CORPORATE LIFE CYCLE

Declining Stage Funding

The only significant business risk of a declining company is the unknown length of the late stage which basically allows the firm a financial risk profile which can be high.

The core issue is therefore for how long it may make sense to allow the business continuing. It seems only rational that firms in this stage aim to reduce fixed costs as well as to avoid long-term financial commitments. As a matter of fact, firm management will rather focus on the short term: For example, any capital expenditure will – next to commonly used benchmarks – have to be assessed on the basis of its payback period rather than long-term focused cash flow methodologies.

The firm´s low business risk could technically be matched with a relatively high-financial risk source of funding: This means that there should be plenty of capacity for leverage. Now, the business as such – approaching decline – may not have significant funding requirements for its operations anymore. But, this debt capacity could be utilized, among others, to pay dividends even exceeding net profits, as long as sufficient retained earnings are available. - Payments may even exceed available cash in the balance sheet. In this case, such dividend payments could be funded simply by raising debt capital. – Technically, excess dividends hand back capital to shareholders and can be interpreted as redemption of equity. An alternative to this are of course share buybacks.

In the capital markets and from a valuation perspective, the negative growth prospects of the business will be reflected in a low price earnings ratio. The declining earnings momentum will also over time result in a declining share price. This dynamics can be mitigated through excessive dividends, though.

Usually debt funding is based on future expected cash flows and earnings parameters to ensure that interest and redemptions can be met. However, in the declining stage debt funding of a business will foremost focus on the realizable values of assets. This approach not only justifies lending at this stage, but also dramatically reduces the costs associated with a possible future financial distress of the firm. - Structuring the borrowings will be designed to enable lenders taking possession and realizing value of their respective security swiftly, especially under circumstances when the business no longer has an economically viable use for these assets.

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