Growth Stage Funding

As a firm grows, funding will continue to be foremost equity-related. In advanced stages of growth, though, as business risk decreases, a firm may gradually start assuming a slightly higher financial risk profile.

During its growth phase, a company still carries a high degree of business risk, despite its products or services already successfully launched. The key focus of a 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 will still have to be low and foremost supported by equity funding, with only minimal dividends payed, if at all.

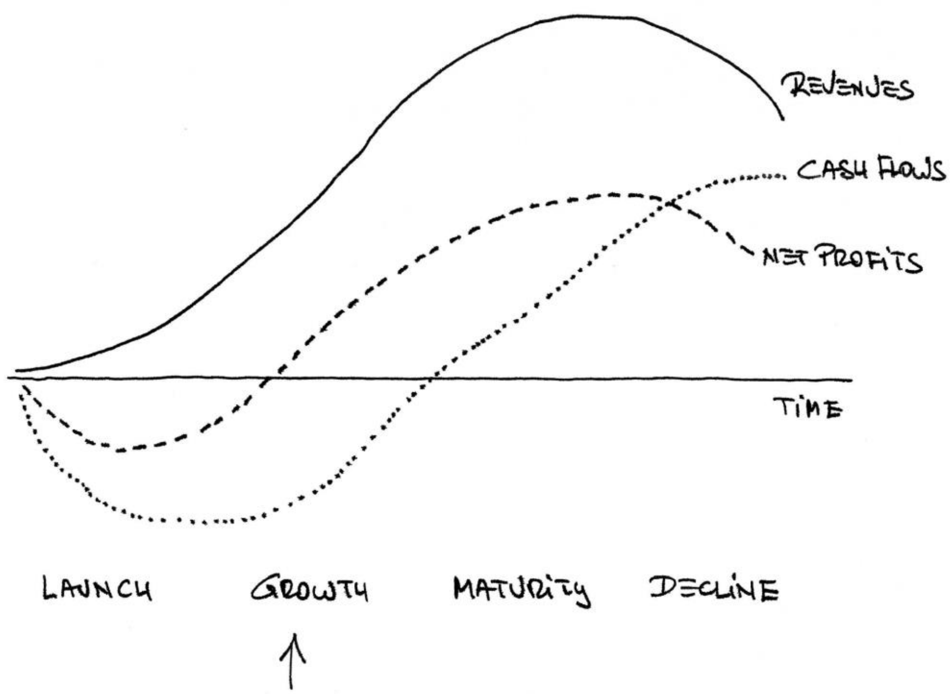
As far as a firm´s shareholder structure is concerned, one may observe a first shift towards investors with some relatively lower return expectations than that of early-stage investors, such as venture capital funds. This shift may be facilitated through an Initial Public Offering (IPO) of shares on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

Hence, some investors may want to seek an exit at a stage when the firm still requires substantial additional funding. That, however, may not always be welcome in attracting new investors who clearly prefer current shareholders remaining committed for a further while. This tension could be addressed by implementing a rights issue, for instance: Thereby current shareholders are given a first right of refusal to participate in a share capital increase to avoid dilution. However, they can also decide to waive their participation and sell their rights to new shareholders, with their respective stake diluted accordingly To enable a rights issue, new shares would have to be issued at a slight discount to the fair or (provided 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) often remain locked-up in their respective investment.

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

Not least as high-growth businesses tend to be affected significantly more by certain market events (e.g. adverse shocks) compared to more mature, established ones, earnings volatility will still be high: So, will also be a growth 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 to be applied on future expected cash flows.

On the other hand, due to the firm´s profitability not yet having reached its full potential, valuation parameters, such as multiples (e.g. 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 an above-average 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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