactorily addressed.
- To attend company board meetings on behalf of the institution, or to receive board papers.
- To review, and discuss with the directors when appropriate, the monthly management information on the company's performance.
- To report to the governors, or to their delegated authority, on the performance of the company.
- To carry out regular reviews of the following :
  - relevant formation issues (Checklist B)
  - management of the company (Checklist C)
  - review procedures (Checklist D).
- To prepare a report to the institution (see Appendix II) together with appropriate commentary and conclusions.
- While getting close to the activities of the company, the Nominated Officer must remain aware of the difficulties which may arise in respect of fulfilling the primary duty to the institution and not becoming over committed to the activities of the subsidiary.

Appendix II: Nominated Officer’s report

We set out in the following pages a suggested framework for the Nominated Officer's report. This comprises a summary sheet, together with a ‘’certificate of completion’’ for each of the checklists set out in Section 5 of the main guidelines.

Although not intended to be prescriptive, such a framework highlights the key issues and should facilitate clear reporting to the institution.

The structure is as follows:

Summary

Certificates of completion for checklists:

A - Preliminary considerations

B - Company formation

C - Management

D - Review

E - Exit/realisation of investment

Nominated Officer's report - Summary

Name of institution: .....

Name of company: .....

Name of Nominated Officer: .....

Position of Nominated Officer: .....

Date of report: .....

Checklists completed:		**Yes/No**	**Certificate attached**
A	Preliminary considerations		
B	Formation		
C	Management		
D	Review		
E	Exit/realisation of investment		

I confirm that there are no matters, other than as disclosed in this report, which have come to my attention during the course of my review and which in my opinion should be brought to the attention of the governors.

Signature .....

Date .....

Date of issue: .....

Nominated Officer's report - Preliminary considerations

Name of institution: .....

Name of company: .....

Name of Nominated Officer: .....

Certificate of completion	
Have all matters contained in the attached Checklist A been satisfactorily addressed?	**Yes/No**
Are there any matters which in the opinion of the Nominated Officer should be brought to the attention of the governors or delegated authority?	**Yes/No**
If yes, give details and the suggested course of action below:	
Conclusion: As outlined in my attached report dated ....., I recommend that we consider setting up a company.	
Signed by: ..... Position (Nominated Officer): ..... Date:	

Date of issue: .....

Nominated Officer's report - Company formation

Name of institution: .....

Name of company: .....

Name of Nominated Officer: .....

Certificate of completion	
Have all matters contained in the attached Checklist B been satisfactorily addressed?	**Yes/No**
Are there any matters which in the opinion of the Nominated Officer should be brought to the attention of the governors or delegated authority?	**Yes/No**
If yes, give details and the suggested course of action below:	
Conclusion: As set down in my report dated ....., I confirm that appropriate expert advice has been taken to ensure the company is constituted properly and in accordance with the institution's instructions.	
Signed by:	
Position (Nominated Officer):	
Date:	

Date of issue: .....

Nominated Officer's report - Management

Name of institution: .....

Name of company: .....

Name of Nominated Officer: .....

Certificate of completion	
Have all matters contained in the attached Checklist C been satisfactorily addressed?	**Yes/No**
Are there any matters which in the opinion of the Nominated Officer should be brought to the attention of the governors or delegated authority?	**Yes/No**
If yes, give details and the suggested course of action below:	
Conclusion: As set down in my report dated ..... I confirm that the company's management arrangements have been established in accordance with agreed procedures.	
Signed by:	
Position (Nominated Officer):	
Date:	

Date of issue: .....

Nominated Officer's report - Review

Name of institution: .....

Name of company: .....

Name of Nominated Officer: .....

Certificate of completion	
Have all matters contained in the attached Checklist D been satisfactorily addressed?	**Yes/No**
Are there any matters which in the opinion of the Nominated Officer should be brought to the attention of the governors or delegated authority?	**Yes/No**
If yes, give details and the suggested course of action below:	
Conclusion: As set down in my report dated....., I am not aware of any circumstances which should be drawn to the governors' attention and which could cast doubt on the continuation of the arrangements with the company.	
Signed by:	.....
Position (Nominated Officer):	.....
Date:	.....

Date of issue: .....

Nominated Officer's report - Exit / realisation of investment

Name of institution: .....

Name of company: .....

Name of Nominated Officer: .....

Certificate of completion	
Have all matters contained in the attached Checklist E been satisfactorily addressed?	**Yes/No**
Are there any matters which in the opinion of the Nominated Officer should be brought to the attention of the governors or delegated authority?	**Yes/No**
If yes, give details and the suggested course of action below	
Conclusion: As set down in my report dated ..... I confirm that all material matters associated with the company closure/disposal have been addressed.	
Signed by: .... Position (Nominated Officer): Date:	

Date of issue: .....

Appendix III: Duties of company officers

DIRECTORS

What is a director?

These rules apply only to companies limited by shares or by guarantee.

As a matter of law, the term 'director' includes any person acting in the capacity of a director, by whatever name he/she may be called. The essence of directorship is exercising substantial control over the business or an aspect of it, and being accountable only to fellow directors for that role.

In addition to formally appointed directors and 'de facto' directors, it is also possible for certain people to be construed as 'shadow directors'. A shadow director is not a director of the company but someone in accordance with whose directions or instructions the directors of that company are accustomed to act. Depending on circumstances, either the institution as a separate body or specific governors can be shadow directors.

Nominated Officers must be alert to the risk (in many cases unavoidable) that they or their institution could be directors, or shadow directors, of the related company. They should be aware of their duties as such and if there is a potential conflict of interest they should inform the company and the institution and seek appropriate advice.

Duties and responsibilities of directors

Directors have duties laid upon them by statute law and common law. Under common law, duties can be split into two main categories: fiduciary duties and duties of skill and care.

Fiduciary duties

Fiduciary duties are designed to prevent abuse of a director's position. Directors must act in good faith in the best interests of the company (and not in their own interest or the interest of a third party - including the institution), and they must act for a proper purpose. Directors may breach fiduciary duties if they participate in wrong doing by another, or if they ought to have supervised an activity of the company but failed to do so, or ought to have known what was happening even if they did not.

Conflicts of interest may occur particularly in relation to contracts and loans.

(i) Contracts. Directors are obliged to put the company's best interests before any other consideration. In particular they are obliged to disclose interests of their own or those of any party connected to them in contracts in which the company is involved (and they may in some cases have to obtain the approval of the shareholders to such interests), and to disclose such interests in shares or other securities of the company. Directors must make full and honest disclosure before voting on a resolution in which they have an interest.

(ii) Loans and transactions equivalent to loans. Transactions between the company and a director, or a party connected with him or her may be open to challenge under the principles of breach of fiduciary duty. This is an obvious area for a possible conflict of interest between the director and the company. Company law also imposes specific restrictions on loans and similar transactions. The rules are complex and advice should be sought in any particular case.

Duties of skill and care

Directors must show such skill in the performance of their duties as may reasonably be expected from a person holding office as a director, and exercise such care in the conduct of the company's affairs as an ordinary person might be expected to take on his/her own behalf. Broadly, breach of these duties means that the director has done his/her legitimate duties badly.

Statutory duties

Statutory provisions relate specifically to matters such as service contracts, loans, interests in contracts and property transactions with the company, health and safety at work and environmental legislation.

Breach of duty

If a director has breached his/her duties, the outcome will depend upon the breach. A transaction entered into in breach of duty will often be void or voidable and capable of being set aside. In certain circumstances it could lead to personal liability for the acts of the company. However under new legislation, although companies continue to be prohibited from exempting directors from liability, they are permitted to take advantage of a specific exemption to indemnify directors against liability to third parties. In other cases, and specifically in relation to breach of statutory duties, the relevant legislation lays down criminal penalties of fines, imprisonment or disqualification.

Corporate governance

The management of the company's affairs is usually entrusted to the directors by the articles of association. The manner in which such powers are exercised is paramount in determining whether the company is well run.

A number of codes of practice have been written, the most prominent of which is the Combined Code of Practice (which only applies in theory to UK publicly quoted companies), but whose principles have been adopted more widely in the private and public sectors.

Good governance practice is to follow codes of practice (suitably adapted) even if not specifically targeted at that type of related company. This includes the following canons of good practice:

- Boards should meet regularly, exercise effective control over the company and monitor management's activities. Effective control may depend upon how the Board operates as a team, and its collective ability to provide necessary checks and balances in the company's management.
- To avoid one individual having unfettered control there should be a clearly defined and accepted division of responsibility at the head of the company. It is not generally advisable to have the chairman also acting as chief executive.
- The board should have a formal schedule of matters reserved to it to ensure control remains at board level. Procedures to be followed where - exceptionally - decisions are required between board meetings should be clearly laid down.
- All directors should be entitled to seek legal or financial advice at the expense of the company in furtherance of their duties.
- All directors should have access to the company secretary (who is responsible for ensuring board procedures are followed and applicable regulations adhered to).

Matters of corporate governance must be clearly determined and agreed from the outset, with the help (where appropriate) of independent advisers.

COMPANY SECRETARY

What is a company secretary?

These rules apply only to companies limited by shares or by guarantee.

The role of company secretary is different from that of a director, although a director may in certain circumstances take on the additional role of company secretary (as long as there is at least one other director). The company secretary is an officer of the company generally appointed to ensure compliance with certain statutory and other legal requirements. Companies limited by shares or guarantee must appoint a company secretary.

Duties and responsibilities of a company secretary

A company secretary is, like a director, in a fiduciary relationship with the company, although in most cases the required standard of responsibility will be lower than that for directors. The company secretary must therefore act in the best interests of the company and must put the interests of the company before his or her own interests. There are a number of specific areas where the company secretary is under a duty to ensure compliance by the company with the company's constitution and with general law. These are broadly as follows:

(i) Convening meetings (both of directors and of shareholders); preparing and sending out notices; filing resolutions with the Registrar of Companies as required; ensuring that procedure at meetings is adhered to, in line with the company's constitution; keeping books for the purposes of entering minutes of all shareholders' and directors' meetings and, where appropriate, meetings of the company's managers.

(ii) Ensuring that the company's statutory registers are accurate, up to date and in compliance with the terms of the Companies Act 1985, in particular:

- register of directors and secretaries
- register of members
- register of interest in shares
- register of directors' interests
- register of mortgages, charges and debenture holders
- register of share applications and allotments
- register of share transfers.

The company secretary, together with the directors, should ensure the following:

- accounts, directors' reports and an annual return are properly prepared and filed for the company;
- an annual return is properly made for the company;
- compliance with the publicity requirements of general law in relation to companies;
- conspicuous display of the company's name at places of business;
- compliance with requirements to publish the company's name and other details on notepaper.

Breach of duty

The company secretary, although having ostensible authority to act without any necessary reference to the board in administrative matters, is generally responsible to the board for his/her actions. In a number of areas, however, fines are statutorily imposed for failure to maintain necessary registers and make necessary returns. Proper advice on this should be sought at the time of setting up the related company and subsequently if necessary.

Appendix IV: Contents of key documents

MEMORANDUM AND ARTICLES OF ASSOCIATION

Memorandum of Association

A company limited by shares or guarantee is formed by the requisite number of people subscribing their names to a Memorandum of Association which governs the relationship between the company and the outside world, and will broadly set out the powers of the company. The Memorandum of Association must (inter alia) state the following:

(i) The name of the company.

(ii) Whether the registered office of the company is to be in England and Wales, or in Scotland.

(iii) The objects of the company.

(iv) If liability is limited (in which case there are additional requirements for public companies).

(v) For a limited company with a share capital or limited by guarantee the memorandum must also state the amount of the share capital or amount of the guarantee with which the company proposes to be registered.

The memorandum must be signed by each subscriber in the presence of at least one witness, who must attest the signature. The memorandum cannot be altered except in the mode and to the extent permitted by the Companies Acts.

Articles of association

The articles of association prescribe the internal regulations of the company. They must be printed, be divided into consecutively numbered paragraphs and be signed by each subscriber of the memorandum in the presence of at least one witness, who must attest the signature.

There are a number of statutory 'tables' setting out articles of association for limited companies which can be adopted in whole or part, or modified or replaced altogether. It is unusual to have a bespoke form of articles. Articles for a company limited by shares should set out procedures for internal governance in relation to the following:

- share capital and variations of rights
- lien
- calls on shares
- transfer of shares
- transmission of shares
- forfeiture of shares
- conversion of shares into stock
- alteration of capital
- general meetings
- notice of general meetings
- proceedings of general meetings

- votes of members
- directors
- borrowing powers
- powers and duties of directors
- disqualification of directors
- rotation of directors
- proceedings of directors
- managing director
- secretary
- the seal
- dividends and reserves
- accounts
- capitalisation of profits
- audit
- notices
- winding up
- indemnity.

The articles of a company limited by guarantee will be in a different form as they will set out the rights attaching to membership of the company. It may be appropriate to include provisions for the expulsion of a member or members of the company if they are in breach of any agreed rules applicable to membership of the company.

In each case the articles should be carefully drafted with the aim of the project in mind. It may be possible to alter articles (and to amend the memorandum) at a later date, to take account of changing circumstances, but appropriate advice should be sought on the text of such change and on the procedure for implementing it.

Effect of the memorandum and articles

The memorandum and articles, when registered, bind the company and its members to the same extent as if they had been respectively signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and articles.

MEMORANDUM OF UNDERSTANDING

The memorandum of understanding will be different for each project.

The following are examples of matters which it may be appropriate to include in a memorandum of understanding:

- obligations of the company to the institution
- scope of activities to be undertaken
- management structure of the company
- dividend/covenant policy of the company
- overhead contribution (company to institution and vice versa)
- apportionment of costs for shared use of staff and premises
- authorisation limits for the company (this could also be put into the articles of association)
- borrowing/lending/banking arrangements (restrictions in the articles should also be considered)
- financial and other reporting and transfer of information
- responsibility of key officials, in particular where they are common to both organisations
- remuneration of company officials and employers
- title to intellectual property rights/royalties
- share ownership
- formation of subsidiary companies
- insurance/indemnity for officials common to the company and the institution
- auditing arrangements
- health and safety issues
- quality control.

A decision should be taken in each project as to whether some or all of the memorandum of understanding should be binding. If it is not, then consideration needs to be given as to which obligations should be enforceable and separate agreement(s) may need to be put into place.

Recommended good practice is for the memorandum to be binding.

SHAREHOLDERS' AGREEMENT

A shareholders' agreement will normally be required in any situation where the company is not a wholly owned subsidiary of the institution, but represents a joint venture between the institution and one or more other joint venture parties. The exact terms of a shareholders' agreement will depend upon the circumstances of each case and will be the subject of specific negotiation between the relevant parties . The following are examples of matters which should be considered for inclusion within a shareholders' agreement (or the articles of association of a joint venture company).

- In what proportions are the shares in the company to be held between the different joint venture parties? Under company law, the percentages giving different degrees of control of a company are more than 75% or more than 50%. Similarly, under company law for minority shareholdings an interest of 25% or 10% or 5% or more, or less than 25% or 10% or 5%, have material implications.
- Are all shareholders in the joint venture company to hold equal ranking ordinary shares, or should there be any special or restrictive rights attaching to a particular party's shares? Is there a requirement for shares of a different class such as preference shares?
- How are individual joint venture parties to be treated in the event of the joint venture company needing to raise additional share capital, and how will they be protected against their shareholding in the company being unfairly diluted?
- Is there a requirement for loan finance, and if so, where is it to come from? If it comes from a third party that requires shareholder guarantees, which shareholders are to provide such guarantees?
- How is the board of the joint venture company to be constituted? Commonly, each joint venture party will have the right to appoint and remove a certain number of directors to the board. How frequently are board meetings to be held and do they require the attendance of each shareholder's appointee(s) in order to be quorate?
- How is the chairman of the board to be appointed and is he/she to have a casting vote?
- It would be normal to include provisions governing the rights of the individual joint venture parties to have information relating to the joint venture company and monthly management accounts and annual accounts.
- Although day-to-day management control is delegated to the board, is it appropriate for decisions on certain key matters relating to the joint venture company to require the unanimous consent of all the joint venture parties?
- Minority shareholders will normally wish to build in certain protections of their position which go beyond those provided by the general law.
- Are restrictive covenants required that prohibit the individual joint venture parties from competing with the joint venture company?
- What is the policy of the joint venture company on the distribution of its profits to its shareholders?
- Is a mechanism required to bring the joint venture to an end in the event of irreconcilable differences developing between the shareholders in the future, or if one or more parties simply wish to withdraw and/or sell shares?
- It would be normal to include pre-emption rights in the share transfer provisions of the joint venture company's articles of association, requiring any shareholders wishing to dispose of their shares to offer them to other shareholders first before being entitled to transfer them to a third party.
- Is there an exit strategy for the shareholders to realise their shareholding in the joint venture company? A majority shareholder will sometimes wish to have the right to require a minority shareholder to sell his shares if the majority shareholder wishes to sell his shareholding. Equally, a minority shareholder will wish to prevent a majority shareholder from selling unless the majority shareholder procures that any purchaser also offers to buy out the minority shareholder at the same price per share.

- Are there any specific arrangements between the shareholders and the joint venture company for the provision of services, the transfer of assets or the licensing or assignment of intellectual property rights to the joint venture company that need to be provided for?

Even if a company limited by shares or guarantee is not being used as the entity, an equivalent agreement will be required covering whichever of the above matters are relevant.

Appropriate professional advice should always be sought on the establishment of a joint venture company and the drafting of a shareholders' agreement.

Appendix V: Specimen memorandum of understanding

The following is applicable only to a wholly owned subsidiary and should not be used as a draft for any other purpose. The contents of a memorandum of understanding with a company limited by shares or by guarantee will form a binding contract between the institution and the company (otherwise the institution will not be able to enforce the terms of the memorandum).

Appropriate advice should be sought in drafting any such document.

MEMORANDUM OF UNDERSTANDING

Purpose of the Memorandum

The purpose of this memorandum is to define the relationship between ABC institution (ABC) and XYZ Limited (XYZ).

Obligations of XYZ to ABC

1. To help faculties/departments within ABC generate external income to meet their funding requirements.

2. To assist academics to secure research grants and contracts and to develop opportunities for these with outside bodies and industry in the UK, EU and overseas.

3. To carry out on behalf of ABC, and in collaboration with the appropriate parts of ABC administration, the administration of all research grants and contracts and institutional consultancies.

4. To provide the relevant management information to ABC administration and departments on research grants and contracts and institutional consultancies.

5. To help ABC academics protect and exploit their intellectual property rights.

6. To promote the transfer of technology from ABC to industry, through licensing and the formation of campus companies, thereby ensuring an income stream back to ABC.

7. Through the Nominated Officer to be accountable to the governors of the institution.

Scope of activity - research contracts

1. XYZ will endeavour to broaden the opportunities for academics to secure research grants and contracts, by setting up specialist offices and other mechanisms to develop expertise and establish relationships with outside bodies and industry in the UK, EU and overseas.

2. XYZ will help academics prepare applications for research grants and contracts and will provide financial administration for those received.

3. XYZ will be compensated for its work by receiving payments, which are currently set by agreement with ABC, at the following levels:

- x% of the overheads obtained on non-Research Council grants and contracts
- x% of the overheads [indirect costs] on payroll costs of Research Council grants
- a minimum of x% of overheads on institutional consultancies and equipment hire charges.

Additionally, XYZ may seek to negotiate on the larger contracts, and where a contract management service is provided by XYZ and by agreement with the academic concerned, an appropriate management fee, which will be retained entirely by XYZ.

Scope of activities - intellectual property rights (IPR)

1. XYZ will advise ABC academics on an individual basis of the best way to protect and exploit their IPR.

2. XYZ will seek to obtain patent protection at its own expense for any IPR assigned to it.

3. XYZ will seek to exploit any assigned IPR through sale or by licensing and/or the formation of a campus company.

Scope of activities - licensing

The annual net income derived from each licensing agreement will be allocated in accordance with present ABC policy i.e.

Up to £5,000	Academic x%	ABC x%
£5,000 - £20,000	Academic x%	ABC x%
Above £20,000	Academic x%	ABC x%

Scope of activities - campus companies

1. Where appropriate, XYZ will exploit ABC technology through the formation of a campus company.

   [state intention of investment/future realisations]

2. XYZ will own the ABC interest in the shares in any new campus company; shares held by ABC in current campus companies will be transferred to XYZ. Thereby, XYZ will be responsible for managing the investment in all campus companies including those which are subsequently floated.

3. XYZ will nominate a director in all campus companies who will be responsible for reporting to the managing director of XYZ who, in turn, will report to the XYZ board.

4. The policy of XYZ is not to hold majority equity positions in campus companies. Thus, apart from the formation period when XYZ will own 100% of the equity, shareholding in any future campus company will be reduced to a minority position in a planned manner, with means put in place for eventual realisation of the equity. On formation, XYZ will be responsible for ensuring through the Nominated Officer, assisted by the finance director of XYZ, that appropriate financial controls and administration are put in place.

5. Decisions regarding the acquisition and disposal of equity, receipt of dividends, royalties etc, will be made by the board of XYZ against a background of prior consultation with the institution (Nominated Officer).

Financial arrangements

1. XYZ is expected to return all profits to ABC by means of the deed of covenant. Any amendment to the policy will require the prior approval of ABC's governing body.

2. In operating as an autonomous company, XYZ will establish its own bank account and borrowing facilities without requiring ABC to act as a guarantor. All borrowings will require approval of the board against a background of prior consultation with the institution (Nominated Officer).

3. XYZ will hold in its balance sheet investments in both campus companies and publicly quoted companies.

4. XYZ will operate within the framework provided by the ABC financial regulations, including the internal audit arrangements on research grants and contracts.

Employees

A personnel policy for staff working in XYZ is being prepared in collaboration with the registrar and the bursar, and will be issued by [date].

Management structure

1. An academic advisory board will be formed with a representative from each academic department to provide the main communication link between academics and XYZ. The chairman of this board will be the director of XYZ, ex-officio, thereby ensuring that issues important to academics are raised at XYZ board meetings.

The chairman and deputy chairman of the academic advisory board will be appointed by ABC's governing body with the agreement of the academic advisory board.

It is recommended that the academic advisory board should meet quarterly.

2. The XYZ Board will consist of 10 directors, meeting monthly, as follows:

From XYZ:	Chairman Managing director Finance director (not the bursar)
From ABC:	Deputy chairman Chairman of the academic advisory board - ex-officio Vice-principal (finance) - ex-officio An honorary officer of the governing body Bursar - ex-officio as representing ABC Administration with the registrar nominated as alternate director
External:	Two members.

Note that it is the intention that a representative from the academic advisory board and from ABC administration should attend all board meetings. The appointment of alternate directors should facilitate this and copies of all board papers will be circulated to them whether attending or not.

3. A remuneration committee consisting of the chairman, deputy chairman and the bursar will determine the compensation of XYZ directors, including external non-executive directors should this prove necessary, but excluding the chairman, and noting that ABC nominees are ineligible for payment.

4. An audit committee will be formed consisting of the bursar and two non-executive directors (one from ABC and one external). One of the internal directors will serve as chairman.

Actions of XYZ requiring the approval of the governing body of ABC

1. Appointment of directors.

2. The acquisition or disposal of assets, including investments in campus companies and publicly quoted companies of more than £[ ] in a single transaction.

3. The annual budget for the following year and any modification to the strategic plan, which will be presented in June each year.

4. The directors' annual report and accounts at the AGM.

Review clause

This memorandum, which constitutes the current state of intent of ABC and XYZ, will be reviewed in June of each year prior to the submission to ABC's governing body of the XYZ budget for the following year.

Signatures

.....	.....
On behalf of the institution	On behalf of the company
Date	Date .....

Appendix VI: Outline business plan

This guidance is based on a publication by RSM Robson Rhodes intended for companies seeking to raise external finance from venture capitalists. The institution is effectively in the role of a venture capitalist when considering an investment in a new venture. We recommend that it should prepare a comprehensive business plan and the following guidance may be useful.

Contents

EXECUTIVE SUMMARY

1.1 Investors see hundreds of business plans each year and they are unlikely to find time to read them all from cover to cover. Instead, they prefer to read a short summary of a business plan which highlights the important aspects and investment opportunities and which contains only enough information to enable them to determine quickly whether the proposal is of interest.

1.2 The summary is therefore of critical importance. It must sell the proposal in a few succinctly written pages setting out a convincing case. It should be written after the rest of the business plan.

1.3 The summary should cover the following:

- **Purpose of the plan:** outline the reason for presenting the plan (eg to attract investment), the goals sought and the distinguishing features which will allow them to be realised.
- **The company and its founders:** say who formed the company and when, what it does or will do, what is special or unique about it and, in particular, the opportunities available to it. A brief résumé of the backgrounds of the entrepreneurs may be relevant, highlighting their particular experience or qualifications and their suitability to pursue the business opportunities available.
- **Market opportunity:** outline the opportunities, indicating the size and growth prospects for the product or services offered and the way in which projected market share is to be achieved.
- **Products/services/technology:** describe briefly the products or services sold and any unique features or advantages they have. Indicate any proprietary technology, trademarks, intellectual property rights or skills which give the company an edge in the market place. Outline future product development and plans for extending the product range.
- **Past trading record:** if the business has an established track record (be it several years or months), provide a brief summary of sales, gross profits and pre-tax results explaining significant trends. Highlight the achievements to date and milestones reached.
- **Summary of the financial projections:** provide information on sales, gross profit and pre-tax profit for at least three years, briefly explaining trends and any divergence from historic performance.
- **Funding requirement:** state the size of the investment needed and how the finance will be used.

CORPORATE OBJECTIVES

2.1 It is important to state the aims and objectives of the entrepreneurs, both personally and for the company. These goals must be appropriate to the company's industry sector and compatible with the objectives of potential investors. Since venture capital investment is a form of partnership it is vital that each party has the same broad objectives.

2.2 This section will aid the investor in the appraisal process and avoids entrepreneurs wasting time and energy trying to sell a sound business opportunity to investors whose objectives are ill-matched with their own.

2.3 Entrepreneurs should address four basic issues:

- What do the founders want for themselves: money, power, success, excitement, status?
- What do the founders want for their company: to go public, to sell out, to build an empire?
- How do the founders' and corporate objectives fit with the experience of other companies in the industry sector? Investors will question business plans which deviate significantly from industry norms.
- What are the investors' objectives and how do these compare with the above?

If these objectives are not coherent, investors will resist.

HISTORY

3.1 A common way of evaluating future potential is to look at past performance. It is important, therefore, to give the potential investor background information on the company and its performance and development to date. Where there is little or no trading record, the original rationale behind the company's formation should be stated.

3.2 Give the date of formation or incorporation and provide a brief summary of developments since. Point out past successes (or otherwise) in terms of products or services developed and marketed and explain how these will enhance the company's future.

3.3 Discuss any setbacks or losses, emphasising corrective action taken both to prevent recurrence and to improve profitability. If there are good reasons why the past is not a reliable indicator of projected performance, briefly explain why. This can be developed further in the rest of the plan.

3.4 The following should be included in this section:

- date of incorporation and commencement of trading
- details of the group structure if relevant
- explanation of financing to date, including the previous and current involvement of outside shareholders, if any. A list of shareholders should be included as an appendix
- progress to date:
  - successful development of products/services
  - expansion of the management team and evolution of balanced management structure
  - description of past financial performance, together with an indication of the current position
  - the influence of any industrial, economic, political, social or technological trends on the company
  - milestones reached

- major agreements which bind the company, whether to investors, major credit sources, customers or suppliers.

PRODUCTS OR SERVICES

4.1 A potential investor will want to know what you are going to sell, what kind of product protection you have and the opportunities for and possible weaknesses in your products or services.

4.2 Describe the products or services fully, but bear in mind that investors may not have much technical or industrial knowledge. A more detailed assessment will be made later, but is not required in the business plan.

4.3 Emphasise any unique feature of your product or service and highlight any advantages over what is currently available in the market. If products are under development, indicate the stage of that development, how long it will take to reach the market place and the cost of doing so.

4.4 Product literature, photographs or other supporting information may help to explain what the products or services are and who is likely to buy them. These should be appendices to the plan.

4.5 Discuss any product disadvantages or the possibility of rapid obsolescence owing to technological or styling changes or market fads. Do not try to cover up any shortcomings: they are sure to come out in a more detailed product evaluation and acknowledging them will make the plan more credible.

4.6 To summarise, this section should cover:

- a description of current products or services
- the application of your product or service, both primary and secondary
- the unique features of each product or service
- product advantages over competitors and how these will benefit the customer
- patents, trade secrets or other proprietary features
- any barriers to competition which may give a favoured or entrenched position in the market (exclusive distribution, legislation, development lead)
- opportunities for the expansion of the product line or the development of related products or services, including the extent and direction of any research and development.

MARKET AND MARKETING STRATEGY

5.1 This is another important section as it sets the scene for the rest of the plan by estimating total available market size and the share the venture can realistically achieve. Its purpose is to convince the potential investor that the product or service has a substantial market in, preferably, a growing industry and can achieve sales despite existing or likely future competition. It provides the basis of projected turnover, which will determine the size of the venture and the amount of finance sought.

5.2 This section should be prepared first, with time and care spent collecting market data on overall size and growth rates, and presenting facts, figures and their source wherever possible. Concentrate on the market segments which specifically relate to the products or services offered rather than more general analysis, as prospects and trends directly applicable to your business

may not be representative of the market as a whole. Extracts from relevant surveys or statistics should be appended to the report as supporting information. In situations where either a market is being entered for the first time or a new market is being created, actual experience cannot be used for comparison. Here it is even more critical to undertake research to reassure the investor as to the reasonableness of sales projections.

5.3 This section should address the following:

Customers

- Who are the existing or anticipated customers for the product or service?
- What is the basis of their purchase decision: price, quality, service, personal contacts or some combination of factors?
- Indicate potential customers who have expressed an interest in purchasing the product or service and explain why.
- Similarly, indicate potential customers who have shown little or no interest in purchasing and explain why.
- Explain how negative customer response will be overcome.
- Consider what customers expect in the way of price, quality and service.

Market size and trends

- What is the total size of the current market for the product or service offered? Indicate the source of the estimates.
- Is the market expanding, contracting or static? (Discussions with customers, distributors, dealers, agents and sales representatives may prove useful in determining both market size and trends).
- If the intention is to sell regionally, a regional breakdown should be given.
- Indicate the major factors affecting market growth (economic, industrial, political, climatic, population shifts).
- Indicate how the effects of seasonality on the business can be minimised.

Competition

- Make a realistic assessment of the strengths and weaknesses of competitive products or services and name the companies which supply them.
- Compare competing products or services on the basis of price, quality, performance, service, warranties and other relevant features.
- Indicate the advantages and disadvantages of competing products or services and explain why customer needs are not fully met.
- Highlight your three or four principal competitors and explain why customers buy from them. Indicate why the venture will be able to compete favourably.

Estimated market share

- Summarise the features of the product or service which will enable it to take market share from competitors.
- Highlight customers who have made or are prepared to make purchase commitments, and give an assessment of future major markets.
- Based on the customer, market and competition assessments made above, estimate what share of the market the company is aiming to achieve in the next three years. The anticipated growth of the company's sales and its estimated market share should be related to the growth of the industry, customers, and strengths and weaknesses of competition.

Marketing strategy

Explain how you intend to achieve sales targets. This should cover overall marketing strategy, pricing, sales strategy, after-sales service and advertising and promotion, detailing what is to be done, how and by whom.

- Overall marketing strategy. This should be developed from market research and analysis. The general marketing philosophy and strategy should be outlined:
  - which customers will be targeted for sales efforts, initially and thereafter
  - how customers will be identified and contacted
  - where the company intends to be positioned in relation to the competition (i.e. by way of price, quality, response, etc)
  - whether sales will be generated regionally, nationally or internationally, and the timetable involved in graduating from one to another.
- Pricing. This is a critical factor as the 'price must be right' to allow market penetration, sustain market position and generate profits. If products or services are superior to those of competitors, investors will be surprised if the price is lower. Two things should be remembered:
  - costs always tend to exceed expectations (Murphy's Law)
  - price cuts are more acceptable than price hikes.

  Since both imply pressure on gross margin it is important to demonstrate that the pricing policy adopted will generate net profits after all direct and indirect costs, allowing for possible future price competition.
- Sales strategy. How will sales be achieved and by whom?
  - will the company use its own sales force, sales agents, distributors?
  - what incentives will be given to stimulate maximum sales efforts by internal sales people and by third parties?
  - what is the longer term intention with regard to your own sales force?
  - how are distributors/dealers attracted and chosen and what are the terms of trade?
- After-sales service. Indicate the importance of any servicing agreements and warranties in the customer's purchasing decision and how the commitments will be met. Detail any service charges and compare your service with that provided by competitors.

- Advertising and promotion. Describe the approach that will be adopted to generate sales leads by creating customer awareness, e.g. exhibitions, trade magazine advertising, direct mail, promotional literature, advertising agencies, etc. A schedule of the costs should be presented in an appendix.

RESEARCH AND DEVELOPMENT

6.1 If the product or service requires any design or development before it is marketable, the extent of this work should be disclosed. Similarly, if future prospects depend on the successful development of new products it is important to state the nature and extent of such work and the timescales involved. As well as being interested in existing products, investors will be perhaps even more concerned with product succession, given the likely length of their involvement with the company. They will therefore expect to have the R&D strategy outlined in the plan.

6.2 Points for consideration include:

- current status of the development programme
- the in-house expertise and whether any development work is to be sub-contracted
- the experience and expertise of the person responsible for overseeing development
- any major anticipated problem areas and the approaches to their solution. State what effects these may have on the development timetable
- future development work on new products
- a design and development budget showing both cost and time. Allow some contingency as costs are often underestimated
- the accounting policy with respect to R&D. If costs are capitalised, present the case for this.

BASIS OF OPERATION

7.1 This section describes the facilities, location, space requirements, equipment and labour necessary to produce the product or service. When writing it, bear in mind that the reader may not be an expert in your field of activity. Highlight features of the operation which yield an advantage over competitors.

7.2 As operational requirements vary from business to business, not all of the following points may be relevant to your venture but they provide a general guide:

Location

7.3 Describe the present or planned location of the business, explaining the rationale for choosing the site and outlining both positive and negative features relating to:

- labour availability
- level of wage rates
- proximity of customers and suppliers
- ease of distribution
- availability of grants – (should be of secondary importance and viewed as a bonus).

Facilities

7.4 Give details of current facilities and future requirements, e.g. plant and office space, machinery, specialist tooling and other equipment. An assessment of future needs should be based on the expansion of capacities necessary to meet the projected sales growth. Lease/buy options should be considered for both equipment and space, and details of future capital expenditure should be given.

Manufacturing plans

7.5 Explain the manufacturing process involved in producing the company's products, together with the policy with regard to sub-contracting (i.e. make or buy decisions). It may be useful to present a production plan showing cost-volume details at various turnover levels, breaking down costs between raw materials, direct labour, factory overheads and purchased components. Stockholding at various turnover levels should be outlined, together with stock control, production control and quality control. Quality control is particularly important to minimise service problems and customer dissatisfaction. Purchasing should be explained, indicating purchase control procedures to ensure efficient buying. In all cases detailed analyses should be set out in an appendix.

Labour force

7.6 Discuss whether the local labour force has the necessary skills in sufficient quantity and quality (high productivity, low absenteeism) to manufacture the product or supply the service. If skills are inadequate, outline training plans and cost.

MANAGEMENT

8.1 Venture capitalists recognise that, however good a product or service, it is people who make a business successful. They back committed and experienced management teams, rather than individuals, and they shy away from ‘one-man bands’ because there is a limit to the amount one person can accomplish.

8.2 A well-balanced management team is favoured for two reasons:

- the business will probably survive the loss of a key person
- a full range of skills ensures that the important managerial functions (e.g. production, sales, finance) will be attended to.

8.3 Accordingly, this section will figure largely in the potential investor’s decision.

8.4 From the investor's perspective, management teams can be categorised from the most to least preferable as follows.

- Most favourable: all members of the team are identified, working together and fully committed to the venture. This is the ideal situation, especially when team members have experience and a successful track record, and explains why investors are keen to back management buy-outs from parent groups.
- All the team members are identified but not everyone is on board. This is a typical situation where the existing management cannot bring in the necessary complementary

management skills until funding is in place. The possibility that the people identified may not join is a source of concern for investors.

- One or more members of the team have yet to be identified. In these circumstances it is important to indicate how the gaps in the management team will be plugged. Part-time staff or outside advisers may be recruited until a suitable full-time person is found. The recruitment aspect makes the team less attractive and the investment more risky.
- Least favourable: the 'one-man band'. The limitations of this situation are usually unacceptable to investors unless the person has an outstanding track record in developing successful businesses and it is possible to build a team around him/her.

8.5 Therefore, assembling your team, or at least identifying its members, before seeking venture capital, will significantly reduce the perceived risks and increase the likelihood of success. Also of paramount importance to investors is the financial commitment of management to the venture. Investors will expect management to invest personally in the opportunity as an explicit show of faith and commitment. If there is no such financial commitment, investors who are usually asked to put up most of the cash, may be reluctant to back the venture. The amount of management's personal investment differs from case to case, but the sum should be significant in terms of personal wealth if it is to show real commitment.

8.6 Points for inclusion in this section are:

- provide a brief synopsis for each key manager, reviewing career highlights, duties and responsibilities and past accomplishments which demonstrate their ability to carry out the role required
- explain how the management team is to be organised and describe each member's primary role. If the company is established and has an effective management structure, an organisation chart should be included as an appendix
- describe the board of directors, including any non-executive members and their function
- provide details of salary packages and any personal investment in the company. Include a list of shareholders as an appendix
- identify any weaknesses in the team and explain how they will be overcome, e.g. training, recruitment, outside advisers
- explain the strategy to retain and motivate staff, such as key executive share options, bonuses, profit sharing, etc
- describe support provided by professional advisers both current and ongoing.

PRINCIPAL RISKS AND PROBLEMS

9.1 Inevitably, there will be risks attached to the development of a business; and the business plan invariably contains some implicit assumptions about them. It is important to give thought to these risks, as the identification of any significant negative factor by potential investors can seriously undermine the venture's credibility and hence jeopardise its financing.

9.2 Furthermore, by identifying and discussing the potential risks, entrepreneurs demonstrate not only the thoroughness of their approach but also their ability to deal positively with risks. Their credibility is thus enhanced in the eyes of investors.

9.3 This section should therefore identify and discuss any major risks and problems which may occur. Risks relating to the company and personnel, product development, market, and the timing and financing of the venture need to be considered. The following list is not exhaustive but highlights issues which may be relevant:

- delayed product development
- price cutting by competitors
- overspending on design, development or maintenance
- sales projections not achieved or overachieved
- difficulties in procuring raw materials
- problems in collecting from debtors
- the need for more R&D expenditure in order to remain competitive
- underestimated costs and time delays in moving premises
- inability to recruit staff
- inability to retain key staff.

9.4 Risks and problems should be discussed in order of importance, and management's actions to minimise their impact should be outlined.

FINANCIAL INFORMATION

10.1 This section represents the ‘gelling together’ of the plan in the form of financial projections. It should include:

- details of any previous financial record, briefly explaining historic trends and hiccups, if any. If available, the past 5 years' results should be summarised, and the audited accounts together with latest management figures included in the appendices
- a summary of projected results for the next 3 to 5 years, concentrating on the principal features of the projections, trends, rising or falling margins, fluctuations, commitment to R&D, major capital expenditure and key assumptions. Detailed projections, together with the assumptions on which they are based, should be provided in the appendices and should include:
    - profit and loss accounts monthly for at least 12 months, and preferably for 3 years, and annually thereafter. The break-even point should be clearly identified
    - cash flow projections, monthly and yearly as above
    - balance sheets, monthly and yearly as above

- a commentary on the forecasts, considering the overall shape of the company as projected rather than a detailed review of specific points
- the nature of existing or planned financial reporting and control systems
- sensitivity analysis covering key risk areas and a summary of their effects on the projections, in particular their impact on the funding requirement.

10.2 Investors routinely expect business plans to project sales, profits and other financial information for 3 to 5 years into the future. These projections are basic to the evaluation of the investment opportunity, and to a large extent will determine how much of the company's equity investors will expect in return for their investment.

10.3 Projections must represent the entrepreneur's best estimate of future operations and should be supported by the strategies described in the previous sections of the plan. They should also provide the operating plan for the financial management of the venture.

10.4 When compiling projections, always work from the top downwards, i.e. start with the sales projections determined by the market and market strategy sections. It is a common mistake to project from the manufacturing cost level on the assumption that everything that can be made will be sold.

10.5 Although profit and loss statements are important from the point of view of probable returns (forecasts must be realistic if they are to be of value as aids to decision making or policy formulation), the cash flow forecast can be more critical as it details the amount and timing of expected cash inflows and outflows. Generally the level of profits, particularly during the early years of a venture, will be insufficient to meet the working capital needs and, as inflows do not match outflows on a short-term basis, the cash flow forecast allows management to identify and plan cash needs. It also helps the investor to ascertain the finance required.

10.6 Balance sheet information details the assets required to support projected levels of operation and shows how these assets are to be financed (liabilities). These are important tools for both investors and banks, who will analyse balance sheet ratios to determine whether they are within acceptable limits to justify investment. The opening balance sheet will form the base for the financial projections. It is important to state when it was compiled and from what source (year-end audited position, monthly management figures or blank piece of paper).

10.7 Once the company's projections have been prepared it is necessary to draw upon section 9 of the business plan to highlight any major risks that could prevent the achievement of the forecasts and the sensitivity of the figures to those risks. Although investors will form their own view about risk factors, they will take note of the company's own assessment. Using the original projections as the ‘base’ case, both positive and negative sensitivities should be considered to give a best, worst and median set of projections. As a result, the total finance required, plus contingency to take account of principal risk areas, will be determined.

10.8 The ability to meet income and cash flow projections will depend upon the company's ability to monitor and control costs. Investors will want to know what accounting and cost control systems are or will be employed by the business, so brief details should be given.

FINANCE REQUIRED AND ITS APPLICATION

11.1 The preparation of detailed financial projections and sensitivity analysis of them should enable the amount of investment required to be determined. This section should include:

- how much money is required now
- whether additional finance will be needed in the future if plans are achieved and when this will be required. In some cases where all the finance is not required immediately investments can be made in stages against the achievement of pre-defined targets
- what the finance will be used for
- what proportion of the funds are expected to be raised from debt sources rather than through equity investment
- details of current investment in the company, both equity and loan (including bank facilities)
- the percentage of the company that investors are being offered in return for investment
- an indication of how the investor will realise his investment.

LONGER TERM OBJECTIVES

12.1 It is useful to state the aims and aspirations of the company and its management beyond the period covered in the plan. This section gives an insight into the type of business that is anticipated and is important for attracting compatible investors who have similar return criteria.

ANNEXES TO THE BUSINESS PLAN

These have two roles:

- they help keep the main body of the business plan to a manageable length; and
- they provide supporting information to help sell the opportunity to the interested investor.

Annexes should be listed and clearly marked so the reader can find them easily. Their contents may include:

- detailed financial projections together with assumptions
- summaries of the training and experience of key managers
- organisation charts – current and projected
- market information – studies, editorial from trade journals, etc
- product literature, particularly promotional literature with pictures of the product
- customer lists or details of prospective customer interest
- audited accounts and monthly management figures
- patents/trademarks
- suitable references for key personnel, products or services.

ANNEX A - SAMPLE DETAILED ASSUMPTIONS

The main assumptions upon which the financial projections are based should be clearly stated. Failure to provide this information renders the figures meaningless, and the investor will have little or no insight into how the projections have been compiled. Not every assumption need be stated, only the ones which will have a significant effect on the projected results.

Typically, these will include:

- sales increase by unit volume or value and product mix
- gross margin analysis by product line
- debtor collection period
- creditor payment cycle
- stock turn by product line
- a schedule of company assets and related depreciation rates
- inflation (in times of low inflation this can be ignored)
- exchange rates
- capital expenditure schedule outlining the levels and timing
- manpower schedule detailing the numbers of people involved in the project and the build-up of employees over time. Include a breakdown of wages and salaries
- research and development schedule indicating the level, timing and nature
- loan repayments due
- bank interest rates
- capital introduced.

Capital introduced is a complex issue with the following extremes:

- projections assume no additional funding, so that the finance required is demonstrated by the level of bank borrowings in the cash flow. However in most cases the figures will be distorted by the unrealistically high gearing and bank interest costs which result from this treatment
- projections assume capital introduced at a given point in time. But preconceived ideas as regards amount, timing and structure of finance are inappropriate.

In view of the above, the following approach is generally recommended:

- initial projections are prepared on the basis of no additional finance
- an assumption is made as regards equity finance raised, and projections amended accordingly. This will ensure that any gross distortion of the figures is avoided
- the report makes clear that the assumption made is for illustrative purposes only and that the financial package is open to discussion.

ANNEX B - SAMPLE STRUCTURE FOR FINANCIAL PROJECTIONS

Pro forma profit and loss account

	Month 1	2	3
Sales	*	*	*
Cost of sales			
Materials used	*	*	*
Production wages	*	*	*
	*	*	*
Gross profit	*	*	*
Overheads			
Directors' remuneration	*	*	*
Wages and salaries	*	*	*
Printing and stationery	*	*	*
Telephone	*	*	*
Vehicle expenses	*	*	*
Leasing	*	*	*

Pro forma profit and loss account (continued)

	Month 1	2	3
Repairs	*	*	*
Advertising	*	*	*
Exhibitions	*	*	*
Rent and rates	*	*	*
Light and heat	*	*	*
Insurance	*	*	*
Professional fees	*	*	*
Legal and audit	*	*	*
Travel and subsistence	*	*	*
Sundries	*	*	*
Interest	*	*	*
Recruitment	*	*	*
Bad debts	*	*	*
Depreciation	*	*	*
	*	*	*
Net profit before tax	*	*	*

Pro forma cash flow

	Month 1	2	3
Operating cash flow			
Receipts			
Trade debtors	*	*	*
Other income	*	*	*
	*	*	*
Payments			
Trade creditors	*	*	*
Accruals	*	*	*
Prepayments	*	*	*
Wages and salaries	*	*	*
PAYE/NI	*	*	*
VAT	*	*	*
	*	*	*
Net inflow/(outflow)	*	*	*
Interest payable	*	*	*
Capital flows			
Receipts			
Investment proceeds	*	*	*
Bank term loan	*	*	*
Sale of fixed assets	*	*	*
	*	*	*

Pro forma cash flow (continued)

	Month 1	2	3
Payments			
Loan repayments	*	*	*
Fixed asset purchases	*	*	*
	*	*	*
Total cash inflow/(outflow)	*	*	*
Opening cash balance	*	*	*
Closing cash balance	*	*	*

Pro forma balance sheet

	Month 1	2	3
Fixed assets			
Cost	*	*	*
Depreciation	*	*	*
Book value	*	*	*
Current assets			
Stock	*	*	*
Debtors	*	*	*
Prepayments	*	*	*
Cash	*	*	*
	*	*	*

Pro forma balance sheet (continued)

	Month 1	2	3
Current liabilities			
Trade creditors	*	*	*
Accruals	*	*	*
Bank overdraft	*	*	*
Bank loan	*	*	*
	*	*	*
Net current assets	*	*	*
Net assets	*	*	*
Shareholders' funds			
Share capital	*	*	*
Reserves	*	*	*
	*	*	*

Appendix VII: Protection and exploitation of technology and intellectual property rights

Where a company is being set up to exploit the commercial potential of an institution's technology and intellectual property rights, several issues may arise. This is a complex area and specific advice may be needed. Among other matters, the following issues should be considered.

- Check that the technology and rights belong to the institution or that it has the right to exploit them. This will require consideration of the institution's arrangements with its own academics and arrangements with other third parties who may have been involved in the development of the technology and rights.
- Ensure that appropriate patent protection has been applied for before any publication of the results of research, and that any publication does not prejudice the patentability of a relevant invention. Prior publication can be fatal to a patent application.
- In discussions with third parties, ensure that they have signed an appropriately worded confidentiality agreement prior to disclosing information to them. Technology disclosed without such an agreement in place can be rendered worthless.
- Where a particular development, for example software, attracts copyright protection, ensure that it is marked with an appropriate copyright notice. This will ensure it attracts copyright protection in certain overseas jurisdictions and put third parties on notice that the copyright owner regards it as valuable and claims copyright protection to it.
- As between the institution and the company, on what basis is the company to acquire its rights to the technology and rights as they then exist? This will normally be pursuant to a licence rather than by outright assignment, so that if for any reason the company fails or the licence otherwise comes to an end, the rights revert to the institution. Is the licence to be exclusive or non-exclusive? Are any 'field of use' restrictions appropriate?
- As between the institution and the company, what obligations will there be on either party to further develop the technology and rights, and who will own improvements that may subsequently be made by each party to the technology and rights? Consider what cross-licensing arrangements may be required to allow both parties to use such improvements.
- What financial return will the institution receive from the company for the licensing to it of the technology and rights, in terms of an up-front payment, running royalties, guaranteed minimum royalties or any combination thereof, in addition to any return it derives from its shareholding in the company?
- The arrangements for the licensing of the technology and rights will normally necessitate entering into a formal licence agreement between the institution and the company. This will set out the extent of the rights granted to the company by way of licence, the financial return to the institution, and other matters such as the future protection and enhancement of the value of the technology and rights (including responsibility for applying, and paying, for patent protection, and responsibility for taking any necessary infringement action against third parties).

- Careful consideration should be given to the terms of any warranties and indemnities that may be contained in a licence agreement.

Appropriate professional advice should in all cases be sought in relation to the protection and exploitation of technology and intellectual property rights and the terms of any licence agreement. This advice should be considered at an early stage to avoid unnecessary complications and potentially substantial costs later being incurred by the institution.