

# Fundamentals of funding laid bare

by Charles Whelan and Richard Hall, partners, HW Corporate Finance

*The corporate finance market is more buoyant today than it has been for some time, according to HW Corporate Finance, a division of Haines Watts, one of the Thames Valley's leading accountancy firms. With more private equity waiting to be invested than the GDP of Holland, it's a great time for businesses to review their investment strategies and consider raising additional capital for future expansion.*

But before you get carried away on a wave of enthusiasm, a reality check is in order: good preparation and thorough planning are essential if you want to attract the most appropriate funding with the best partners, and here Charles Whelan and Richard Hall, Partners, HW Corporate Finance, give their advice on how to get your funding strategy right.

In today's rapidly moving commercial environment, every business needs to be able to adapt and evolve, either in response to a lack of critical mass in its particular market sector, competition, or in an effort to capitalise on new opportunities. And such change usually means growth in some form. If this is organic growth, then the business may be able to fund it wholly or partially itself. However typically some external help will be required, almost certainly where the chosen route is by acquisition. A third alternative is a merger or partial or complete sale of the business to a larger player.

It is important to remember that whatever route you chose, before someone will invest they will need to understand your business and confirm this understanding through due diligence. Failing to recognise this can result in a situation where an issue (which you may not consider important but is fundamental to the investor) is identified late in the process, resulting in a significant amendment to the terms of the deal. Had this issue been identified earlier, a different strategy or investor might have been sought. As an example, HW Corporate Finance recently carried out a purchaser due diligence for a client in the IT sector, identifying considerable issues in the accounting records, which resulted in a complete restructuring of the deal.

Knowing which growth option to take is not always simple, but the initial planning for each is very similar. HW Corporate Finance is currently helping a client in environmental technology to formulate a range of plans to take advantage of the best option as and when it presents itself.

The first step is to clearly understand what the key strengths and weaknesses of your business are. Top of your checklist should be:

- **Management** – Having the right management team and staff to move the business forward. Do you have the right people in the right roles? Do you have enough staff to cope with an increase in business? Remember that investors want to see strong, focused management teams.
- **Unique Selling Points** – Identifying what is special about your business that makes it attractive to an investor.
- **Strategy** – Having a well thought through plan of where you want the business to be in the future and how you intend to get it there. The most successful companies always have the end goal in their sights and have a clear understanding of their market and competitors and how both of these may change in the future.
- **Finance** – Understanding your financial capabilities, taking into consideration every aspect of the business, from premises and transportation to staff training, sales and future development. Your plan should include a detailed model that clearly identifies how much funding you will need, what it will be required for and what returns investors can expect.

An experienced corporate finance professional can help immeasurably in assessing the strengths and weaknesses of a business from a third party perspective, challenging the plans and assumptions that have been made and helping to ensure that the strategy is as robust as possible. For example, HW Corporate Finance helped a client in retailing to identify gaps in their management expertise whilst trying to undertake an MBO. As a result, they were able to bring a highly experienced Managing Director on board and, once he was in place, funding for the deal was secured.

The starting point is to formulate all your planning and ideas on paper – initially as a business plan, which will help you to focus on where the funding will go, what future investment may be necessary and where it will position you in relation to your competition.

Appointing external advisers at this stage will maximise the



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benefit you receive as they will help you swiftly identify potential issues, ensuring that these are thoroughly addressed before the due diligence process begins. Furthermore their presence will mean that your focus on the business is maintained, allowing you, the specialist in your business, to maximise its value.

With all these tasks in hand, the business owner can begin the search for funding, with several options available:

- **Bank debt** – If the sum required is modest in comparison to the total value of the business (typically less than three times the operating profits), then this is the cheapest form of finance as it represents the least risk to the investor. This often forms the first tranche of funding, even if other forms of capital are also to be used.
- **Private equity** – If the funding needed cannot be raised by bank debt, or if the company does not have a stable trading record, then this could be the most appropriate route. Private equity is a very good method of extracting cash to help existing shareholders exit whilst at the same time bringing in new management, or for making a large single investment, such as an acquisition. Sources of private equity range from business angels to venture capital houses.
- **Listing** – In some circumstances, a listing on the Alternative Investment Market (AIM) – or more rarely on the main market – could be appropriate, particularly if the business is able to demonstrate fast growth, plans to use the funding for growth or requires tradeable paper to make acquisitions.

But access to funding comes at a cost. Of these three sources of finance, pure bank debt is the

least expensive, with total costs usually being around 2.5% of the funds raised. On the other hand, private equity may cost approximately 5% of the funds raised and has on-going costs of around £20,000 each year. Of the three, an AIM flotation is likely to prove the most expensive and it is unlikely the costs here can be kept much below £400,000, with annual costs typically exceeding £50,000.

Other differences between these forms of funding can be found in the level of external scrutiny that the business will receive. For bank debt, expect this to be fairly minimal, whilst for a private equity investment, you can expect the investor either to insist on joining the board of directors or at least act as an observer. An AIM company, on the other hand, will need a number of non-executive directors and to give regular updates to the City. The directors will need to invest a considerable amount of time explaining their proposals to the City and these will be scrutinized thoroughly to check that they have been achieved. Woe betide you if you do not achieve them!

So there's plenty to think about, and the final decision about how to fund future growth will depend on your ambitions for the business and getting the balance right. But remember - above all else do your homework, follow the advice of professional external advisers and remember their mantra: Proper planning prevents poor performance!

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