# THE FUNDING OBSTACLE COURSE

FUNDRAISING AND REFINANCING WERE ONCE ALL ABOUT RESOURCES. TODAY, REPUTATIONAL ISSUES WEIGH HEAVILY ON THESE TASKS. NICK HOOD LOOKS AT THE INTERNAL AND EXTERNAL POLITICS AT PLAY

Treasurers the world over talk about raising funds for their companies, often in the same breath as refinancing existing debt. They know the hurdles they and their colleagues have to get over in order to find new resources or reshape current facilities to reduce finance costs, change cash-flow profiles or free up assets to be used in other ways or be sold. They will also be aware of the internal political issues they may face as they take part in these often complex exercises. Only in exceptional circumstances or MBA case studies will the agendas of the CEO, CFO and treasurer be perfectly aligned.

Treasurers will also have some sort of view of the attitude of funding sources, their likely requirements in terms of financial and commercial criteria, as well as supporting data such as past, present and future accounting and forecast data.

But, almost a decade on from the global financial crisis, far from recovering, the world economy is stuck in low gear with its wheels spinning; beset by major geopolitical shocks such as Brexit and seismic changes in certain industries, especially those impacted by the collapse in energy and other commodity prices. These events have fundamentally changed the way that debt and leverage are perceived by many stakeholders. The damage to financial systems has also revolutionised the market for business funding, reducing the lending capacity of traditional banks and unleashing a torrent of new options from the alternative funding market.

## Media panic

It seems that everywhere we turn, risk is perceived to be heightened and, crucially, what is perceived as financial engineering has never been under greater scrutiny. The UK residential care home sector is a case in point. Five years on from the collapse of its largest single player, Southern Cross, the media is suddenly full of warnings about debt levels as highly leveraged private equity-style structures are seen to be inappropriately risky for such a high-profile sector on which the elderly and vulnerable depend. Equally, the carnage in the energy sector since the oil price shock is raising awkward questions about the industry's business model and dependence on debt.

The key point is that long-accepted norms such as ratios, sensitivities, contingencies and risk assessment assumptions are being challenged. The overall shape of corporate balance sheets and the transparency of corporate accounting are everything now, not individual covenant calculations. Financial structures that seek to magnify equity return by maximising debt are being questioned. Previously unremarkable corporate family trees that disappear into the mists of opaque offshore jurisdictions now cause suspicion, as do tax-efficient, cross-border commercial arrangements. Equally, growth for its own sake or which is seen to be about more than management ego and bonus deals has become a potential negative rather than the key driver for successful businesses.

It would be easy for all of this to be dismissed as paranoia at a time when the world seems to be spinning out of control, but for the rise of social media as a commercial influencer. No longer the stuff of kids' chat rooms, this phenomenon can now influence the outcome of financial restructuring and even the ownership of a business. In 2013, a campaign on Facebook changed and ultimately determined the future of Niemetz, the maker of Austria's iconic Sweden bomb chocolate sweet, despite the contrary wishes of its owners and managers. Social media platforms play an increasing role in influencing how business is conducted and what is, or is not, finally acceptable ethical behaviour.

## Outsider influence

So how does all this affect how treasurers go about one of their core activities: financing and refinancing their companies? Most obviously, they need to be mindful that their suggested solutions for funding requirements must not only address the financial needs of the business, which is a given, but also take into account reputational issues. They need to ask themselves

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a simple question: what will outsiders think about the shape of our balance sheet and our future profitability after this transaction?

Here, too, the UK healthcare sector has a very recent example to offer. One of its leading players recently announced a sale and leaseback deal aimed at reducing its debt burden, which under normal circumstances would have been a routine piece of refinancing. Unfortunately, it had been a similar (in headline terms) arrangement that had brought down Southern Cross in 2011. The outcome was a slew of critical articles in the *Financial Times*, a leading healthcare magazine and elsewhere, questioning both the deal and the future prospects of the company concerned. Almost any other refinancing option might have been preferable, assuming there were alternatives.

Treasurers need to consider not just the impact of any proposed transaction on their company, but analyse carefully how it compares with the financing arrangements of other players in their sector and the reaction of their market to them, so that this information can be shared with their colleagues as part of the case for, and the debate about, proceeding.

This is because stakeholders are far more sophisticated about the interconnectivity of a business with its trading partners than just a few years ago. Nowadays, no business is an island. Suppliers and trade insurers quite rightly think not just about customer credit risk, but also about supply-chain integrity and the risk that other suppliers may damage a company's cash flow by tightening terms or withholding credit altogether because of their doubts about its financial strength.

The collapse of UK retail chain BHS is a prime example, brought down ultimately by its inability to secure credit from suppliers, which stretched its cash resources in difficult trading conditions beyond breaking point. Trade insurers had judged that once BHS had lost the support and covenant of its previous owner, Arcadia, its balance sheet was woefully inadequate. Of course, had they known what was really going on with its finances, the sale to Retail Acquisitions may never have happened and its collapse might have taken place even sooner. This may have been an extreme case, but the downside of either fundraising or refinancing is that not only can it weaken an entity's finances, but even where it doesn't, it draws attention to them and invites greater scrutiny.

In the voluntary sector, charity treasurers are increasingly finding that institutional sources of grants and funding are looking much more closely at the overall financial position before committing to what would otherwise be routine applications for support. Even the most worthwhile projects providing the best outcomes and deliverables are being declined because of doubts about financial viability caused by weak balance sheets.

Florid debt burdens and high leverage can also adversely impact the valuation of a business; whether it is through its share price in the quoted company arena, as a target for a trade acquirer or in an exit sale by the owners of private companies.

Ultimately, treasurers need to be the voice of reason about all financing issues, highlighting not just the mechanics and purely financial implications, but also the broader considerations in this changed commercial world. Others in their management team may have different drivers and incentives, which can cloud their judgement. A healthy dose of common sense from its treasury department can be a great antidote to excessive commercial exuberance.

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