## Maturity Stage Funding

**Companies reaching their stage of maturity are associated with a substantially lower business risk, justifying an increasingly leveraged balance sheet.**

Even firms in midst their maturity stage are not without business risk, which may come from an aggressive (price) competition, perhaps due to excess capacities, or a sales growth momentum which is slower than originally anticipated. However, in an ideal case a firm enters its maturity stage with a commanding, solid market share: The result of having successfully implemented investment programs and marketing activities during the previous growth stage. Nevertheless, some key issues remain, such as: For how long will the company be able to maintain its market share? How fast will the market eventually deteriorate?

With business risk substantially reduced, a firm can now afford to assume a higher financial risk profile by increasing its leverage: Strong cash flows enable it to service significantly higher levels of debt. And, financial institutions feel more comfortable, too, not least as the firm, the debtor has now plenty of assets available which could be pledged as collateral.

Besides, the firm´s enhanced debt capacity opens the opportunity to approach new, additional sources of funding. These could contribute to increase the value of the company, as a wider range of lower-cost funding becomes available. Therefore, one of management´s main tasks in this stage should be its focus on optimizing a firm´s funding mix of debt and equity.

However, observations indicate that management teams are often cautious in this regards: Executives have a tendency to favor strategic flexibility. Therefore, more equity (as well as cash) may be kept than necessary, serving as cushion, despite the fact that the firm already operates in an environment of significantly reduced business risk. Such caution may lead to a firm interpreted by the capital markets as underleveraged. And, eventually, an inefficient capital structure could attract suitors, especially financial sponsors, with the firm all of a sudden becoming an attractive takeover target, not least due to its more or less significant debt capacity.

Having entered its mature stage, a firm can start paying dividends in full, at least increase them handsomely compared to previous levels, as net cash flow will have turned positive and expected to remain stable. This may also be due to the fact, though, that the number of attractive growth opportunities has meanwhile diminished. Consequently, holding larger amounts of cash on a firm´s balance sheet is difficult to justify any longer.

The combination of rich cash inflows, but lower growth prospects will also be reflected in a lower price earnings ratio, perhaps even followed by a gradually declining share price. Medium-term efficiency gains could moderate this trend, however. Combined, though, the net result of these forces are in most instances a considerably more robust and stable share price.

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

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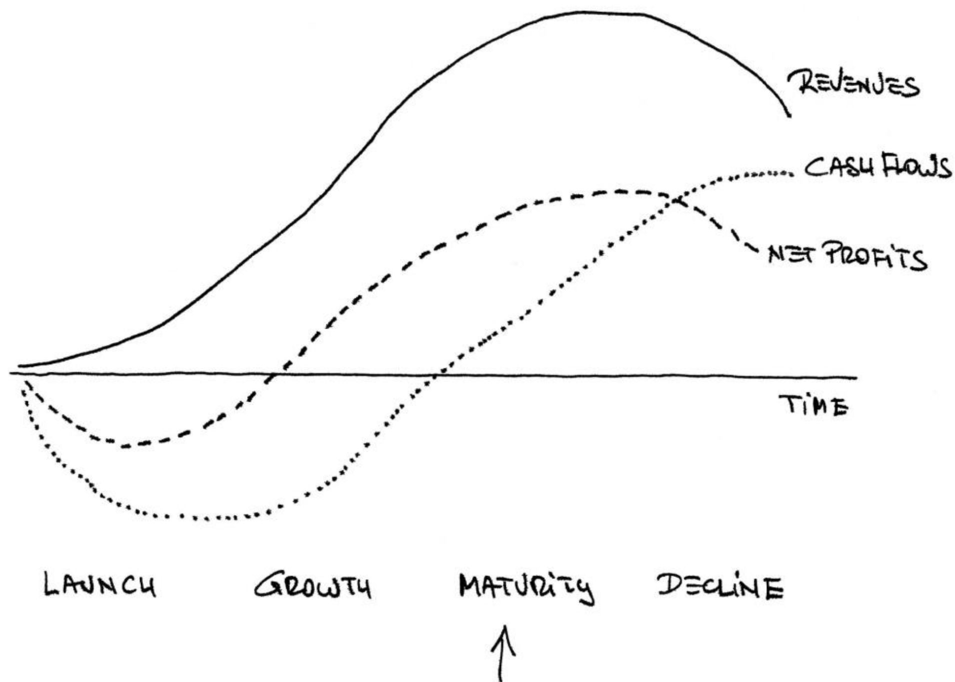
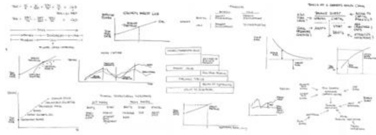



## MATURE STAGE

| | |
|---|---|
| BUSINESS RISK | LOW - MEDIUM |
| FINANCIAL RISK | MEDIUM - HIGH |
| FUNDING INSTRUMENTS | DEBT<br>HYBRID CAPITAL<br>(EQUITY) |
| FUNDING SOURCES | PRIVATE CAPITAL MARKETS<br>PUBLIC CAPITAL MARKETS |
| DIVIDENDS | HIGH |

**For more concepts click on:**



## Corporate Finance Concepts

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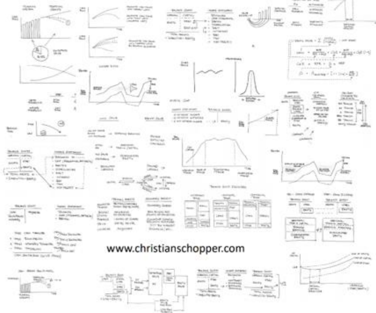


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