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The capital challenge

Raising capital for your business is challenging at the best of times. In the current market it may be near impossible. What will make it even harder is if you haven't thought through the proposition from the investor's point of view.

Many business owners take the view that they are doing investors a favour by giving them the opportunity to invest in their fabulous product/business/idea. And their quest for capital degenerates from there on in.

There are lots of reasons why you might want to raise capital.

It might be to manage short term cashflows.

It might be to grow your business, either by acquiring other businesses, investing in new plant and equipment, or entering new markets.

Or you might be thinking about selling up and capturing the value you've built up over time.

Each of these requires a different approach and different type of investors. Regardless of the purpose of the capital and who you plan to approach, one thing is for sure – you need to convince them of the good investment opportunity!

Remember, a potential investor is not just looking at the upside, they're also looking at all the reasons the investment opportunity doesn't stack up. So what do you need to convince a new investor of? Simplistically, these are:

- **The potential of the business opportunity.**
Your plan needs to convince investors that an opportunity exists and also show how it will be achieved using solid financial projections. Remember they are looking for reasons not to invest, so you also need to identify risks and barriers and how these will be overcome.
- **The financial soundness of the business.**
Unless you are a start-up, you need a full financial history of the business, including current balance sheet position. The more complete, the better sense of the fortunes of the business to date and its major drivers.
- **The capability and know-how retained within the business.**
Investors want to understand the core capability and know-how which has taken your business this far, and if it will remain there. This will be a combination of people, systems and processes, unique IP and brand.
- **Sound governance arrangements.**
If you want to attract third party capital for growth, expect to have to put in place independent governance structures.
Don't expect to raise capital if you can't respond to these fundamentals.
The next question is who to approach?

Depending on your goals for the business, there are three broad types of investors:

- 1) **Debt** is something most business owners prefer. Essentially debt brings in money only. You retain control of the business and carry all the risk as well as the benefits. Banks are the obvious source if you can convince them. Other sources may be investors or lenders who know you and your business well.
- 2) **New Equity** is an option if you are starting or growing a business. The good news is that there is a range of investors interested in investing in businesses which have growth potential.
Angel investing is a growing investment class which invests around \$50 million a year in Kiwi businesses. Angel investors are typically ex-entrepreneurs and successful business people who provide capital and, often, expertise and guidance to early stage businesses which can't source traditional sources of business funding. (See www.angelassociation.co.nz for more information.) Angels will invest up to \$1 million. Above that, and you're looking to small private equity fund managers, or strategic investors.
Strategic investors – those who are natural acquirers of your business, or would have an interest in a strategic partnership that will benefit your business and theirs – are another potential source of new equity. For example, a New Zealand IT company, NextWindow, was bought this year by a Canadian company which wanted to access NextWindow's unique IP for its own product line.
- 3) **Replacement Equity** through selling either a share or all of your business can release capital to retiring shareholders, or bring in a different set of skills. The best match of investor will depend on what you hope to achieve in the business.

If it is a small "family style" business and you are looking for your successor to take over its day-to-day running, then the biggest challenge is how to structure their buy-in. Those with the know-how don't always have the money available up front. Be prepared to be patient, focusing on choosing the right successor. If necessary, work out a plan for gradual payment of capital over a transition period. While you might prefer an outright sale, it may not be realistic in the current market.

A final word – if you are paying a broker or advisor to help you find an investor or buyer for your business, make sure they have taken the time to understand your business both now and in the future and they can offer you options for raising capital and how they might assist.