



Building an Effective Business Case: The Example of Corporate Fund Raising

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Definition

- A Business Case...

...forms the foundation of any proposal venture or project. It establishes the need, justification and proposed alternatives to resolving a business issue or strategic objectives. Business Cases are generally designed to answer the question: what will be **the financial consequences if we choose X or Y?** It is therefore a **tool** that supports planning and decision making; **of it depends the credibility of the project.**

Business Cases are shaped significantly by the identity and needs of the intended audience. In the context of corporate fund raising the Business Case has **to provide evidence** that the project is **a good investment.**

What it is not: a Business Case is not a budget, nor a management accounting report and not a financial reporting statement.



Contents

Definition	2
Building a Business Case for Corporate Fund Raising	4
Supporting the Business Case	6
Structuring the Business Case	8
Tell a Tale of Value	8
Tell a Tale of Return	9
Business Plan & Model	11
Non Financial Items	17
Effectiveness	19



Building a Business Case for Corporate Fund Raising (1/2)

- Which Transaction? -> an Investment, e.g. an “item of value purchased for income or capital appreciation”.

- Offer of Equity and/or Equity-linked instruments (e.g. rights issue, convertible bonds issue, etc.) against « New Money Injection »...

- ...for a start-up project, a business expansion, a corporate restructuring (debt equity swap, privatization, etc.), a buy out (acquisition, management buy out, leveraged buy out, etc.)

Transaction: An agreement between a buyer and a seller to exchange an asset for payment.

Equity: Ownership interest in a corporation in the form of common stock or preferred stock. It is the risk-bearing part of the company's capital and contrasts with debt which is usually secured and has priority over shareholders if the company becomes insolvent and its assets are distributed.

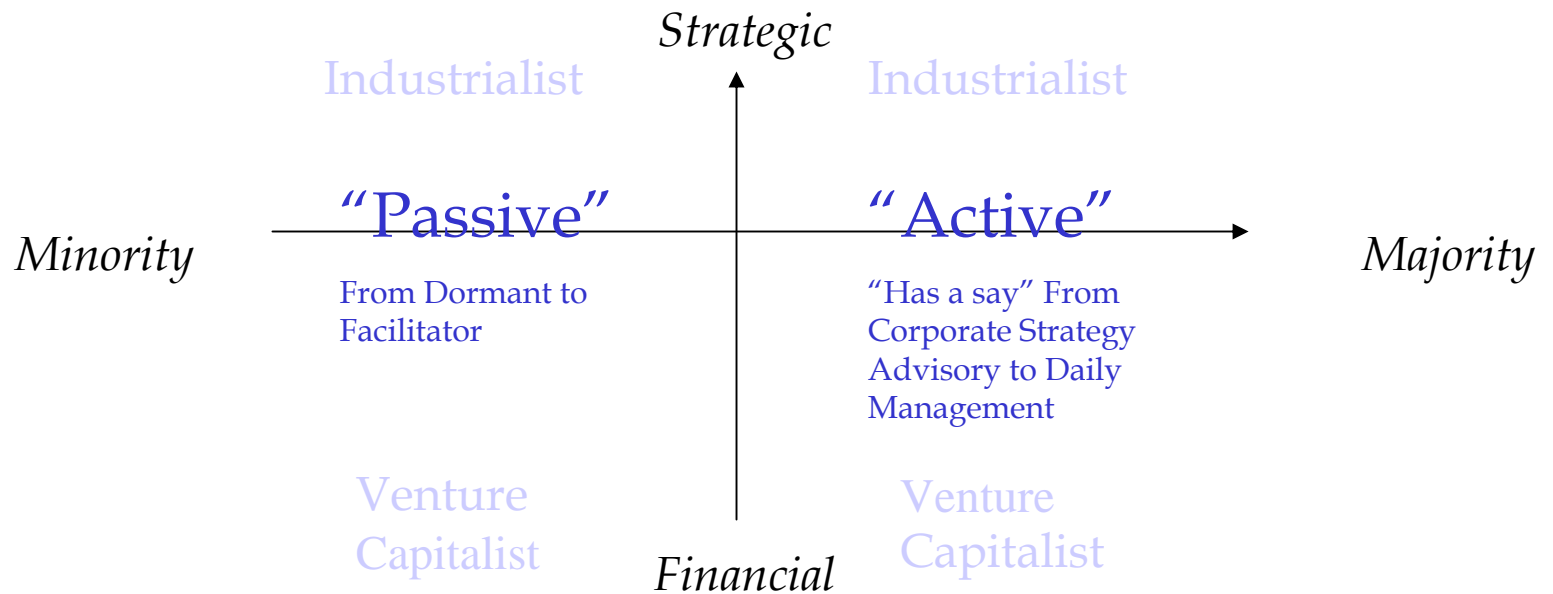
*Equity-linked instruments: “Ownership interest **to be ...**” (e.g. Convertible bonds, warrants)*

Buy-out: The purchase of controlling interest in one corporation by another corporation, in order to take over assets and/or operations



Building a Business Case for Corporate Fund Raising (2/2)

- Which Investors?



*Majority = Controlling Interest: Ownership of more than 50% of a company's **voting** stock - or somewhat less, if the remaining ownership is sufficiently spread out.*



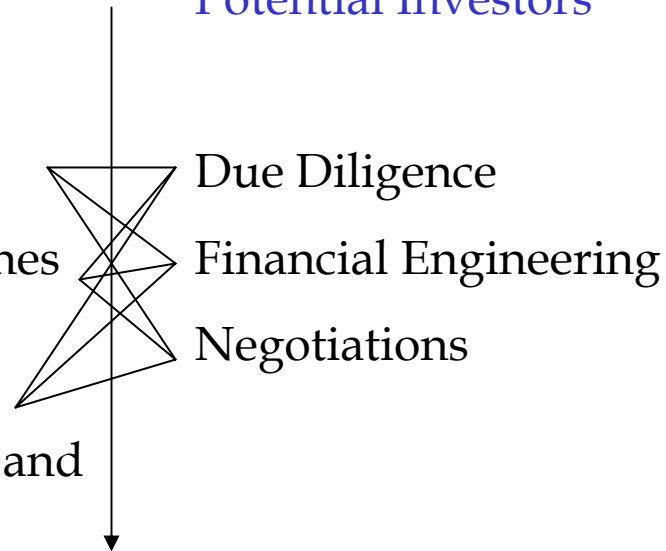
Supporting the Business Case (1/2)

- Process

Company's Existing Shareholders

Potential Investors

- Offer: Terms of the Transaction
- Valuation: "pre-money" i.e. Determines the Price of Equity for Investors
- Business Case: Description of the investment, in financial, non-financial and "opportunity of investment" terms



Closing

Opportunity of Investment -> Opportunity Cost: is the rate of return expected if an alternative course of action were taken. The opportunity cost of investing in, say, a new business computer, could be the interest that would have been earned had the computer's purchase price been used to purchase high grade bonds, instead. Opportunity cost, in a nutshell, is the effective "cost" to a company resulting from the unrealized revenues of an opportunity or action forgone.



Supporting the Business Case (2/2)

- Documentation

- Classic Procedure for listed and non listed companies: Info Memorandum (*Word*) and Business Model (*Excel*) – *selected inside information for due-diligence purposes (may be completed by other documentation such as: Market Research, Feasibility Study, Prototype Analysis, etc.)*
- Other procedures: “auction” -> restricted access to documentation, limited time.
- Public companies – *other miscellaneous public information (brokers’ reports, press articles, Forms, Audited accounts, etc.)*

Due Diligence: The process of investigation, performed by investors, into the details of a potential investment, such as an examination of operations and management and the verification of material facts.

Inside information: Material information about a company which is known by the company's Board of Directors, management, and/or employees but not by the public. In the case of listed companies, when this information is released it will have an impact on the company's stock price.



Structuring the Business Case: Tell a Tale of Value

- “Opportunity of Investment” Terms

- Paradigm 1: “Within 3 years this company will become a leader on its market” e.g. an expected future “star” as per the BCG matrix (*)

-> highlight the comparative advantage

Sector, Products/Services, Competitors
Position of the company in its market
Profitability
Expansion
Team (capabilities and vision)

BCG Growth-Share Matrix

		Relative Market share (cash generation)	
Market growth rate (cash usage)	Star	?	
	Cash Cow	Dog	

(*)The matrix has been designed to show various business units of a same entity. Here we consider the company’s business versus the entire marketplace.

-> identify and discuss the value drivers

Comparative Advantage: The name for the ability of one business entity to engage in production at a lower opportunity cost than another entity ≠ absolute advantage (The name for the ability of one entity to engage in more efficient production than another entity. Assuming equal inputs, the entity with an absolute advantage will have a greater output).

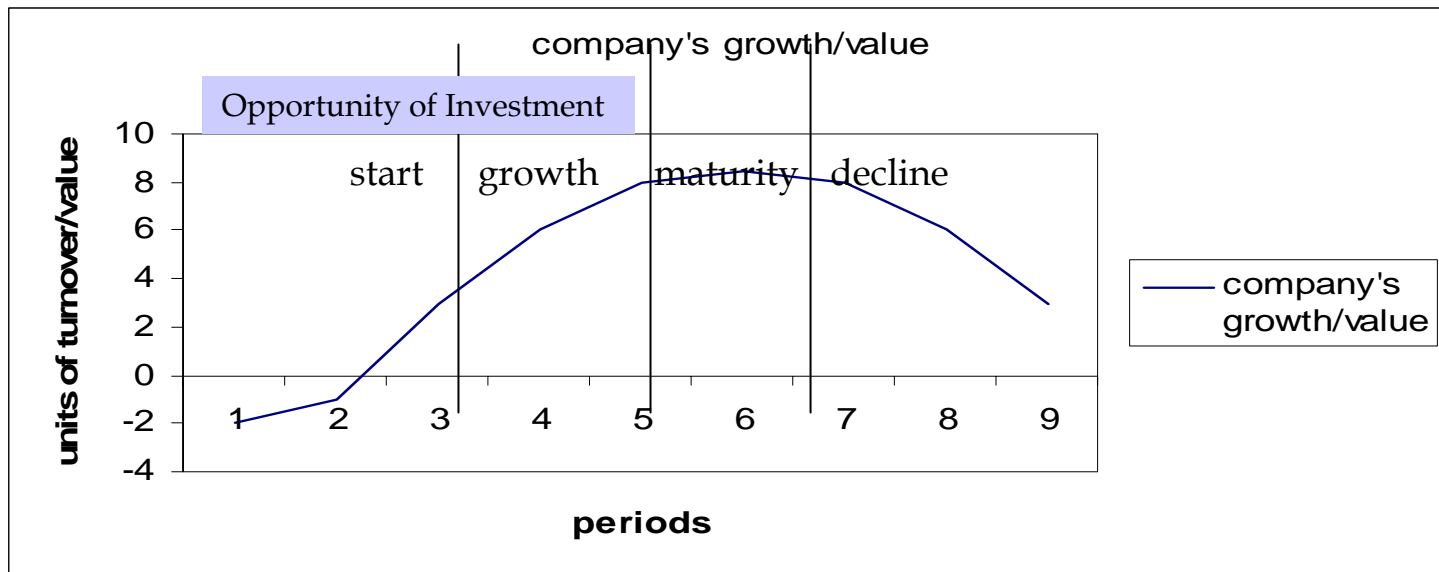
Driver: An aspect of a business that effects a change on another aspect of the business. A driver is most commonly a factor that contributes to the growth of a particular business.



Structuring the Business Case: Tell a Tale of Return

- “Opportunity of Investment” Terms

-Paradigm 2: “It is the right time for you to invest” e.g. Opportunity Cost for the Investor investing in *This* company at its present growth stage.



*Opportunity Cost: In our context the opportunity cost of an investment is **the cost of capital**, i.e. the rate of return that a company would otherwise be able to earn at the same risk level as the investment that has been selected.*



Tell a Tale of Value & Return

- *Rationale of an Offer to Investors*

- Example (Executive Summary):

It is offered to potential investors to invest part or 100% of a minimum of USD [...] against common stock of a holding company owning 100% of the shares of X, through a rights issue. *[description of offer]*

X is a start-up business involved in *[description of activities]*

Under current assumptions (base case) X's valuation for Investors is USD [...]. Post-investment, investors will own about [...] % of X's common stock. Expected returns are close or above [...] % for an exit on the 4th to 6th year of ownership of shares. Exit would be realized through *[description]* taking place in Year [...].

The criteria in favor to such an investment are: *[rationale, including quality of management]*

The main risk is associated to *[description]*. However we are confident that [...]

Return: several metrics may be used to measure the "Return" (ROI, Payback period, etc.). Corporate Investors prefer the Internal Rate of Return (IRR) which takes into account the future cash-inflows and cash-outflows as well as the passage of time. The IRR for an investment is the discount rate for which the total present value of future (net) cash flows equals the cost of investment. (or an interest rate for NPV=0)



Structuring the Business Case: Business Plan & Model (1/2)

-Financial Terms: Scenarios & Metrics

- Business Plan: **reflects ONE (best) scenario of corporate strategy**
- Business Model: is the **centerpiece** of the business case; and a **tool** allowing
 - the **financial translation of this scenario**
 - the **sensitivity analyses on key assumptions** (variables & parameters)
- Dynamics of a Business Model
 - > Business forecasts (volume & price of sales) determine expenses and capital expenditure
 - > PL, BP, **CF** determine **cash requirements**
 - > Amount of funding required from Investors
 - > Terms of the Transaction: Valuation, Financial Engineering, Expected Rates of Returns

Key assumptions: a selection of Variables and Parameters. Variables = Reflect the value drivers of the business - Parameters: economic, tax rate, etc.

Sensitivity Analysis: Asks "what happens if the assumptions change?" e.g. Investigation into how projected performance/cash-flows/funding requirements/company's value varies along with changes in the key assumptions on which the projections are based.



Business Plan: reflecting one scenario

- *Typical Contents of an Info-Memo for Corporate Fund Raising*
- Example:
 - Executive Summary
 - Market Opportunity
 - Company Presentation
 - Strategy
 - Go to Market
 - 5 Year Financial Projection
 - Offer and Risk Assessment
 - Annexes and Appendices



Structuring the Business Case: Business Plan & Model (2/2)

- Financial Terms: Major Issues

- **Modeling structure**, reflecting the **scenario design**: Revenues structure, constitution of cash-flows and cash (cost model)
- Revenues forecasts
- Selection of Key Assumptions (Variables and Parameters) in a view of sensitivity analyses
- Basic calculation issues: approximations due to lack of adequate information may lead to significant errors. (Assess and check the margin of error !)

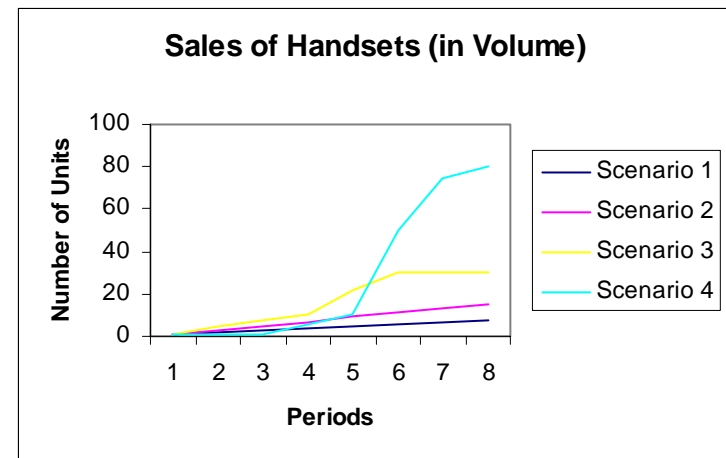


Revenues Forecasts and Modeling Structure

- *Revenues Forecasts*: The modeling of the Revenues Forecasts deals with the simple (?) business question: which are the components of my revenues, how do they increment?
- *Modeling Structure*: A financial model gives a representation of a (future) business, after one selected scenario design. During the sensitivity analyses, several changes of key variables (or assumptions) are performed so that **the behavior** of CF statements, Cash requirements can be exhibited. The modeling structure is the **design of the relationship** between the key variables. This design must be tested several times within a recurring process, in order to avoid absurd outcomes.

Story (step 1): modeling revenues forecasts for mobile phones in Bihar, one of the poorest Indian states, during the first round of licensing -> no historical data -> should we compare with other countries, make analogies with the ownership of cars, etc. ? Will people buy a phone after they have been able to afford a car ? Before ?

-> what is **the design** of the sales series likely to be (before sensitivity analysis) ?



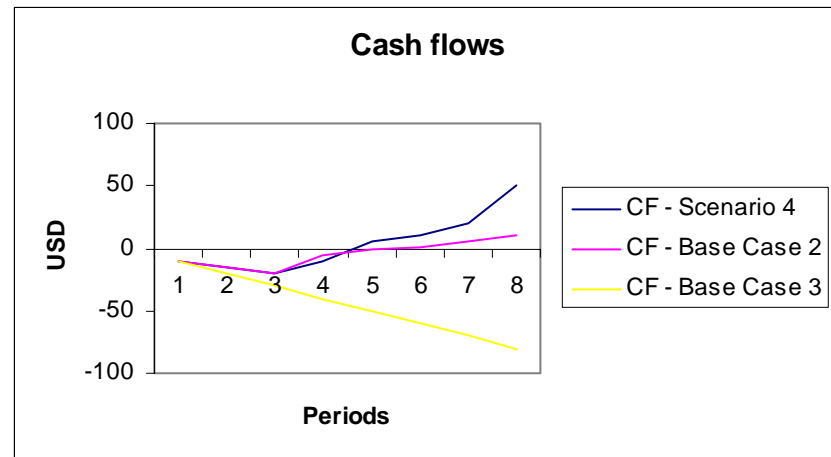
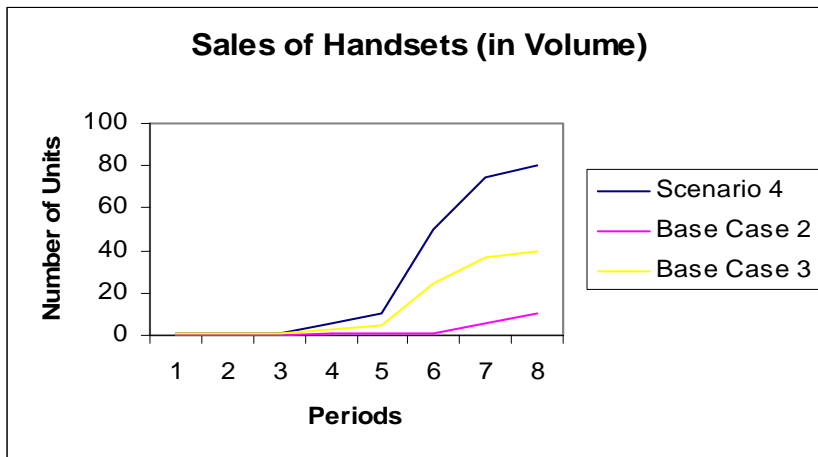


Sensitivity Analyses

- *Sensitivity Analyses*: key assumptions may include Business volume or sales revenues, market growth rate, salary levels, exchange rate, prices of raw materials, time required for staff to learn new skills, time required to develop products, etc.

Story (Step 2): Scenario 4 has been selected eventually. We are now defining the base case (the most likely to happen...and we can justify it!).

Story (Step 3): Please have a look at the **behavior** of Cash flows depending of the choice of the base case. Which one do you prefer to present to potential Investors?





Modeling: Some Do and Don't!

Do not use excel as a simple calculator!

A good financial model should be as "light" as possible, in order to master it better.

Time might be included in financial modeling, especially in the case of start-ups and new projects where cash issues may be critical for the viability of the project.

The best scenario is the scenario which is deemed to have the highest probability to occur. (It is not necessarily one of the low-medium-high cases)

Quantify as much as possible every benefit or cost impact associated with the case subject (ex: time !).



Structuring the Business Case: Non Financial Items

Non financial (or non quantifiable) items are

- Relative to Business Operations

- Relative to the Negotiation with Investors

- A Transaction involves a negotiation on different components:
the price is only one component among others.

- The negotiation may deal also with other terms of the Term Sheet, the Shareholders' Agreement and other documents attached to the Transaction.

-> Non financial items should be recorded and made tangible in the business case even though they cannot be described in financial terms.



Examples of Non-Financial items

Relative to Business Operations :

"business benefits" such as:

Intangibles items

Management Vision

Organization

Or others: Hidden liabilities, etc.

Relative to the Negotiation with Investors

To be included in the "Term sheet", the "Shareholders' Agreement" & other documents:

Terms of payment

Conditions precedent -> on accuracy of information, on occurrence of certain events, etc.

Issues pertaining to power & control -> composition of the Board of Directors, voting shares, information, etc.

Issues pertaining to the change of control of the Shareholders and/or the change of the Shareholding pattern.

Transfer of know-how attached to people -> employment agreements, etc.



Effectiveness (1/2)

- Why do Business Cases never meet the reality?

- Inadequate: fraud, lack of preparation, non expertise.
- Real issues:
 - Intrinsic: a paradigm does not encompass contingencies (e.g. what is beyond control). A financial model gives only a **representation** of a future business, in economic terms.
 - Lack of history (new growth, new project, start up)
 - Vision assumes defining high targets (optimism?)
 - The **special nature** of the Business Case (\neq budgets, accounting reports and business plans) where there is lots of **freedom to design the structure** and **select the content**.

“The case is built from information that goes beyond existing budgets and business plans. Two people working independently can evaluate the same proposed scenario, use correct financial arithmetic and still produce quite different business case results.”

“ Two good analysts can work independently on the same subject and arrive at different business cases results, but they should be very similar results if the subject has been defined fully, concretely, and precisely” (source: Marty J. Schmidt, Solutions Matrix Ltd)



Effectiveness (2/2)

- Effectiveness as a Conclusion

- Effectiveness does not result in “meeting the reality *a posteriori*”. A good Business Case

-Informs and makes potential Investors understand the **structure of the business** (\neq contingencies), hence identify and believe in the value drivers (**legitimacy of the demonstration**)

- Gives Managers/Existing Shareholders an opportunity to **exhibit a critical non financial item: their vision and capabilities**

- With the result of:

-> encouraging potential Investors to venture into the project with the company's existing shareholders/originators (*affectio societatis*)

-> giving credentials to Managers on their ability to communicate and negotiate (**trust building**)

- **Remains a tool-> a necessary but not sufficient condition for a successful Transaction.**



Alpana Advisory Services Pte Ltd

Alpana Advisory Services Pte Ltd was started in 2000 in Singapore by Ms. Valérie Bonin, a French citizen. Ms. Bonin is a graduate from ESSEC, a leading business school in France. Prior to starting her own company, she has been working for about 15 years with various investment banks, in private equity, mergers & acquisitions, corporate finance and project finance departments, on transactions taking place in Western Europe, the US and South & Southeast Asia. She has been living and working in various places in Asia since 1995.

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Thank you for your attention !