

Evolving needs for Emerging and High Growth Companies: Series B stage

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If your company is in the process of closing a Series B financing, there are some corporate readiness and corporate structure items to consider as your business takes its next steps.

Partners Christian Jacques, Emerging and High Growth Companies Group, Simon Hodgett, Technology Group, and Steven Dickie, Employment and Labour Group, tackle the topic of strategically scaling at Series B, including optimizing corporate structure and internal controls, developing processes and teams to enable efficient contracting, implementing a principled approach to executive and multi-jurisdictional hiring, and key acqui-hire considerations.

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Transcript

Christian Jacques: Hi everyone and welcome. This session is a short discussion about what comes next after closing a Series B financing. I'm Christian Jacques, a partner in the Emerging and High Growth Companies group, and I'm joined today by two fantastic colleagues, Simon Hodgett, partner in our Technology group, and Steven Dickie, partner in our Employment and Labor group. As most of the usual challenges for a Series B company relate to scaling, we'll be focusing our discussion on two key dimensions about growth; namely corporate readiness, which is about making sure your structure and governance can support expansion, commercial readiness, which is about managing bigger and more complex commercial relationships and people readiness, which is about attracting and retaining talents. We'll touch briefly on each of these, but first please let me start with a few corporate items that I believe often deserve the attention of the Series B stage.

First is corporate structure. Growth often means extending into a new market and the corporate structure at work at the seed stage may no longer serve you that well. So it's worth reviewing whether your structure is still optimal or whether you should now open a U.S. or an international subsidiary, whether to deal with local higher revenue or for other tax reasons. Getting that early on prevents avoiding messy fix at a later stage. Second is internal controls. Series B investors expect a lot more discipline. That means putting in place not only clear signing authorities and approval processes that essentially ensure consistency, but also a code of conduct and other policies aligned with the company risk profile. These are not red tape anymore, but rather they reassure investors and employees that the company can scale

in a responsible manner. Maybe less of a company point, but more of a founder personal strategic point, it's family trust planning.

Many funders start exploring secondary liquidity at or after a Series B, and the best outcome happens when that family trust structure is already in place. It's a small step that can have a huge impact on tax efficiency. So once those corporate foundations are in place, the next challenge is really commercial execution, and this naturally brings us to the commercial side of the house. So, at the series B stage, companies are no longer negotiating one deal at the time, they're managing multiple enterprise customers, more complex partnerships and expanding into new jurisdictions. So Simon, when a company starts signing those bigger deals and expanding globally, what shift do you see in how the structure negotiates and maintains their commercial agreements?

Simon Hodgett: Thanks, Christian. At this stage, the company should have a lot of confidence in its commercial agreements. It should have reasonable practices in place. The templates should have been used quite a bit, with a good sense of how those agreements conform to the business and to the expectations of customers. And they should also reflect the company's risk tolerance. In addition to that, there should be processes developing around speeding up the contracting process, an appreciation of whether or not these are contracts that are negotiated, or if they're largely accepted by customers and then staffing accordingly, putting in place a contract manager, potentially those who are going to administer the contracts within the company and are going to deal with the fact that the contracts may require approval from senior management. That may include non-legal expertise, or it may even include adding in an in-house lawyer to assist with that.

Mainly it's learning what the business needs as far as the volume and being able to smoothly contract based on what it's learned so far with an understanding that the systems aren't really for right now, therefore a vastly more expanded business. And the other thing to think about is if you're going to be expanding internationally and how to approach that. Many times this is a very difficult area for our clients because it's expensive to get advice on every jurisdiction you're in. So there's a little bit of a risk decision that has to be made. If you're going to enter into a jurisdiction in a very dedicated way and there's going to be a decent amount of volume in that jurisdiction, or there's an extraordinary amount of risk, it's worth thinking about getting local counsel involved to look at the agreements and to assist in that way. So that's an area where it's important to understand the risk and to talk to your legal advisors to make sure that you understand and manage that.

Christian Jacques: Thanks Simon. Another big challenge is professional complexity. As they expand, Series B companies may have to set up a new type of process, hire a lot of new employees and basically make sure that everything runs smoothly even at a larger scale. Steve, on the talent side of things, what shift do you typically see there?

Steven Dickie: Thanks Christian. And some parallels with what Simon was saying on the commercial side by the Series B, you should have battle-tested forms of employment agreements that are routinely used. We've eliminated all the ChatGPT and downloaded forms and everything like that. Everything is running smoothly. At this stage you're going to be looking to really level up your talent, and that might include trying to attract industry veterans away from incumbents who are looking for a new challenge to disrupt the market and join you. And with that comes various considerations, including when to break the mold and when to move off your employment agreement template on things such as severance packages and other executive protections, and common terms that would be offered to executives, but maybe not to rank and file or early stage employees. What you need is a process for addressing that, potentially a dedicated form of executive employment agreement that brings some consistency and coherence to bringing on those types of level up leaders and, to ensure that the company's interest is served while at the same time making it a smooth onboarding experience, strongly recommend that you partner with

expert employment council to peer around those corners, anticipate negotiating points, and really help deliver up a good experience and finished product.

Where it can be less successful and where I've seen it happen is, at the last minute, a bunch of complex terms get dumped on to council at the end and what you want to avoid is having to walk things back, qualify things for compliance, or other reasons. And so really being ready for those new strategic hires from the get-go makes the most sense. I think also, and building on something that Christian was talking about codes of conduct by this stage, you really should have a fully fleshed out employee handbook or manual, not only the basic statutorily required policies, but best practice workplace policies on common topics that you know are going to come up as you've expanded your workforce. So what is the company's policy on pregnancy and parental leave support and other typical topics which we can of course assist with both from a compliance standpoint, but also ensuring that they meet your talent retention objectives.

And then lastly, as you're going into other markets, you might also be hiring in other markets. Plugging you in with local council in the key jurisdictions to assess risk profile, that risk reward on compliance versus good enough. Are you're starting to build critical mass in various jurisdictions such that using an employer of record or other quick fix solution in other jurisdictions abroad no longer makes sense. So these are the types of things that your external counsel, partnering with your people, leaders and HR executives, can help outline with respect to what you need to do.

Christian Jacques: Thank you, Steve. Simon, let's take this in a slightly different direction. At the early stage seed and Series A, the diligence is usually at a pretty high level with investors focusing essentially on the big picture and the team, by the time companies read Series B founders, were often surprised at how much deeper investors are digging especially into commercial contracts and compliance. And by Series C that become even more of one of the main area of focus as commercial risk usually starts outweighing the corporate structure risk. From your point of view, how can companies get ahead of that curve and make sure they're maintaining their diligence readiness following their Series B financing?

Simon Hodgett: This is a really great question. When we're negotiating complex deals for our clients at this stage, we often will raise this with them, that you may want to think twice about agreeing to an ambiguous set of wording in an agreement to make a sale in order to move forward at any cost because someone's going to review that in great detail in the future, whether it's an IP problem, a liability problem, or some other problem in the agreement. And I also think at this stage it's worth going back and looking at the portfolio of agreements that were entered into previously. Obviously in the early stages, companies have to enter into what they enter into. In many cases there's not a lot of choice with respect to customer agreements; you're trying to generate that initial revenue, it's very important to close the deals and things may have been agreed to that weren't optimal.

So I think it's important to look at this stage back through the portfolio of customer agreements and other agreements and decide do we have things in there that we optimally should not have agreed to, and then devise a strategy. It may be that many of those agreements, if you're in the kind of business where your agreements cycle over quite frequently, it may be that you let those expire and you renegotiate some of the terms that will be problematic for the future. There may be other issues that you just understand that they exist in the agreements and you anticipate the questions and you have good answers for them in the future. But it is a great point, and all the time when we're entering into commercial agreements, we should be thinking about how they're going to look not just between the parties, but for those third parties who are going to give them the scrutiny in the future. So that's a few ideas, but having an awareness of where those things exist in the portfolio of agreements I think is the critical point.

Christian Jacques: Thank you, Simon. Steve, Series B financing is really about scaling up in a

big way. This is when I usually see companies starting to plan expansion into new markets or building teams at a much larger scale. And in my experience, this is often when we start having discussions about small M&A, those acqui-hire deals, right where talent is the main asset being acquired. I'm curious to know from a labor perspective, how do these transactions typically unfold and how do you help clients navigate the complexity of integrating those new teams successfully?

Steven Dickie: That's a great call out, Christian. So acqui-hire doesn't have a technical legal term, but typically it's an asset sale whereby maybe some intellectual property goes over to the buyer. But primarily the motivator for the transaction is to secure a proven team. And perhaps there are various incentives or accelerators based on the number of employees that end up accepting an offer of employment with the buyer in those circumstances. From an overall transactional perspective, typically it's a fairly simple structure, although there are key employment law differences between employees based in Québec who come over in an acquisition and those in the rest of Canada. So it's good to understand the geographical footprint of where people are located. In terms of key legal considerations from an employment law perspective outside of Québec, new offers of employment from the buyer are needed. Employees aren't assets that can be transferred against their will in these situations.

And usually the buyer has a free hand to offer any terms that the buyer deemed suitable, but given the objectives of the transaction are certain retention incentives and structures needed to entice talent to join the new team. And from a legal viewpoint, like a statutory perspective, there's a deemed continuity of employment between the old employer and the buyer. That's important for length of service, minimum termination entitlements, vacation, anything that cues off of employment standards legislation. And so from the acquirer's perspective, you're going to want to diligence things like existing employment terms, as well as probe for liability such as unpaid wages, overtime risks, that sort of thing, all of which can inadvertently port over to the buyer. And if as part of that exercise we turn up a lot of issues or there's a risk of a material issue arising that may feed back into the transaction structure.

So, for example, is there going to need to be a sufficiently large holdback on the deal consideration to cover off those potential contingent liabilities that could inadvertently go over to the buyer as well? So that's where the employment diligence and employment compliance considerations and risks feed back into our M&A colleagues in terms of how they're going to approach the transaction. Then aside from the legal factors, you hit the nail on the head, careful integration management planning should be undertaken before, during, and after the transaction to ensure that you're getting good value for entering into this deal. How are the new team members going to be distributed and effectively integrated into the buyer's teams? So aside from the core legal considerations, careful planning, or lack thereof, can make or break these types of expansion strategies.

Christian Jacques: Thank you, Steve. Thank you, Simon. I think we're already beating the clock on this, so this is it. I hope that you enjoyed this quick discussion. It was a privilege for me to be able to introduce Simon and Steve, two great partners who help our clients focus on scaling up efficiently and navigating the complexity that comes with growth. Thank you for watching and don't hesitate to contact us if you need any formal support or have any questions or comments.

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