The research commercialisation office of the University of Oxford, previously called **Isis Innovation**, has been renamed **Oxford University Innovation**

All documents and other materials will be updated accordingly. In the meantime the remaining content of this Isis Innovation document is still valid.

URLs beginning www.isis-innovation.com/... are automatically redirected to our new domain, www.innovation.ox.ac.uk/...

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Golden Shares & Anti-dilution Provisions

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From time to time the idea of introducing anti-dilution provisions into university spin-out company shareholder agreements re-emerges for discussion. When the idea that universities could have special 'golden' shares in spin-outs from their universities was first proposed many years ago, the practicalities were challenged by some seasoned investors, as no special provisions would survive further rounds of investment.

However, the idea has recently been revived by some influential UK based investors and other commentators as being a potential solution to solve problems that they see are holding back the formation of technology companies in the UK namely:

1. that UK universities take too much equity in spin-outs and more equity should be retained by founding entrepreneurs to incentivise them to carry out this type of activity
2. that negotiations between universities, founders and investors around equity and IP (which are often linked) take too long and this may be limiting the numbers of start-ups being created

As one experienced investor and advocate for this model explains:

"The real idea is to maximise the number of spinouts formed and not maximise what the universities get for the IP. My argument is they will make more money since there will be so many more companies formed" [1]

As such, it is worth exploring the idea and issues raised.

What is anti-dilution and what form do anti-dilution dilution provisions typically take?

Anti-dilution is the idea that a shareholder, in this case the university in the context of a university spin-out company, has a special class of shareholding and special interest in the company. The university's shares are special because they are not diluted by future rounds of investment until a predefined event occurs. There are many forms by which an anti-dilution mechanism can be implemented.

The table below shows a few of the more common mechanisms:

'Get topped up as you go'	Issue to the university some more shares to bring it up to the previous (founding) level whenever new shares are issued or at the end of a defined event (e.g. Series A financing)
'Option to top yourself up later'	An option for the university to acquire/buy new shares at pre-set value on the pre-defined financing event occurring
'Future one-off cash payment instead of shares'	A pre-agreed one-off payment under the licence agreement that is linked to an exit or acquisition of the spin-out – e.g. a fixed payment of £Xm or an amount equivalent to X% of issued shares/acquisition value etc.

The first two models above have become common in some US universities and typically take the form of 5-20% founding equity stakes with anti-dilution to the end of Series A investment (typically defined via a pre-set valuation on the value of the university equity being reached or by a capped sum of money raised).

Most recently a new model around perpetual anti-dilution in the form of a 'Golden Share' has been proposed as discussed below.

The Golden Share idea

The Golden Share idea is similar to the above models except that the equity stake is much smaller in return for enjoying anti-dilution over a longer time period through to an exit or value realisation event. One way the proposal can be expressed is along these lines: 'the Golden Share shall carry no rights, but in the event of a distribution of assets on a liquidation or return of capital, a share sale, an asset sale or an IPO (with appropriate definitions of these events) the holder of the Golden Share shall be entitled to an amount equal to a set percentage of the Net Proceeds in priority to any other class of share'.

The percentage is set at the start of the company's life. Advocates of the scheme have suggested that the Golden Share for the university should be equivalent to 1% of the company upon foundation with an additional 1% being non-contractually promised in the form of a philanthropic gift back from a grateful founder/alumnus in the future.

Questions and issues raised

There are a large number of questions and issues raised by the idea. These are set out in the table below:

Issue	Comment
Evidence 'for' and 'against'?	
How do we know If the Golden Share is a good idea? Is there any evidence for it working or being accepted by academics or investors?	In the UK, there is virtually no information and experience with anti-dilution provisions or the success of a Golden Share approach. At this stage there is only opinion and advocacy from various potentially interested parties. In the US there is some experience of implementing a time-limited anti-dilution protection until the end of an anticipated funding round, for example Series A or B venture capital funding. It can only be presumed that such a model may be acceptable to founders and investors (though published data on this is not readily available).
Will universities be better or worse off?	Supporters of the University Golden Share are suggesting the University percentage is set at 1%. This may or may not be financially attractive to universities. In some cases the university share at exit is worth much more than 1%, in others after a long period of time and multiple dilution, less.
Will the Golden Share or anti-dilution provisions survive future negotiation with investors?	Given the long term nature of the golden shares' protective rights, later stage investors who will have no association or affinity with the original university spin-out formation event and team of many years ago, may insist on the removal of the special protections. The university is therefore compelled into accepting something at stage 1 which is taken away at stage 2, 3 or 4. If the university insists on maintaining its protections and the investor withdraws, the university may be blamed for damaging the prospects for the company.

Other shareholders and interested parties views	
If the University receives anti-dilution protection or Golden Shares will other founding parties or early stage investors want it too?	Other shareholders in the university spin-out - Academics, Management, Angels, Seed investors, early VCs etc. may well want special treatment as well. Why not if it is sold as a great idea for the university? Clearly however, it is unmanageable for a growing company to have many Golden Shareholders and later investors are very unlikely to invest in such a company.
Will investors invest in a company with anti-dilution provisions? **What about if the university has a golden share?**	As stated above, evidence from parts of the USA suggests some investors will allow a limited anti-dilution to Series A provided the point at which it falls away can be agreed. It is not clear whether incoming investors have sometimes forced such clauses to be removed as a pre-condition of investment or not. It is clear that not all investors are in favour of a university Golden Share; this is because perpetual anti-dilution protection does not mesh well with issuing different classes of shares to later investors or liquidation preferences stacks (favoured instruments of investors to ensure an orderly and structured exit that benefits shareholders in an agreed 'right order').
What about Research Funders, will they agree? **And other research collaborators, other universities for example; will they agree?**	Some large research funders (e.g. charities) take a proportion of the university's founder shares, and wont consent to the spin-out route until this is agreed. What will they think? If there are founder researchers from more than one university, will they all agree to this plan?
Practical questions	
Some have suggested that the government in the UK should impose and enforce this approach for UK universities. Is it appropriate for government to intervene in the market in this way? **If imposed by government and/or research funders as a precondition of funding, will such funders underwrite the university golden share if it is negotiated away later by investors?**	A significant evidence base would need to be compiled to convince universities, TTOs and investors that a 'one size fits all' solution such as the golden share can be made to work given the diversity of situations and sectors in which spin-outs form and act. In addition, the enforceability of such provisions would have to be very carefully implemented in order to work with the variety of pre-existing agreements entered into by universities with their subsidiaries and/or third parties to handle their equity stakes and investment matters. For example the existing university relationships with IP Group, Imperial Innovations, Oxford Science Innovation, Cambridge Innovation Capital, Mercia, Epidarex etc. In some universities a wholly or partially owned subsidiary owns the shares in the university's spin-outs. Does it suit the model of these companies to own a Golden Share?

If imposed on universities, how do you decide the percentage taken at formation, Universal or case by case?	Modelling by some university TTOs suggest that in some cases a university may be worse off (e.g. a non-capital intensive business that achieves an early exit, or spin-outs that drive straight to revenue - software for example) whilst in other cases a university may be better off (capital intensive, heavily dilutive business that exits later, therapeutics for example). It does not follow that these differences would even out over a portfolio over time as many universities portfolios are biased towards certain sectors or companies (e.g. healthcare or ICT)
Does a 'one size fits all' fixed golden share percentage work for all technology and sector types?	It is interesting to note that many of the proponents of the golden share model are experienced in the ICT sector where relatively rapid exits are common. It does not follow that what works in this environment is transposable into other sectors given the reasons outlined above.
What if there is no exit / sale event?	The Golden Share idea is being promoted on the basis that universities will be better off (overall). However, where companies scale, organically grow and do not exit it is unclear how dividend distributions operate under the Golden Share model.
Will the additional 1% component of the golden share (i.e. that to be provided as a philanthropic gift assuming successful exit) ever be seen?	It requires a considerable leap of faith by the university and its TTO to believe that the additional 1% gift will ever be seen. The culture of alumni giving back upon success is gradually improving in the UK but still has a considerable distance to travel before it can replicate the culture seen in the USA.
The golden share model also implies that no royalties are requested (on the basis that these introduce additional points of delay in negotiations). Is it practical to expect universities to rely on equity alone as the sole mechanism of future return?	Universities often request royalties as part of future consideration as they allow the risk to be shared, cash payments deferred into the future and are, in their own right, a form of anti-dilution protection. Crucially, in many universities founders share in these royalty streams ensuring that such founders also enjoy a measure of protection in the event of heavy dilution their founding equity stake.

It is acknowledged that more could be done to speed up the formation of spin-out companies and that this requires the active engagement of TTOs, founders and investors. In this way the golden share proposal may be welcomed insofar as it is a new idea, but one with uncertain benefits and insurmountable practical challenges.

What is really needed is some evidence based proposals and decision making that involves all interested parties. Without this, it would be a brave step to introduce the golden share idea without a clear understanding of circumstances under which it may work, and how it addresses the problem at which it is aimed.

Tom Hockaday & Tony Hickson, June 2015

Further information & next steps

We are all committed to listening, changing, and exploring ways to make technology transfer between our universities and business more successful, more effective and less painful for everyone involved.

We are preparing additional information and FAQ sheets to explore the issues and challenges raised here in more depth.

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[1] **"Golden Share" model may appeal to start-ups, but VCs are likely another story.** By David Schwartz. Published: August 27th, 2014. Technology Transfer Tactics.