BusinessPlus+ Newsletter

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Looking for an External Business Investor? - Part 1

When it comes to growing your business, an external investor can be just the accelerant you need to scale with purpose. The right investor can not only provide much-needed funding, but they can also open doors to new talent and customers, offer strategic guidance, and support you through operational challenges.

For entrepreneurs who are already putting everything they've got into their business, raising investment capital can be a daunting and time-consuming process – fraught with missteps and hurdles that can slow your business down.

The best way to avoid these missteps is to know what to expect well before you begin to reach out to potential investors. Here is our guidance on how you can start your capital raising journey on the right foot.

Getting Yourself Ready

First, founders need to ensure they are ready for the process because capital raising is as much a psychological journey as it is a financial one.

By that, we mean it is critical for business owners to be clear on what they want to achieve from the raise and their long-term vision for their business. **It's important to take time to reflect and look further down the road – are you seeking external investment to maximise your short-term financial outcomes, or are you looking for a long-term partner who can help you take the business to the next level?** If it's the latter, a growth capital investor is a good option to explore.

In a similar vein, founders should also consider their future role in the business. Such as, how much involvement do you want moving forward? Are you still willing to remain involved in the business in a day-to-day management capacity, and if so, for how much longer? The answers to these questions may impact how much you need to raise, how much equity you're willing to offer in exchange, and the type of investment partner you should seek.

For example, if you're interested in retaining control of your business, you'll need to understand the impact of dilution and seek growth capital investors who only want to take a minority stake in your business and support you over the long haul. These investors provide influence and guidance – without taking over. Private equity funds, on the other hand, will generally be seeking to take control of the business and so may be better suited if you are looking to maximise immediate financial outcomes at the cost of control. You'll also want to consider the size of the cheques the investor typically writes, the industries in which they typically invest, and importantly, the ways in which the investor can support your business beyond cash. These are some of the reasons why it is important for founders to educate themselves on the various sources of capital available to them and the implications of these differences.

The best advice here is to talk to those who have been through it – including other entrepreneurs, business owners and investors. By understanding the pros and cons of capital raising and seeking out perspectives from those you can trust, you'll have fewer surprises – and less stress – along the journey.

Getting Your Business Ready

Once a founder is personally ready to begin the capital raising process, attention shifts to ensuring the business is ready to raise funds. **A key focus for this stage is being able to effectively articulate your business strategy – including your goals for the business and how you plan to get there.** Your strategy does not have to be a complex document or over-engineered pitch presentation; in fact, it can likely fit on one page.

A critical element of your strategy is communicating your financials and ensuring they can stand up to the rigours of external due diligence. You'll generally need to prepare a current balance sheet and profit & loss statements (P&L) for the previous two years, year-to-date, current year forecast and next year forecast. The P&L should be 'cleansed' or normalised to exclude any personal expenses but should also include a market rate salary for the owner operators. The financials are where most founders should and do end up spending most of their time and energy when preparing to raise capital because the numbers go straight to the value of the business – which is exactly what you'll be negotiating with investors.

The value of your business is based on the historical and forecast financial data, so any errors in your reporting can impact how much your business is worth and weaken your standing when it comes time to negotiate. A corporate finance advisor, auditor, or internal accountant can be a huge help in cleaning up the P&L, pre-empting any potential issues that might attract unwanted investor attention, and clarifying the true value of the business.

Operational readiness is another core focus for founders at this stage. It's all about the details, such as ensuring you have properly executed contracts and shareholder agreements, an accurate share register and ownership over your intellectual property, among other tasks. When you're preparing to raise capital, it's also an opportune time to consider cleaning up your share register. You can reduce complexity by buying out passive, difficult, or unsophisticated shareholders and in turn, cut down on the total number of investors to which you need to be accountable. A 'clean' cap table is generally more appealing to later stage investors as well.

Another point to remember is that while it may be easier to raise capital when the business is performing well, growth-focused investors do not want to see founders padding the numbers or investing too heavily in short term profits that aren't likely to translate to real growth over time. It's important to maintain the long-term view of your business while you manage your near-term priorities as best you can throughout the raise.

The reality is that raising capital can be a huge distraction to a founder, and while investors like the Australian Business Growth Fund (ABGF) move quickly (in as little as 8 weeks), the time between you starting to prepare for a raise and cash landing in your bank can stretch from nine to 12 months. You need executive support around you so that you can prioritise your time and energy. Again, it's worth considering a corporate advisor who can help you map out your raise strategy and provide additional counsel and oversight.

One of the most pressing issues for business owners is deciding how to finance their growth – specifically, when to borrow (debt funding) or when to raise (equity funding).

Potential Benefits of Equity-Based Growth Capital

While debt funding plays an important role in certain circumstances, it's likely many businesses will require a mix of both sources at some point to grow sustainably. Growth capital is particularly useful for entrepreneurs with a high-growth bias. While the process of raising external growth capital may be less familiar to some business owners, there are significant benefits in doing so – particularly with the right investor.

1. Move into the Fast Lane

As the saying goes, timing is everything. Business owners must act decisively to capitalise on new opportunities, maintain momentum and gain market share. Securing an injection of growth capital from a high-quality investor can be a game changer for any business.

At opportune times, external investment can enable you to move more quickly compared with 'bootstrapping' your business. With capital at your disposal, you could be better positioned to claim a first mover advantage and win new customers; enter a new geography or launch new products and services. For business owners looking down the road to their eventual exit strategy, securing growth capital (including when used in conjunction with other sources of funding) could help you achieve your goals even faster than you originally planned.

2. Open New Growth Possibilities

Running a business is a constant juggling act – you're either focused on getting more cash in the door or putting the cash you have to best use. And when the purse strings are tight, business owners often need to take a binary 'this or that' approach to spending. Raising capital enables business owners to expand their thinking and proactively invest in the areas most likely to drive exponential growth – freeing them from having to choose between multiple areas of equal importance.

Unlike other sources of funding, growth capital also provides businesses with more flexibility on where and how to spend their money – not just on typical capital expenditures, such as machinery or equipment, but also on operational costs, such as hiring staff or boosting marketing expenditures to drive sales.

3. Free Up Resources

Entrepreneurs need to wear many hats, especially in the early stages. However, as the business grows and becomes more complex, this becomes quickly sub-optimal. As a result, many business owners wait too long to hire the capabilities they need to continue growing. Soon enough, they are diverting most of their time and energy toward burdensome administrative tasks and away from other critical areas that energise and excite them.

Forward looking business owners utilise growth capital to make key hires. Bringing in leadership talent can supercharge critical growth areas and free up owners to delegate and focus on what they are best at and love doing most.

4. Access Additional Expertise

When an entrepreneur secures growth capital from a quality investor, they should be receiving much more than just a cheque. Active and experienced investors provide business owners with much-needed support – serving as a Sherpa on the journey by offering additional resources and advice and opening doors along the way.

Having access to external investors eases the burden of growing a business. They may participate on your company board, facilitate introductions to potential customers and talent networks, and assist in navigating strategic roadblocks, succession planning and operational challenges. This support enables businesses to not only avoid unnecessary mistakes but also maximise their valuations for future funding rounds or for an eventual sell-out.

Ambitious business owners and entrepreneurs always have one eye on the future. But whether you want to strengthen your team, ramp up sales and marketing, build out your capabilities or expand your operations, securing the right capital is an important step in making your vision a reality.

Growth funding is a type of equity funding designed to help businesses invest in growth opportunities that will enable them to scale. This guide provides an overview of growth capital explains how it differs from other types of equity funding and details how to decide whether it is right for your business.

So, What Is Growth Capital?

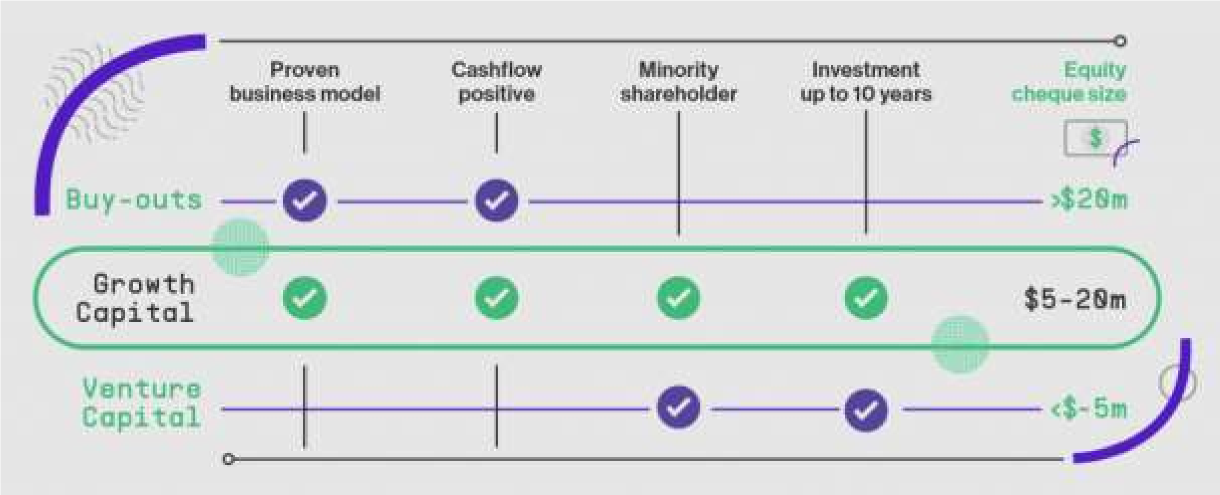
Growth capital is designed to support businesses with a demonstrated track record of commercial success in furthering their growth aspirations. Like other forms of equity-based funding, investors provide growth capital in exchange for an equity stake in the business. Some investors are providers of minority equity investment – this means they make investments in exchange for less than a 50% equity stake in a business. A minority investment with the right funding partner enables the existing shareholders to retain control and steer the business in the direction they want.

How Does Growth Capital Compare to Other Types Of Funding?

True growth capital fills the gap between other forms of equity-based funding, such as venture capital (VC) and buyout funds.

The VC market has been growing steadily in Australia over the last decade – with companies such as Canva and Airwallex shooting to 'unicorn' status in just a few years. Both VC and growth capital focus on backing high-potential entrepreneurs and businesses, but there are a few key differences.

First, growth capital is typically provided to established companies with a proven business model. From a profitability standpoint, the business would have often hit breakeven or already have positive operating cashflow and **can demonstrate a strong commercial ability to scale and grow profitably in the future**. Investments are always risky, but in growth capital investments, the risk is typically centred on the management team's ability to execute a clear strategy and navigate the challenges related to scaling their operations into new product categories or markets.



By comparison, companies that are more suited to VC funding tend to be earlier in their journey – such as start-ups. VC firms and angel investors may be the first to back the company aside from the founders themselves – and these investors are attracted to the business's 'hockey stick' growth potential. With that potential, however, comes significantly more risk, as the businesses may be pre-revenue and may not yet have a commercially viable version of their product. Instead of focusing on profitability, early-stage investors back investee companies in raising additional rounds of capital – often supporting a negative cashflow in the business as it continues to grow and scale.

As with growth capital investment, VC investors are typically minority investors, which incentivise the founders they're supporting to stay with the business as it grows. **VC investments tend to be smaller than growth capital investments (often less than $5 million for early rounds compared to upwards of $10-$20 million with growth capital), and due to the early nature of the investment there is an expectation that a longer investment horizon is required until an 'exit' can be made (between 5 to 10+ years).**

Business funding may also come in the form of a buyout from a larger private or listed company (often called a "strategic buyer") or from a private equity fund. This capital is quite distinct from growth funding in that the capital is typically used to buy out existing shareholders – that is, existing shares are sold from an existing shareholder to a new shareholder and no new shares are issued in the business. This is different to growth equity where new, additional shares are issued to the new investors and the capital raised typically remains within the business itself. Buyout funds typically seek out larger investment amounts (anywhere from the tens of millions to more than $1 billion for larger funds), with an expectation of a shorter investment horizon (between 3 to 5 years).

Another characteristic of buyout funding is that investors in this category are typically looking for a controlling stake in their investee companies – which may not align with the goals of business owners who are seeking to retain control of their company. With minority investment growth capital, founders stay in control and can leverage the incoming capital to maximise the value of their business before they decide to sell down completely.

It's More than Money

Few business owners or entrepreneurs would claim they have all the connections, support, and advice they need to succeed. That's why, regardless of the specific funding source, there is inherent value in securing capital for your business that provides more than just a cheque.

With an investor that provides 'patient' growth capital and is committed to supporting the long-term future of your business, such as over a 5-to-10-year period, you have a partner that is signalling they will continue to support the business through short-term market upheaval. They become a collaborative, long-term shareholder who is strongly aligned to the goals and values of your business.

That is why active minority investors often provide significant added value to their investee companies. In some cases, support can include participating on the board, facilitating introductions to potential customers and talent networks, and assisting business leaders in navigating strategic roadblocks, succession planning and operational expertise.

It's key for business owners to be clear about the type of support an investor is committed to provide and how it can work to support the overall business strategy.

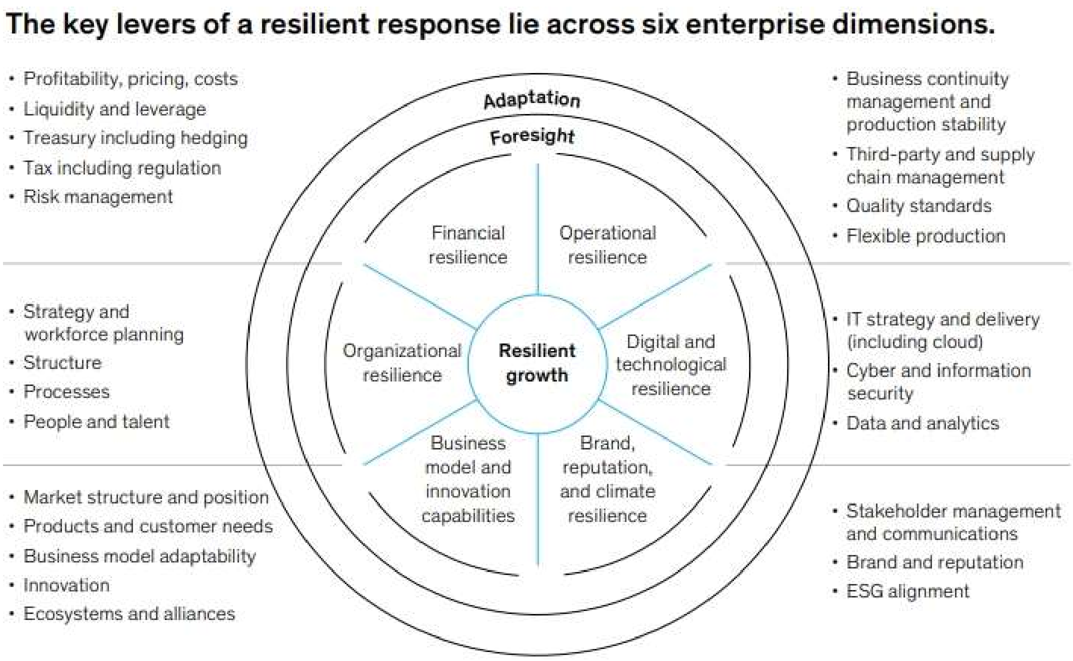
Is Your Business Ready For Growth Capital?

For certain businesses, growth capital is the ideal type of funding to take them to the next level. So how do you know if it's right for your business? A few indicators that a business is suitable for growth capital include:

- **A stable financial position** – Businesses that have had a consistent cashflow and are at break-even or profitable are good candidates for growth capital investment.
- **A track record of growth** – If you can demonstrate consistent growth since inception of your business, growth capital investors are likely to identify you as a high-potential company.
- **A unique value proposition** – Investors look for businesses that can demonstrate a clear competitive advantage over their competitors or businesses with solutions addressing clear gaps in their chosen markets.
- **A solid plan for future growth** – Equally important for businesses looking to secure growth capital is a coherent roadmap for growth, backed up by robust financial forecasts.

Timing is also an important factor. The best time to reach out for investment is well before it is strictly 'necessary' to raise funds. Growth capital investors don't offer 'rescue capital' and are less likely to invest in a business that is experiencing cashflow distress. Business owners should be proactively thinking about their capital needs, particularly while you have the time and headspace to make considered decisions in the best interests of your business.

A growth capital investor will in essence be only seeking to be involved with a strong, growing and resilient business as shown in the six dimensions of an enterprise below.



Additional Resources

To be eligible to apply for funding from the Australian Business Growth Fund, your business will fundamentally need to be demonstrate the following:

- ***Australian based headquarters.***
- ***Business turnover between $2M and $100M per annum.***
- ***At least three years of continuously profitable historical business operations.***
- ***A clear business growth strategy.***

If you are interested in obtaining more information about the Australian Business Growth Fund, please go to their website - www.abgf.com.au