



# Raising finance in London



Initial public offerings are not the only way to raise money in London

BY JAMES NWANKWO AND NADIM KHAN



**G**IVEN the extraordinary recent market events, some might argue that the availability of finance for small- to medium-sized growth companies has all but dried up in the London financial markets. The good news is that finance may still be available for unlisted companies seeking to raise funds privately or embarking on an initial public offering (IPO).

## PRIVATE FUNDRAISINGS

In recent years, private fundraisings have become an increasingly popular method of attracting investment without the need for a company to conduct an IPO. Private finance is a cost-efficient way of raising funds for a company and also for preparing a company for a listing on the London markets.

A company is rewarded in a private fundraising with the ability to plug funding gaps without recourse to costly bank debt (and, in current markets, increasingly

costly if available at all) or the costs associated with an IPO. The fees for raising capital on an IPO will be higher to reflect the minimum level of due diligence required for an IPO regardless of the amount being raised. Private financing can be completed more quickly and more cost-effectively than an IPO as there is no need to produce and verify a lengthy admission document or a prospectus.

From the perspective of investors, taking a punt on a private company, while a higher risk, may offer better returns on exit when the company is eventually sold in a trade sale (typically three to five years) or goes public (usually within three to 18 months of a pre-IPO fundraising).

Once a company decides to raise money privately, the first step may involve the preparation of a detailed private placement memorandum or investor presentation that describes the company's business and operations, summarises its business strategy and

## GLOBAL REPRESENTATION ON AIM\*

	Number of companies as per country of operation	Total market capitalisation as at end-Dec 2008 £m
Africa	55	1,434
Australia	40	1,076
Canada	35	1,004
Central & Eastern Europe	28	624
Channel Islands	5	116
China	58	2,109
India & Bangladesh	29	1,726
Isle Of Man	14	965
Israel	12	102
Japan	4	74
Latin	32	796
Middle East	14	456
Other	16	1,662
Russia & CIS	48	1,878
South East Asia	37	1,466
UK	938	15,761
USA	77	3,360
Western Europe	108	3,091
<b>Totals</b>	<b>1,550</b>	<b>37,699</b>

\*Alternative Investment Market  
Source: London Stock Exchange

Continued on page 18



Continued from page 17

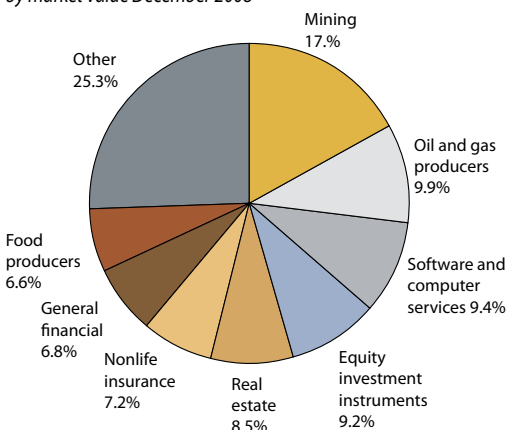
describes the relevant market, and may include financial statements and/or projections. The memorandum allows prospective investors to understand the business and the critical factors that a company believes will lead to successful growth and investor return. The document may also highlight a company's strengths and weaknesses.

Unlike an IPO prospectus, a memorandum is not vetted, nor is it subject to the same compliance and regulation. However, as is likely to be the case, if the memorandum is to be used as an investment tool for attracting investors to the UK, then there are certain complex restrictions and regulations associated with offering securities in the UK with which the company needs to comply.

Most unlisted companies seeking admission to a public market embark on pre-IPO fundraisings to secure funds for working capital purposes in order to facilitate short-term growth and expansion plans or, indeed, to fund the costs of a flotation in the future. In addition to the need for funding to meet day-to-day working capital commitments, companies that have a strategy that eventually leads to a flotation are aware of the need to create a 'story for the market' to attract new investors. Therefore, funds raised at the pre-IPO stage tend to be used to secure acquisitions and facilitate internal reorganisations in order to make a company and its business look more appealing to prospective investors at the time of flotation.

Private investors such as individual business angels,

Sector distribution of international AIM companies by market value December 2008



Source: London Stock Exchange

venture capital funds and private equity houses are also likely to 'follow their money' and invest again at float, particularly if the company has secured pre-IPO financing from well-respected institutions.

Given current market sentiment and increasing investor scepticism, it is worth noting that only those companies operating in the right sector with a strong management team and a formidable and realistic business plan will be considered by potential investors.

### IPO – WHICH MARKET?

While the decision to seek a flotation is one that requires careful consideration, the decision as to which market is suitable for your company is equally important and may ultimately determine whether the flotation process is successful.

There are three principal options available in the UK for companies seeking equity capital and a public market in their shares: Main Market, Alternative Investment Market (AIM) and PLUS-quoted.

There are many factors to consider when choosing a market.

**Profile and status** A company's profile on a particular market and the size and diversity of its corresponding investor base are important factors. The liquidity provided by a particular market will determine its attractiveness to potential investors. In general, the Main Market would offer a company the highest profile, the most liquid market for its shares and the largest and widest investor base, as compared with AIM, which in turn would offer more than PLUS-quoted.

**Fundraising: what level of equity funding do you require?** Each market differs as to the amount of potential capital that can be raised. The Main Market offers the deepest potential capital fundraising pool of the three.

**Minimum trading history requirement** Since AIM and PLUS-quoted are designed to attract smaller, growing companies, these markets do not require the company to have a minimum trading history. The Main Market, on the other hand, requires a minimum three-year trading record.

**How big is your company, in terms of expected market capitalisation?** There are no minimum market capitalisation requirements for AIM and PLUS-quoted companies. However, the Main Market requires a minimum market capitalisation of £700,000 (US\$977,053) and at least 25% of the company's shares must be held by shareholders unconnected with the company. In practice, Main Market companies will have a market capitalisation far in excess of the minimum.

**Public scrutiny** With an increased public profile also comes greater public accountability. Decisions of the board and the operations and performance of the company will be scrutinised by shareholders and the press, which could have an impact on a company's share price.

**Cost, administration and regulation** Since it is a more heavily-regulated market, a Main Market flotation and its ongoing compliance requirements can involve the company in significant costs and management time. A company considering a flotation on the Main Market must produce a detailed admission document, in the form of a prospectus, which must be vetted and approved by the UK Listing Authority, a division of the Financial Services Authority. The prospectus must include detailed information on the company, such as its management structure, business and financial results for the three financial years preceding admission.

### WHY AN IPO?

The key reason why a company decides to launch an IPO is usually to raise finance to fund growth and expansion plans. Other reasons include:

- to raise the profile of the business. A listing may improve the perception of a company's stability and raise its status among clients, shareholders, competitors and potential investors;
- to enable investors to realise their investments. The marketability and liquidity in the company's shares provides venture capitalists and owner managers a potential exit route;
- to incentivise employees. Granting share options to tie in key personnel, enabling them to share in the company's capital growth and offer them access to a liquid market;
- to gain access to capital markets. For future fundraising;
- to gain greater acquisition opportunities. The ability to offer 'paper' (listed shares) as well as cash consideration can be appealing to potential targets.

As AIM and PLUS-quoted are less regulated, the costs and management time associated with the flotation process and ongoing compliance are comparatively less. This makes these markets more attractive to smaller companies looking to raise less equity capital.

### STRUCTURING THE IPO

An IPO can be structured in a number of ways, the most common being:

**Introduction** The most cost-effective option to obtain a listing involves an admission to a market of securities where a sufficient number of shares of the company (usually a minimum of 25%) are already held in public hands without a capital fund-raising. Typically, companies that are already listed on an existing UK market that are looking to move up (for example from AIM to the Main Market), or companies already listed on an overseas market seeking a dual listing, will consider this method.

**Placing** An offer of shares (this could be a mixture of existing and new shares) to certain institutional investors rather than an offer to the public at large. This option is most commonly used with an admission to AIM. Although this method allows a company to raise finance with lower costs and gives it the ability to select its investors, a limited shareholder base can affect liquidity in the short term.

**Public offer** An offer of shares to the public. The offer may be underwritten, meaning that any shares not taken up will be acquired by certain institutions for a fee, ensuring that there is a minimum take-up. This route can help a company raise significant funds, however, it can also be the most onerous and costly.

### CONCLUSION

Notwithstanding the current economic climate, London continues to attract international interest from companies seeking finance. However, company directors need to think long and hard about whether an IPO is the best route to achieving the company's short-term capital requirements.

At the same time, they also need to be aware that now more than ever may be an opportune time to raise funds privately with a view to, if necessary, using such funds to best position themselves and their businesses for flotation when investor confidence eventually returns to the global capital markets.

James Nwankwo (james.nwankwo@lewisilkin.com) is a partner and Nadim Khan (nadim.khan@lewisilkin.com) is a senior associate in the corporate team at London law firm Lewis Silkin LLP.