Raising Finance

Knowles Warwick
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When might investment capital be required?

- Starting a business
- Developing new products
- To diversify into new markets
- Introducing international trade
- Researching new technologies
- Investing in new management
- Increasing turnover rapidly
- To secure lucrative supplier/customer contracts

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What is a “deal structure”?

“Deal structure” refers to the financial plan for your business ***before*** you talk to potential investors

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Types of deal structure

- **Equity stake**
- Convertible loan notes

An ***equity stake*** is when an investor exchanges money for ownership interest in your company

The amount of money received depends on the value of the business and the amount of equity the owner is prepared to release

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Deal process

Once you have agreed upon the amount of equity…
it can get complicated!

You can issue new classes of shares:

- with different voting rights (or none at all);
- that will be paid back more quickly than others;
- that will be paid back at a given time

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Deal process

Three main types:

Other options are available; always take professional advice

Ordinary shares have one vote per share, participate equally in dividends and have rights to capital

Preference shares usually give the holder priority over other shareholders to dividends or capital

Redeemable shares are issued with an agreement for the company to buy them back at a specified date – a clear arrangement with an investor

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Types of deal structure

- Equity stake
- **Convertible loan notes**

An investor puts in an amount of money that matures at a specific date (a ***loan note***). On this date, the investor can choose to take their money or ***convert*** it into an equity stake in the company (based on a current valuation).

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Term sheet

Once an amount and structure is agreed, a ***term sheet*** is issued. This is a non-binding document that outlines the terms and conditions of the investment.

However, getting a term sheet is not the same as receiving the legal documents for the investment. These can take months to come through, especially with the requirement for due diligence work.

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Sources of finance

- Cash reserves/own equity
- Friends and family
- Bank debt
- Regional funding
- Business Angels
- Venture Capitalists

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What type of funding is appropriate for me?

Seed capital

Great idea needs finance to get off the ground

Start-up

Plans are in place but not yet generated any sales

Early stage

Generating sales but need to capitalise on an opportunity

Expansion

Profitable and established business looking to expand

Business Angels
Regional funding/grants
Borrowing
Bank debt

Venture Capital finance
Business Angels
Bank debt
Regional funding/grants

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Debt finance

- Debt is still the cheapest form of finance, however it is harder to access
- Stable track record required along with a sound business model
- Expect to pay an arrangement fee
- Usually requires a personal guarantee from directors/shareholders

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Types of debt finance

Commercial mortgages

A loan to acquire property (the same as a residential mortgage)

Typically:

- Lend in excess of £25,000
- Lend up to 70% of property value
- Repayment terms up to 25 years
- Higher interest payments

Term loans

Loans repayable over a pre-agreed term secured on business assets

Typically:

- Lend in excess of £1,000
- Repayment terms of 5-10 years
- Unsecured element possibly based on cash flow generation

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Types of debt finance

Government-backed loans

75% of loan guaranteed by Enterprise Finance Guarantee

Typically:

- Lend £25,000 to £1million
- 2% p.a. govt. premium payable
- Turnover must be less than £25m

Overdrafts

Fully flexible borrowing secured on business or personal assets

Typically:

- Lend in excess of £1,000
- Interest only due on funds used
- No capital repayments
- Subject to financial covenants

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Types of debt finance

Invoice financing

Cash advance on sales invoices raised by the company

Options:

- Invoice discounting
- Invoicing factor

Typically:

- Receive up to 90% of invoice value
- Advantages of flexibility and growth

Asset financing

Loan against asset purchases such as equipment and vehicles

Options:

- Hire Purchase
- Leasing

Typically:

- Borrow between £10,000 and £10million

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Venture Capital finance

Appropriate when the funding requirement is reasonably substantial or when additional, specific expertise is required.

A Venture Capitalist will take a mix of equity and loan stock in return for their investment. Return achieved by ignoring yield and exit value of equity.

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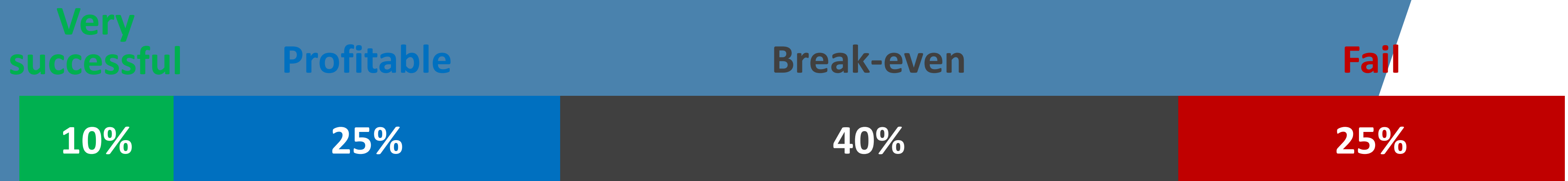
Venture Capital finance

VCs anticipate the following success rate of their investments:



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Chances of success

The chances of raising private equity are very slim:

- **60%** rejected after a 30-minute review
- **25%** rejected after a 3-hour appraisal
- **10%** rejected after a full day evaluation
- **3%** rejected after failed negotiations
- **2%** succeed in raising funds

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Chances of success

Most common reasons for rejection:

- Management team lacking skills
- No track record or poor proof of concept
- Forecast based on weak assumptions
- Inadequate financial returns
- Lack of trust or market awareness
- No clear exit route

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Impact of Private Equity

Advantages

- Long term equity with no interest
- No personal security
- Investor can add skills, contacts, experience
- Future financing options may be easier to attract
- External party can assist with discipline

Disadvantages

- Dilution of ownership
- Cost of capital is expensive
- May be a time consuming process
- May be difficult to find the right investor
- Possible loss of control

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Business Angel finance

- Typically affluent individuals investing their own money
- Investment in smaller, start-up enterprises
- Risk is higher due to high failure rate of start-ups
- Cost of finance is therefore high
- Advantage of speed compared to VCs
- More likely to add value via own experience

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How to approach the Funder

- All funders rely on a ***business plan*** as a primary tool for initial evaluation
- Use an advisor to assist and critique
- Balanced recognition of strengths and weaknesses
- Sensitivities and the financing model
- Plan and rehearse presentations to funders

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Conclusion

- Prepare a business plan
- Identify weaknesses in your business
- Practice your sales pitch
- Identify most appropriate funder
- Get the structure right for management and the business
- Allow for headroom
- Keep your eye on the ball!

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