

Raising capital in a risk-averse world

As banks become increasingly risk-averse, raising capital for manufacturing operations may demand a new approach to financing. The good news is that alternative financing options are available. But how do you identify the right money source for you?

The first step is to determine the type of capital for which your company qualifies. While there are numerous funding structures, companies often find fiscal backing from eight key sources:

- **Angel investors.** These are typically high-net-worth individuals that provide seed capital informally for start-ups, if you're willing to assume a cost of capital between 25% and 40% or more.

- **Venture capital firms.** They provide financing to companies with solid growth prospects in exchange for an ownership interest. Your cost of capital will be 25%



CAPITAL IDEAS

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to 40% or more.

- **Private equity firms.** They invest equity capital in private companies in exchange for common or preferred shares structured as debt, with equity participation. This is a possible source if your company is contemplating an owner's retirement, management buyout, merger, acquisition, initial public offering or reverse buyout. Capital cost will probably be in the 20% to 30% range.

- **Mezzanine debt lenders.** They provide a hybrid form of debt equity in exchange for an ownership stake in the business. This is an option if you're willing to give up 5% to 15% of equity and looking for a lending term of 12% to 20% of four to seven years.

- **Subordinated or junior debt lenders.** They provide funding in exchange for an unsecured or lower-priority claim against assets or properties that are already financed by another lender. Your company should have proven debt serviceability and is looking for a lending term of four to seven years with a cost of 12% to 20 per cent.

- **Asset-based lenders.** Generally used by companies that are undercapitalized, unprofitable or in the process of a turnaround, these lenders provide secured loans against specific business assets. Structured as short- and

long-term debt or leases, asset-based lending includes sales and leasebacks, factoring and invoice discounting. Capital cost ranges from 8% to 25 per cent.

- **Vendors.** They are a source for companies with a strong performance record and are interested in financing an acquisition with favourable terms over two to five years. Capital cost ranges between 5% and 15 per cent.

- **Senior debt lenders.** They provide lines of credit, lease financing or short-term operating loans secured by receivables and inventory in exchange for priority repayment in the event of liquidation. They're used by companies that qualify for bank financing and are interested in prime and prime plus 2% on terms of up to five years.

Reduce risk

All funding sources will require information about your financial performance. Be prepared to share information related to your historic earnings, shareholders' equity, market share, historic rates of growth, return on capital invested and debt/equity ratios.

To reduce the risk of choosing the wrong form of financing, develop a strong business plan that outlines your financial history, intangible advantages and how the funds will support business objectives.

A solid reporting structure will provide potential lenders with the transparency they require to properly assess your company's financial performance. Assess the risks associated with different forms of financing by considering how much money is needed relative to the existing balance sheet, how long the money will be needed, whether or not you can pay back the funds in a debt-like manner.

Find out as much about the potential investors as possible by learning what other kinds of business they have supported, getting references and determining how involved they typically become in the day-to-day affairs of the companies they finance.

By stacking the odds in your favour, you can identify the ideal source of funding while mitigating the risks of making an uninformed choice.



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