Family-owned businesses and capital raising

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Capital markets form an important part of the dynamic market-driven economy, and that, one of the fundamental functions of capital markets is to ensure capital is efficiently allocated between investors and the opportunities they believe will deliver the most attractive risk adjusted returns. The most visible part of capital markets is the stock market, where retail, institutional and other types of investors buy and sell shares in various companies and companies raise substantial amounts of new capital via initial public offerings (IPO). As much as the stock markets and IPOs are more profiled and more visible part of the capital markets, yet public capital markets are just a tip of the iceberg when it comes to the whole capital markets ecosystem – which under normal circumstances have structures and institutions such as investment banks, private equity, development banks, securities transactions underwriters, mutual funds, stock exchanges, central depositories and counterparties, custodian and settlement banks, as well as brokers and dealers, etc.

Anyways, so -- as it were, every year many companies raise capital in both public and private capital markets to fund business expansions and strategic initiatives. As opposed to IPOs, even in emerging and developed markets (i.e., not only in frontier markets like the DSE), in many cases, operating companies raise by more than 4-times of capital from private markets than they do via IPOs – these private markets are financed by high-net-worth individuals; fund managers for private equities in family offices, pension funds and other contractual savings; as well as institutional investors. However, still the one thing which clearly makes public markets preferable is that the secondary market for private securities is just a small fraction of the size of public secondary markets, potentially hampering efficient capital allocation in the private markets where capital is raised by way of private placements.

It remains a fact that raising equity capital for family firms is, on balance, a hard task.

In preparation, a company must prepare a detail Information Memorandum usually in conjunction with Lawyers, Accountants, and other advisers who then populate the deal/data room with all kinds of pertinent documents from financials to Board minutes to sales reports and product descriptions. This is then followed by the investor outreach where the issuer needs to identify potential investors, which could range from friends and family for early rounds or angel investors, venture capital firms, high net worth individuals/families (also known as family offices), or private equity and institutional investors such as fund managers for pension funds and other contractual savings arrangements.

As it were, in private markets, investments generally cannot be sold to retail investors (it is not recommended), rather to those investors who are 'accredited' based on their wealth, income or professional qualifications. Then in these investors outreach efforts are roadshows – where the company meets with investors – this task can be time consuming and involve multiple rounds with follow up questions and responses. However, the beauty of this is that a successful roadshow leads to negotiation and ultimately investment.

All told, the process can take not less than 3-months, distracting senior executives from their daily jobs of running the business.

For family firms going through this process, the biggest issue will normally be the lengthy of fundraising process. The other key issue would be how efficiently could the firm relate to many qualified/accredited investors.

As has been said, private markets are much more opaque than public markets, and identifying potential investors it often comes down to leveraging friends and the management team's professional network. Therefore, companies often work with brokers and placement agents to help them raise funds.

Furthermore, getting the right valuation remains another primary concern for family firms. To a certain extent this can be related to the challenges related to that of connecting with many potential investors – the more the investors a company meets, the greater the likelihood they will find an investor whose portfolio is aligned with their business and vision.

At the same time when an investor is considering a private firm investment where their capital could be tied for years, they may often negotiate hard for favourable terms, especially those related to valuation and pricing of their investments.

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