CORPORATE LIFE CYCLE

Mature Stage Funding

Companies in the stage of maturity benefit from a substantially lower level of business risk which justifies an increasingly leveraged balance sheet.

Also the maturity stage is not without business risk, such as potential aggressive (price) competition, possibly because of excess capacity, or that the sales growth dynamics is slower than originally anticipated. However, usually firms enter the maturity stage with a solid market share on the basis of previous investment and marketing activities which have been successfully implemented during the previous growth stage. Nevertheless, some key issues remain, such as: For how long can the company maintain its market share? How fast will the market eventually deteriorate?

With business risk substantially reduced, a firm can now assume a higher financial risk profile by increasing its degree of leverage: A strong cash flow enables the firm to service markedly higher levels of debt. And, financial institutions also feel comfortable that the firm has now plenty of assets available which can potentially be pledged to provide additional security to lenders.

The firm´s enhanced debt capacity opens an opportunity to approach new, additional sources of funding. These could potentially also increase the value of the company, as lower-cost funding should now be available. Therefore, one of the tasks of management in this stage will be to optimize the firm´s funding mix, the optimal mix of debt and equity, and implementing it. – Having said this, management teams are frequently cautious in this regards: Managements tend to favor strategic flexibility and therefore also tend to maintain more equity (and cash) in the firm than necessary, quasi as a cushion. And, this despite the fact that the firm already operates in a environment with significantly lower business risk. Such caution frequently leads to a firm being under-levered. And, as a consequence, this inefficient capital structure may attract – especially financial – acquirers and the firm could easily become an attractive takeover target.

In a mature stage, dividends can be paid full or at least increased handsomely compared to previous levels, as net cash flow will have turned healthily positive. This argument may be further supported by the fact, however, that there may now be fewer attractive growth opportunities. Consequently, this would also not any longer justify keeping a larger amount of cash on a firm´s balance sheet.

Lower growth prospects will be reflected in a lower price earnings ratio: This is not necessarily immediately reflected in a declining share price as this process kicks in only gradually. This is not least due to the fact that earnings per share may still increase slightly due to efficiency gains, somehow compensating a reduced price earnings multiple. Combined, the net result of these trends and forces should be a considerably more stable share price.

In this stage, shareholders are foremost focused on dividend yield, lesser on capital gains. Therefore, the shareholder composition may change once again, as growth investors give way to yield investors: It is only evident that managing this transition requires a clear communication strategy implemented vis-à-vis the firm´s investor base, outlining the altered market conditions and the position the firm is in.

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BUSINESS RISK	MEDIUM / LOW
FINANCIAL RISK	MEDIUM / HIGH
FUNDING INSTRUMENTS	DEBT HYBRID CAPITAL (EQUITY)
FUNDING SOURCES	PRIVATE CAPITAL MARKETS PUBLIC CAPITAL MARKETS
DIVIDENDS	HIGH

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