

Corporate finance...is it black magic?

Management issue paper

Obtaining financing for a small or medium-sized enterprise (SME) can be an experience filled with anxiety and frustration. Yet most lenders and investors state there is no lack of money available for deserving companies.

This suggests there are some underlying complications in SME financing. In fact, many financing applications suffer from a communication gap between the SME and the intended source of capital.

From raw material to finished goods

Financial statements are just one piece of the information puzzle. From the lender's or investor's perspective, the statements are historical raw material and are only the beginning of the process to arrive at finished goods, i.e., approved financing. The approval process involves studying a range of information that goes well beyond financial statements.

Lenders and investors get repaid in the future. Accordingly, they not only want a thorough understanding of the company's past, they also want well-defined plans and strategies concerning the company's future. Most entrepreneurs have an intuitive

understanding of how their business works and where it's going. However, it is common that only part of this understanding, including thoughts about the future, has been conveyed to the lender. SMEs seeking financing should provide comprehensive information about both the company's past and its future. A structured approach that demonstrates why the financing is required and how it will be repaid improves the prospects of obtaining the requested financing.

What is the current situation?

Has the company's financial situation been changing? What does this mean for the future? A thorough review of the history and present status, financial and non-financial, is essential. A summary of this review and its conclusions should be included in the information presented to potential lenders or investors. Any proposed initiatives must be consistent with the SME's capabilities and with its plans and strategies for the future.

Where does the SME want to go?

A well-defined plan for the SME and the owner is a prerequisite for determining the necessary financing. A quick-fix loan in the absence of such a plan could be counter-

productive. Once the plan and financing needs are defined, financial projections should be prepared and presented as part of the financing application.

Mix and match

Assets should be matched with appropriate financing. For example, long-term debt rather than an operating line should be arranged for acquiring capital assets.

If material growth in sales is expected, venture capital might be appropriate to provide the necessary working capital for growth and the appropriate equity base to comply with debt/equity covenants imposed by the existing lenders. Generally, equity is the most expensive source of funding but if the potential is significant, venture funding may be worth the higher cost.

Application

In order to avoid having all your eggs in one basket, it is good practice to approach more than one source of financing. As with other materials or supplies used in running a business, it is simply prudent to have access to a number of financial sources.

If there is more than one positive reply, then there is the luxury of doing some comparison shopping. There may be differing risk appetites, and perhaps only one "yes." Concurrent applications will save time.

In determining which lenders and investors to approach, consider factors such as business sector, nature of assets being purchased, and the term and security for the financing. For example, a term lender would have little interest in making a one-year loan secured by an export receivable.

Potential sources for financing would include: trade creditors and suppliers; domestic and schedule B banks; factoring companies; export financing specialists; leasing companies; government and quasi-government development agencies; term lenders; life insurance companies; mezzanine debt/venture capital firms; "angels;" personal and family investment, and an initial public share offering.

Conclusion

Many SMEs fail to close the communication gap with suppliers of capital. The more comprehensive and structured the application package and the more focused the process of selecting possible sources, the less likely you will find you are relying on black magic to obtain the financing you need. An important step in improving your application is to obtain professional assistance. Grant Thornton LLP has highly qualified professionals who can help your firm determine the appropriate financing, organize the information package, and approach the right sources of capital.

Documenting your application

The financing application should be professional and comprehensive. It should include:

- 1 An executive summary.
- 2 A specific definition of your financing request.
- 3 A description of the company's plans.
- 4 A marketing review.

- 5 A brief history of the business.
- 6 Information about your production costs, process and sources.
- 7 Information about fixed assets, such as their adequacy for operations, market values, environmental status and availability as security.
- 8 Proprietary assets/knowledge and patents.
- 9 A listing of professional advisers.
- 10 Financial statements, forecasts and assumptions, and ratio-related financial analysis.

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