Raising money for your company

This article introduces the different avenues a company can pursue to raise money. The two broad categories are equity and debt. The following few pages given an overview of these options.

Equity Financing

Stock typically takes the form of shares of either common stock (equity) or preferred stock. As a unit of ownership, common stock typically carries voting rights that can be exercised in corporate decisions. Equity investors invest to participate in the company’s future value.

Preferred stock differs from common stock in that it does not carry voting rights but is legally entitled to receive a certain level of dividend payments before any dividends can be issued to other shareholders. Convertible preferred stock is preferred stock that includes an option for the holder to convert the preferred shares into a fixed number of common shares, usually anytime after a predetermined date.

Listed Equity

Listed equity is that part of equity capital financing that is raised by issuing shares of a company in a public offering. It is a dominant source of raising capital in the early life of most corporations. The first time a public offering is made by the company, it is referred to as initial public offering (IPO). Subsequent issues to raise additional capital are referred to as secondary issues.

Private Equity

The term “private equity” comprises a range of techniques used to finance commercial ventures in ways that do not involve the use of publicly tradable instruments such as corporate stock or bonds. Typical forms of private equity include venture capital, growth and mezzanine capital, angel investing, and private equity funds. Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as an IPO or sale to a public company.

Private equity is an excellent way to raise capital and is one of the best ways to get a young company off the ground. If there is a unique product or service in an industry with a large market obtaining financing through private equity will be a fairly simple process.

Debt Financing

Debt is a major source of raising capital for companies. In basic terms, debt is a loan and is also referred to as leverage. Debt financing is generally considered to be an inexpensive source of capital for business, as the cost of debt is tax deductible, especially when compared to equity, which also involves giving up part of the ownership of the company. Debt financing can be short-term or long-term in nature.

Long Term Debt Financing is opted for acquiring assets like equipment, buildings or land. To ensure stability of a commercial borrower a substantial portion of the debt is in the form of long-term debt.
With long term debt financing, the scheduled repayment of the loan and the estimated useful life
of the assets extends over more than one year.
Short Term Debt Financing is sought to fund the day-to-day operations of the business, such as purchasing
inventory, supplies, or paying the wages of employees. Short term financing is referred to as an operating
loan or short term loan because scheduled repayment takes place in less than one year. A line of credit is
an example of short term debt financing.

**Bond offering**

A bond is a debt security, in which the authorized issuer owes the holders a debt and, depending
on the terms of the bond, is obliged to pay interest (the coupon) and/or to repay the principal at
a later date, termed maturity (bonds can mature anywhere between 1 to 30 years). On the
redemption date, bonds are usually redeemed at “par”, meaning the company pays back exactly
the face value of the bond. Most bonds also allow the bond issuer to redeem the bonds at any
time before the redemption date, usually at par but sometimes at a higher price. Bonds are
considered to be less risky than stocks, since the company has to pay off all its debts (including
bonds) before it handles its obligations to stockholders.

Corporate bonds often pay higher rates than government bonds, because they tend to be riskier.
Corporate bonds have a wide range of ratings and yields as they are determined by the financial
health of the issuers, which varies widely.

For corporations, issuing bonds is similar to making an IPO. A securities firm (BSP Capital) will help
set the terms and can underwrite the sale by buying up the issue. In underwriting, one or more
securities firms or banks, forming a syndicate, buy an entire issue of bonds from an issuer and re-sell
them to investors. The security firm takes the risk of being unable to sell on the issue to end investors.

**Components of a bond**

- **Par or face value** is the bond’s denomination and the amount returned to the investor upon maturity.
  Par is not the price of the bond. The price fluctuates throughout the lifetime of the bond. If the price
  is above par, the bond is selling at a premium. If the price is below par, the bond is selling at a
discount. Price is generally quoted in percentage of face value.

- **Coupon rate** (or just coupon) is the interest rate paid to bond holders as compensation for the loan.
  Coupon payments are generally made semi-annually unless otherwise stated.

- **Maturity** is the term of the bond’s life. Bonds range in maturity from three months to 100 years.
  On the maturity date, the bond’s face value is repaid to the investor and the interest payments stop.

- **Credit rating** is a reflection of a company’s credit worthiness. Corporations with poor credit
  record will incur higher financing costs than the ones with excellent credit records.

**The Relationship between Price and Yield**

Yield is the annual rate of return investors earn based on a bond’s coupon rate and its current
market price. When interest rates rise, the price of an existing bond falls because its coupon becomes
less attractive for potential investors. The opposite happens when interest rates fall. Hence, the
price of a bond and its yield have an inverse relationship.

**Call features**

Some bonds give the issuer, at its discretion, an option to redeem the bond (pay back the principal)
 prior to the maturity date. The bonds become callable when the situation is most beneficial for the
issuer. In general, bonds are called when market interest rates fall, allowing the corporation to issue
new bonds with a lower coupon rate. For taking on the risk of a possible call prior to maturity, investors are usually compensated with a potentially higher return at the time of purchase.

Advanced debt issues

Convertible debt
Convertible debt is a “hybrid” security with debt- and equity-like features which typically has a low coupon rate and the holder is compensated with the ability to convert the bond to common stock, usually at a substantial discount to the stock's market value.

Like any typical bond, convertible bonds have an issue size, issue date, maturity date, maturity value, face value and coupon. They also have the following additional features:

- Conversion price: The nominal price per share at which conversion takes place.
- Conversion ratio: The number of shares each convertible bond converts into. It may be expressed per bond or on a per centum (per 100) basis.
- Parity (Conversion) value: Equity price × Conversion ratio.
- Conversion premium: Represent the divergence of the market value of the convertible bond compared to that of the parity value.
- Call features: The ability of the issuer (on some bonds) to call a bond early for redemption, sometimes subject to certain share price performance. The intention is to encourage investors to convert early into equity (which has now become worth more than the bond’s face value).

Raising capital through ‘retail’ and ‘wholesale’ investors

Wholesale Investors are institutional investors such as super funds, hedge funds and other institutions. These investors are generally sophisticated, professional and have access to a whole world of investment opportunities that, traditionally, has been the exclusive preserve of wholesale investors.

There are some investment opportunities available for wholesale investors only such as:

- Pre-IPO Capital offers – to invest in leading companies prior to their IPO and often at discount to the IPO price
- IPO’s, Hybrid and Fixed Interest Securities – early access and guaranteed allocations
- Equity placements – short notice or “overnight” placements, often at a discount to the trading price.
- Structured investment products – sophisticated products unavailable to general investors
- Private Equity, Property syndicates and Hedge Funds – restricted funds managed by some of the world’s leading institutional fund managers.

Retail investor also known as an “individual investor” or “small investor” are investors who purchases securities for their own personal account rather than for an organization. Retail investors typically trade in much smaller amounts and exert less influence over corporate decisions than larger, institutional shareholders.

Retail vs Wholesale Investors

For a company looking to raise money, the distinction here is important. Generally speaking there is more work involved in raising money from retail investors. There is more paper work, tougher regulatory requirement and hence a greater cost. The advantage however is a broader distribution of your shares or investment product. For more detail on this speak with BSP Capital.
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| Listed Equity        | • Increased public awareness of the company because IPOs often generate publicity by making their products known to a new group of potential customers.  
                      | • Equity capital need not be repaid, unless a company is liquidated and can perpetually be used to grow the business.                                      | • Raising equity finance is demanding, costly and time consuming.                                                                                  |
| Financing            | • Retain maximum control over business as debt does not dilute the owner’s ownership interest in the company.                                     
                      | • The interest on debt financing is tax deductible  
                      | • The lender(s)/providers of debt do not share in profits.                                                                                      | • Unlike equity, debt must at some point be repaid.                                                                                               |
|                      | • The managerial decisions are shared neither with the creditors nor with the debts holders.                                                                 | • The larger a company’s debt-equity ratio, the more risky the company is considered by lenders and investors. Accordingly, the amount of debt a business can carry is linked to equity levels. |
|                      | • Raising debt capital is more economical.                                                                                                       | • Too much debt liabilities can spoil the credit rating of the organization.                                                                       |
|                      | • Except in the case of variable rate loans, principal and interest obligations are known amounts which can be forecasted and planned for.        | • Debt instruments often contain restrictions on the company’s activities, preventing management from pursuing alternative financing options and non-core business opportunities. |
|                      | • The company is not required to hold periodic meetings of lenders and seek the vote of debt holders before taking certain actions.               | • The company is usually required to pledge assets of the company to the lender as collateral, and owners of the company are in some cases required to personally guarantee repayment of the loan. |
| Private Equity       | • Shorter chain of ownership, with private equity investors taking an active role in the running of the company.                                 
                      | • Longer investment horizons  
                      | • Fewer reporting requirements.                                                                                                                   | • Conflicts of interest, because private equity partners involved in the running of companies may have different priorities from other investors in the private equity fund. |
|                      | • Ability to provide better incentives for managers.                                                                                             | • Shorter investment horizons, because the aim is usually to sell the company after a few years, rather than focusing on long-term growth.          |
|                      | • Greater ability to take quicker decisions and retain flexibility and pursue a long-term view.                                                      | • Lack of transparency, making them less accountable to the public and their workforces.                                                           |

All advice and education content is of the nature of general information only and neither purports nor intends to be advice specifically designed for you. No consideration has been given or will be given to the individual investment objectives, financial situation or needs of any particular person. The decision to invest or trade and the method selected is a personal decision and involves an inherent level of risk. Not all risks can be or will be explained in the material.