PART TEN
Growth capital

Funding your business through the recession

10.1

*As we enter the third year of the global financial crisis, businesses continue to encounter a myriad of obstacles, and while there is no doubt that the current recession has marked the end of easy money, there are still sources available and actions to take to ensure survival, say **Paul Beber** and **Brian Johnson** at The Fisher Organisation*

Although the government and the banks have committed themselves to ease the funding difficulties caused by the financial crisis in the banking industry, in practice this is often no more than 'lip-service'. Businesses today are still fighting for a share of the limited funds available and, to add to the challenge, the cost of these funds has risen significantly.

Forced to think beyond traditional routes of funding while interest rates and deposit demands are higher, some creative and alternative finance options should be considered, particularly as less credit is available and lenders become more selective about who they lend to. But just what are the options for established businesses that are finding it difficult to obtain bank loans and overdrafts?

Considering other types of finance

With banks still reluctant to lend to individuals and businesses, or demanding additional security that entrepreneurs either do not have or are reluctant to give, there are other options worth consideration and, fortunately, there are resources available to help businesses accomplish their goals and continue to grow, beyond the 'friends and family financing'. These include:

- Asset-based lending. Invoice finance is the foundation of asset-based lending (ABL), whereby money is advanced against a company's assets. In the case of factoring, the most popular form of asset-based finance, the financier can collect debts on behalf of a business. Apart from invoices, other suitable assets can include stock, machinery and, of course, property.

- Peer-to-peer lending has recently emerged in the UK as a successful alternative, whereby private investors often lend directly via the Internet, offering various types of loans from business to personal, without the requirement for a financial intermediary.
- Government grants have notoriously difficult application processes and can be complex to navigate, but there are genuine opportunities available for those who persevere.
- Enterprise Investment Schemes (EISs) are designed to help smaller, higher risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies. Despite the recession, there is still a considerable amount of investment money available looking for suitable opportunities.
- Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short-term projects, while sharing the risk and costs with a like-minded partner.
- Business angels can often provide substantial investment in return for equity in the business, offering a direct involvement with that investment for business owners.
- Venture capital typically comes from institutional investors and high net worth individuals, and is pooled together by dedicated investment firms. A type of private equity, it is largely provided to early stage, high potential growth companies.
- Venture Capital Trusts (VCTs) aim to bridge the equity gap between banks, government grants and business angels on one side, and institutional venture capital on the other.
- Investment from private equity houses frequently involves either an investment of capital into an operating company, or the acquisition of an operating company, typically in a young or emerging market. There is a wide array of types and styles of private equity including leveraged buyouts, growth capital, distressed investments and mezzanine capital.
- The lack of available bank finance has led some companies to consider getting a public quotation. Companies typically seek a public quotation because it offers profile, some liquidity for its shares, an audience receptive to growth and an environment where management can devote as much energy as possible to doing what their shareholders want them to do – to run the business. Available markets include PLUS, AIM and even potentially the London Stock Exchange.

The going is tough – what do you do?

Although by this stage in the recession those that have survived may think they can start to breathe a sigh of relief, this is actually the time when even more care is required. It is a sad historic fact that more businesses go to the wall when the economic cycle starts to improve than when it is on the way down or bumping along the bottom. Lack of working capital – eroded through the recession – is primarily the problem and a sudden pick up in business can create insuperable strains.

Delay is seldom a good idea in any business, and never when a company is in difficulty. Studies have repeatedly shown that many failed businesses could have survived if only remedial action had been taken in time. When the going gets tough, it may be time to call in the specialists. Working with ailing businesses, corporate advisory specialists aim to rescue a company either by helping to raise required finance or, if necessary, helping to reconstruct the business. They work with the directors, shareholders, lenders and other stakeholders to find the optimum solution for all involved, with an emphasis on recovery.

If some form of insolvency is unavoidable, this may not need to be the end of the line. Insolvency is generally a last resort, and whether it be a complex corporate reconstruction and recovery situation, receivership, administration, company voluntary arrangement, liquidation, or personal bankruptcy, early intervention is key to successful outcomes for all involved.

What next for growing businesses?

The current economic climate has led to many businesses focusing on consolidation and cost efficiency to survive. One positive outcome of this is that most businesses at this stage in the cycle have developed the drive to push their businesses forward. But this does not mean that you can take a rest – far from it. The challenges are not going to go away quickly and the need for businesses to continuously reevaluate their position and goals, and revisit their business plans remains as important as ever.

When preparing your plan, make sure that you carefully evaluate all needs and assess your financing needs properly. If you need additional funding start seeking it earlier rather than later.

Improving your chances of securing the finance you need

Securing funding is proving more difficult than ever before but there are ways to improve your chances of securing finance and managing cash flow while positioning your business for the future.

Top tips for attracting and securing funding:

- Know your business. Consider what your business's product or service is, how relevant it is in the current economic climate, and how sustainable it is in challenging times. Ensure you have a strong business case in support of the strategy and longevity of your business before seeking funds. Keep your business plan up-to-date.
- Closely manage your relationships with key clients. Know your competitors.
- Understand your finances. Instigate robust forecasting and financial management. Know your debt levels, understand what type of debt you have, when those funds are going to roll over, and when and if loans will be renewable.
- Know how much funding you need. Take a long-term view, identify your end goal, and calculate how much funding you need, allowing for contingencies.
- Prepare your business for due diligence. Usually carried out when an investment or acquisition is going to be made, the process of checking the facts of a business before seeking funds can save a lot of time and energy when negotiating an investment.
- Seek advice. Your relationship with your financiers and other professional advisors should be nurtured at all times, but even more so when times get tough. Ensuring they know and understand your business as well as you do can help them determine what sort of funding is required – as well as when it is required – and seek out the best options for your business. Your advisors can prepare strategic reviews, examine the validity of forecasts and business plans, and carry out pre-lending reviews for banks and pre-investment reviews.

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Structured finance 10.2

Structuring the most efficient, cost-effective financing package can make all the difference between success and failure of a company, says ***Kevin Smith***

It is all too easy for the owners or management of smaller businesses to think that funding for their growing operations comes only in the form of equity or debt and that debt can only be in the form of a term loan or an overdraft.

This perception is often caused by the unimaginative approach of many banks and, sadly, many of the banks' small business advisors don't seem to know terribly much more than the businesses that they are meant to be advising.

The reality is, of course, rather different with a whole range of different products available from banks and other more specialized providers of funding. What is the perfect solution for one company may not work at all for a very similar company and structuring the most efficient, cost-effective financing package can make all the difference between success and failure of the company. This is particularly true for growing businesses and, at the very least, the wrong financing package can hamper growth.

In recent years obtaining debt funding from banks has become even more of a challenge although the availability of equity finance has in many ways remained the same.

Equity

There are many different types of equity. As well as 'normal' equity there can be different classes of shares with different voting rights, preference shares, which rank ahead of 'normal' equity in the payment of dividends, and many other variations on the theme.

It is also worth remembering that ownership of shares in a company and control of the company can easily be varied by using a shareholders' agreement so that ownership of the majority of shares does not necessarily translate into control. This structure is often used when equity is injected by a venture capital firm that only seeks to own a minority stake but needs to be able to exercise control in order to limit the risks on its investment.

Senior debt

All banks offer senior debt and many branches, in practice, *only* offer senior debt. This is debt that is backed by some form of security (often a first fixed and floating charge on the assets of the company) and ranks before almost every other creditor. The standard term loans and working capital or overdraft facilities invariably fall into this category. Over the last few years banks have virtually stopped all lending that is not very well secured on tangible assets, making it even more difficult for SMEs to raise funding.

Subordinated debt

Subordinated debt, as the name implies, ranks behind senior debt. This type of debt is often only available to larger companies and, as strange as it may seem, is often part of a package of debt that includes senior debt. Larger syndicated loans may offer both types of debt with the subordinated debt tranche paying a higher interest rate to reflect the higher risks being taken by the funder. Despite the fact that subordinated debt ranks behind senior debt it often has some form of security attached to it and so still ranks ahead of unsecured creditors.

Mezzanine finance

Mezzanine finance is a form of subordinated debt but is actually midway between debt and equity (hence the name mezzanine). It would typically be structured as debt but would have options, warrants, equity kickers or some similar structure to provide some of the potential upside normally enjoyed only by holders of equity. These may be linked to various performance criteria or events, such as flotation or takeover of the company. As with subordinated debt, the risks for the funder are higher so the cost of this type of finance is higher. Nevertheless, providers of mezzanine finance are prepared to accept levels of risk not acceptable with standard bank facilities.

Asset finance

Leasing is the most common form of asset finance. The major difference with asset finance is that it looks primarily to the value of the asset as security rather than to the strength of the balance sheet. This can be particularly useful for smaller companies with only limited balance sheets or for companies that operate in asset-intensive sectors. Leases can be either on balance sheet (finance leases) or off balance sheet (operating leases) and, depending on the equipment being leased, 100 per cent of the cost can be financed.

Factoring or invoice discounting is another form of asset finance as the lender looks towards the quality of the trade debtors and outstanding invoices as security rather than the balance sheet. Again, this can be useful for smaller companies, especially during periods of rapid growth as the facility advances a percentage of outstanding invoices (typically up to 80 per cent of eligible invoices) and as such is more flexible. The funding is also available more quickly than a bank overdraft facility, which looks back in time rather than forward and is far more reliant on the balance sheet. Because it is trade-related with pre-determined repayments of advances, higher gearing is possible than with a working capital overdraft facility.

However, in line with all lending post 'credit crunch', lenders have become more cautious and relative costs have increased.

Trade finance

The term 'trade finance' is normally applied to companies that are exporting, as financing trade within the same country can easily be achieved using general bank facilities.There are many different forms of trade finance (letters of credit, bills of exchange, forfaiting, tolling, pre-export, countertrade, project finance… to name just a few) and many of these can either be with or without recourse to the company seeking the facility.

Trade finance can be just as useful to small and large companies alike as not only is it a way of passing many of the risks on to a bank, but again it can often be done without particular reference to the size or strength of the company's own balance sheet.

Many foreign banks specialize in this type of finance and are more than happy to provide facilities alongside a company's other bank relationships.

Structured finance

Structured finance as a term is normally applied to large, complicated transactions where a whole range of different financing techniques are employed in order to put together a package that provides a workable solution that would not be possible using more conventional lending methods. However, the principal is just as valid for smaller companies.

By using a little more imagination and identifying the strengths of the growing business's financial structure it is possible to mitigate risks more effectively and by playing to these strengths it is possible to structure a financing package that is larger, more flexible and more cost-effective than traditional lending. Remember that as a company grows its funding requirements will increase and change over time, and a good relationship with flexible, enlightened funders will help to ensure that suitable funding keeps pace with the growing company. Finding such a funder (or indeed a combination of funders) is not necessarily easy but it will always be worth the effort.

As we have all experienced, in recent years high street banks in particular have been rather lacking in imagination, even for very solid companies, and this has impacted severely on many businesses. We can only hope that matters will improve shortly.

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Transforming the finance function

10.3

As you grow, how can your finance function add real value to your business? A report from Ana Barco at CIMA looks at the ways in which its role can change

Research and commentary over the past decade described a vision of finance as a function, rather than a physical presence, where transaction processing would be outsourced, specialist advisory teams would deal with areas such as tax and treasury leaving control functions delegated to the business and finance personnel adding value integrated into the operations of the business. But how far has this been achieved in practice? What lessons can be learned? And how can these help the growing company?

This chapter explores the following questions:

- How has the structuring of the finance function developed?
- Has the finance department disappeared?
- Should the finance function be a business partner?
- What is the future for the finance function within the growing company now?
- What does all this mean for the development of your finance function?

The story so far

> Traditionally, the finance function used to operate in an insular manner but in the last decade there has been a step-change in its role. Finance is now 'creating value' in its own right by shaping strategy and tactics. This is made possible by finance business partners who work alongside the business gaining tremendous insights into the business and using their finance skills to bring sharp commercial focus to operations.
>
> Sriram Kameshwar, Head of Knowledge Services, Prudential – India

For the growing company, the last 10 years have seen real change in the finance function, particularly in cost reduction and reduced headcount and often on the back of IT and improved systems and driven by globalization and highly competitive landscapes. But importantly, more companies are increasingly embedding the finance function operationally in the business, creating a holistic, collaborative environment in which the finance function moves towards actively supporting the organization's strategy, decision-making and operations: *business partnering*. Finance function changes can be seen as either motivated by the need for cost efficiency or the need for value creation and are generally geared either to the internal or the external environment. But which model should you adopt, or should it be a combination of both?

Revolution or evolution?

Organizational size, sector and location all affect the range and extent of finance function changes, but so too do the *drivers* of organizational change, such as:

- increased competition;
- advances in IT;
- increased risk and uncertainty;
- the impact of external reporting requirements and regulation;
- new markets;
- changes in top-level management;
- increased service demands.

But growing companies should perhaps consider an evolution rather than a revolution with regard to both the finance function – and their finance professionals – taking on business partnering roles and being integrated within the business. These roles are more closely aligned with finance function changes designed to improve value creation (focused on internal processes and products and services) than with cost efficiency (cost reduction and Business Process Re-engineering (BPR)).

The full service model

Business partnering activities generally complement rather than eliminate the traditional roles of the finance function itself. So in many businesses we usually see a full service model, in which the finance function is responsible for accounting processes and financial information as well as business advice and support. It is mainly in larger organizations that the shedding of traditional responsibilities is encountered more widely, facilitated by outsourcing and the use of shared service centres (finance function BPR). Abandoning traditional roles is not a necessary condition for adopting business partnering practices; however, BPR may release time and personnel for business partnering roles, but it is not necessarily a driver of change or the only way of implementing change. For example, improved systems with distributed inputting may free-up the time of finance professionals for other activities without resorting to outsourcing and the use of shared service centres.

Techniques for improvement

To achieve improving business support through business partnering activities, you do not need to disperse finance professionals throughout the business, nor do those professionals need to spend a large part of their time outside the finance department. Instead, the cross-functional collaboration that is essential in supporting the business can also be achieved through virtual communication and cross-functional projects and initiatives, which allow finance personnel to interact across departmental and geographic boundaries. Attachment of finance professionals to the finance function, regardless of where they physically sit, is now the predominant model and this does not inhibit collaboration. Even where finance professionals are part of the finance function, around half see their duties as supporting or most directly related to other parts of the organization.

Objectivity and tradition?

Limiting the degree of finance professionals' involvement and integration with the business may set a limit on the extent of business partnering activity, but there may be benefits, which appear to carry significant weight. Notably, having finance professionals accountable to the finance function helps to maintain their independence and objectivity – a quality often valued as much by non-finance personnel as those within the function. Limits on integration may also derive from some resistance to becoming more business-facing by individual finance professionals who are more comfortable within more traditional finance roles.

> Integrity, independence and objectivity are not negotiable for the finance professional and are the cornerstone of all finance roles. However, the business partnering role puts these values under stress, which is why such roles require maturity, strength of character and skill in dealing with business partners.
>
> Dominic P Moorhead, President, European Operations of Caris Life Sciences and ex CFO Hoffman LaRoche

So, consultant or business partner?

Although strategic/advisory activities and the business skills that support them largely define the business partner role, many more finance professionals see themselves as providing business advice acting as an internal consultant, rather than undertaking business partnering as such. The distinction between advisor and partner may lie in whether the finance professional takes a stake in or is jointly responsible for the operational and strategic decisions with which they are involved. Doing so represents a somewhat radical move away from the traditional role of the finance professional for all but those at the most senior level.

> I believe there is a benefit in progressing to true partnering. It is something I do see increasingly happening, however it is not part of the standard DNA of the finance department. This is currently outside the comfort zone of finance. We will see a much wider finance role, but the basis will always be the independent person with the proper financial background being a specialist on the finances, governance and compliance.
>
> Erik ter Horst, Vice President Finance, CFO EMEA and Latin America – BT Plc

It is perhaps a step too far for some finance professionals given that they may have been drawn originally to a role that was at most advisory, and also given the nature of historic professional education and training, and the potential effects of taking such a stake on their independence.

The importance of roles and skills

What is certain is that transformation has not led to the dearth of traditional finance roles; the finance function continues to provide a full service model with a wide range of roles. However, the changing interplay of skills and competencies is also certain. Finance professionals now require a mix of technical finance skills as well as commercial or business skills across all roles – albeit in different degrees. A 'front office' finance professional whose duties are business-facing in support of other operating units is likely to spend more time on activities associated with a strategic/advisory role and require a higher interpersonal and business skill set. The time spent on strategic/advisory activities increase when the front office individual's duties mainly relate to other parts of the organization, and it also increases in line with their seniority, reflecting the importance of the strategic/advisory role within the organization.

Ledgers to leaders: what are the real skills needed?

Finance professionals at all levels rate their business competency as being more important to their organizations than their technical competency, though the balance between the two competencies depends on the individual's role, duties and seniority, and on the size of their organizations. But, according to a recent consultation by CIMA, non-finance senior management continue to rate finance professionals' technical skills more highly than their business skills in terms of the value they add to the organization. Although organizations rate business competency very highly, technically competent people may hit the ground running, add value from day one, and can then be trained to gain more business and commercial skills.

But finance professionals require a mix of skills and competencies and while technical skills are a critical requirement at the recruitment stage for organizations, there is definite evidence of a shift in requirements for business and commercial acumen across all finance roles. This interplay of competencies is not restricted to organization-facing roles such as advisory or strategic roles, but is also in evidence across all role types, including in general accounting and the specialist technical ones such as treasury, tax and audit.

A leadership gene?

For the growing company, business skills become increasingly important as executives move from the duties with the lowest business orientation (general finance/accounting) to those with the greatest (where individuals see their work as directly relating to other functions/units). Similarly, business skills (as well as technical skills) are more important for the more senior finance roles, and are more comparable to the skill set required for senior non-finance personnel.

Training is critical. But often it seems finance staff are simply unaware of their employer's training offerings. It is very notable, however, that organizations with a higher degree of business partnering deliver more training and development support. Companies that want to follow this transformation and shift into business partnering roles in their value-creation journey need to evaluate the training and development policies and offerings carefully.

But when it comes to the recruitment of future leaders we see that finance professionals in strategic and advisory roles, alongside management accounting ones, demonstrate the mix of competencies that is associated with those identified for leadership development. Moreover it is these individuals who will be more attractive to organizations' leadership programmes and who are likely to be the finance leaders of the growing company of tomorrow.

So, finally, what's best for you?

If your growing company's finance function operates a full service model you are likely to retain a pronounced need for finance professionals who do not necessarily fulfil a direct business partnering role. Those who have not developed the requisite business skills, or whose strengths are primarily technical, are still vital to undertake activities within and outside the strategic advisory roles; in financial, management accounting, regulation and systems roles.

Even in performing these activities however, better business and communication skills would enable your finance professionals to improve their contribution to the organization. Professional qualifications are widely valued for the technical skills they deliver and, together with the personal characteristics of the finance professional, are the most critical requirements for organizations when recruiting for the finance function.

A sound knowledge of finance, including technical skills provides an excellent platform for a career in business, but it is clear that to make an impact in any role you need a broader palette of skills, not least in communication. Thankfully the

> days when finance staff were just seen as number crunchers are largely behind us but the quid pro quo for being taken seriously as business influencers is that you have to demonstrate that you can make a difference and to do that you need a number of different business skills.
>
> Steve Cresswell, EMEA CFO and COO, Jones Lang LaSalle

The evidence is that the roles undertaken by the finance function and its personnel have evolved away from the traditional information-provision model and towards a more business-oriented model. However, the change has not been revolutionary in that, for example, traditional structures such as the finance department persist and the vast majority of finance professionals still see themselves as part of the finance function.

Rates of change have varied across the range of organizations and there are constraints on how far many will travel down this path of further integration with the business. Notably, continuing the demand for the traditional services of the finance function indicates the need for a portfolio of skills and talents within the finance function, with an important continuing role for those finance professionals who do not seek to operate as partners integrated in the business. Those who develop as business partners or with greater collaboration with the business will help the finance function to better integrate its activities with and meet the needs of the organization shifting towards the creation of value. But the organization's business partnering vision will require management sensitivity to preserve the independence and objectivity of the finance function so vital to ensuring accurate and credible business planning and reporting.

This chapter is based on research by the CIMA Centre of Excellence at the University of Bath School of Management.

CIMA, the Chartered Institute of Management Accountants, is the world's leading and largest professional body of management accountants, with 172,000 members and students operating at the heart of business in 168 countries. Chartered Management Accountants have broad-ranging business and management skills to complement their financial training. They offer strategic and practical advice; make and support key decisions; and manage risk. CIMA develops high-quality professionals through a combination of skills, knowledge and the most relevant financial qualification for business – driving business success.

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