Growth Stage Funding

As a firm grows, funding will still be foremost equity-related. In advanced stages of growth, though, as business risk decreases, a firm may gradually assume a somehow higher financial risk profile.

During its growth phase, a company is still carrying a high degree of business risk, despite the firm´s product or service already successfully launched. The key focus of the firm´s competitive strategy is now on marketing activities to ensure growth of sales as well as increasing market share. Therefore, a firm´s financial risk profile still has to be low, will be foremost supported by equity funding, with minimal dividend payments at best.

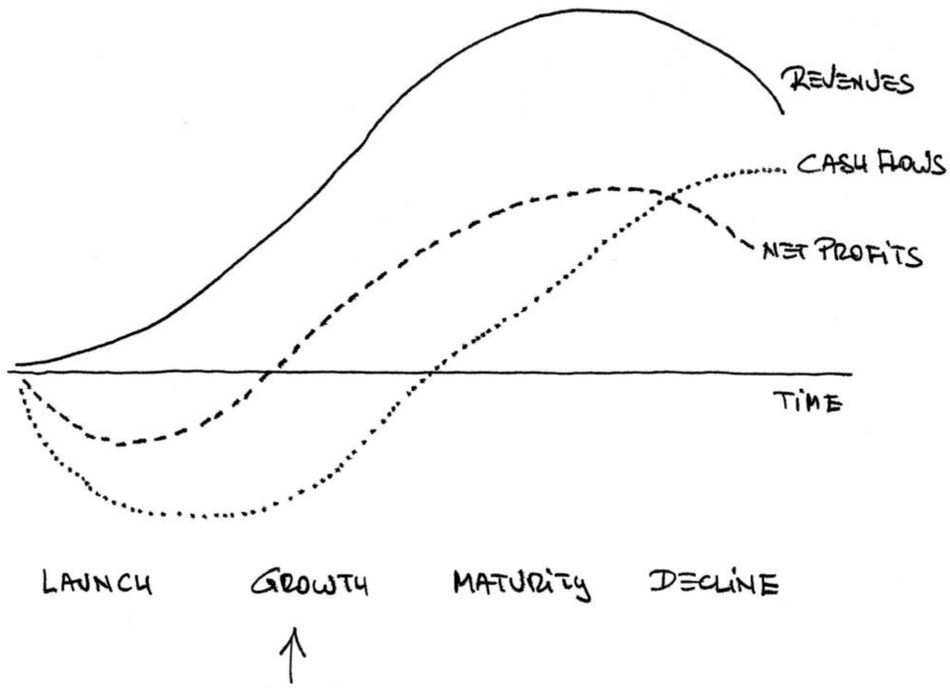
Among shareholders, one may observe a first shift towards investors with relatively lower return expectations than early-stage investors, such as venture capital funds. This shift may be facilitated through an Initial Public Offering (IPO) of shares on a stock exchange, provided the firm is IPO-fit. Alternatively, a private placement to a group of - primarily: private equity – investors may be considered.

Hence, some investors may want to seek an exit at a stage when the firm still requires substantial additional funding. This possible tension can be addressed by implementing a rights issue: Thereby current shareholders are given a first right of refusal to participate in a share capital increase to avoid dilution. However, current shareholders can also decide to waive their participation and sell their rights to new shareholders, with their respective stake diluted. To enable such rights issues, new shares would have to be issued at a slight discount to the fair or (if the firm is already listed) the market value of current shares. – As a matter of fact, the implementation of a rights issue is likely interpreted as a positive signal by the capital markets, as current shareholders (even if diluted) typically remain locked-up in their respective investment.

During the growth stage, cash generated will foremost be reinvested: This addresses not only funding requirements of a firm´s tangible and intangible asset base, but also of working capital expenditures or for covering potential losses. Hence, also in this phase equity investors will primarily be attracted by anticipated high levels of future growth, which eventually may materialize, or not.

Not least as high-growth businesses tend to be more affected by certain market events, such as adverse shocks, than more mature and established ones, earnings volatility will still be high: So, will also be such a firm´s cost of equity, with (relatively higher) level of volatility in finance terms expressed by a (relatively higher) beta factor. - And in valuation terms, a relatively higher market-related risk - expressed by beta - implies a relatively higher discount rate applied on future expected cash flows.

On the other hand, due to the firm´s profitability not yet having reached full potential, valuation parameters, such as multiples like the price earnings ratio, are likely to be high, as equity investors focus on current and anticipated further growth momentum of the share. This, in turn, can only be justified by substantial earnings growth driven – among others - by striving for a dominant market share in a rapidly growing market.



GROWTH STAGE

BUSINESS RISK	HIGH
FINANCIAL RISK	LOW - MEDIUM
FUNDING INSTRUMENTS	EQUITY HYBRID CAPITAL (DEBT)
FUNDING SOURCES	PRIVATE CAPITAL MARKETS (PUBLIC CAPITAL MARKETS)
DIVIDENDS	NO - LOW

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