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# Determining your Capital Requirements

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**This article focuses on determining how much capital you need to raise to achieve your business objectives.**

**Main Points in this article:**

- 1 Capital availability will influence strategic options.**
- 2 Create robust financial projections with realistic assumptions.**
- 3 Conduct scenario analysis to determine high and low capital requirements.**
- 4 Capital assessment is an iterative process.**
- 5 Plan and time capital raisings carefully.**

Capital, or the access to capital, will dictate the number of strategic options that you can successfully pursue.

These options relate to product or business development, the ability to invest in new markets or to your ability to acquire new businesses.

You can enhance your strategic position if you understand both the capital raising process, and your capital requirements.

## Capital Raising Process

The Capital Raising Process is briefly outlined below. It is further explained in the “[How to Raise Capital](#)” article. Check this Website for further details.

Since equity capital is the most expensive form of funding, it pays to be economic and disciplined in your approach. Managing the process and raising equity capital in stages is critical for success.

Successive capital raisings allow you to fund each major project or acquisition as the need arises. The key is to have your capital committed in advance.

Successive capital raisings may have a dilutionary impact on your shareholding percentage, but if you are raising capital at higher prices, the value of your shareholding may substantially increase.

## Financial Projections

The key starting point is the development of some robust projections for the next 3 to 5 year period. The first 12 months need to be reported monthly, and the subsequent periods, years 2 to 5, on a yearly basis. See the “[Preparing Financial Projections](#)” article at this Website for more information.

These projections will be based on various assumptions reflecting both external and internal factors.

The assumptions are critical since any variation may change the timing or magnitude of expected sales. Assumptions may also significantly impact costs and profitability.

These assumptions feed into the income statement and the balance sheet and allow you to generate the cash flow statement.

## Scenario Analysis

Since the world is a fairly uncertain place driven by political, market, financial and event risk, it is essential to construct a number of financial projections: most likely outcome, the most optimistic, and the most pessimistic.

These three projections will give rise to different levels of capital funding.

If your business is growing faster than expected (optimistic case) more capital will be required.

Conversely, if growing slower than expected (pessimistic case) less capital will be required.

By using scenario analysis, you can develop a range of capital estimates and work these through a valuation model to determine the dilutionary impact of the capital raising. See the “**Valuation assuming Dilution**” article at this Website for more information.

### Cash Flow Statement

The numbers from the scenario analysis need to be carefully reviewed. Do these numbers look reasonable, and more importantly, achievable?

A quick check of the sales estimates (growth rate, prices, volumes and mix), margins (benchmark rates), costs (fixed or variable), and balance sheet items (debtor, creditor and inventory days, capital expenditure and any other accrued amounts) may reduce any risk of significantly overstating or understating your cash requirements.

The cash flow statement reflects movements in operating, investing and financing flows.

The last line of the cash flow statement is the most important. It shows the net increase or decrease in your cash position. It also shows how much cash is needed or generated to achieve your business objectives.

Since capital raising is a time consuming and costly exercise, it pays to start the process well in advance. It may take 6 to 12 months to raise capital from external investors.

If your business is not breaking even and is unlikely to do so in the next 12 months, you may need to go back and critically review some of your assumptions and ask “What costs really need to be incurred?” The above process (assumptions, scenario analysis, and cash flow review) is an iterative one.

It may need to be done several times to finetune the numbers.

If your strategy is to grow by acquisitions or via joint ventures, separate models will need to be developed to calculate these cash flow requirements. These models can then be consolidated with the core business models to determine the total cash flow requirements.

The outputs from the above process will generate a figure that needs to be raised. It is also advisable to include a buffer to cover any delays or events that may negatively impact cash flows. Timing of cash flow is always an issue. Unfortunately, unforeseen events always delay the timing of cash flows.

For most growth companies, their balance sheets are generally structured to exclude fixed assets. The main assets are usually debtors, stock or contract cash flows.

This is done deliberately to maximise the use of capital for the growth of the business. This is not however what some bankers want to see.

Bank debt is usually driven by security, although factoring may be another option. Capital is therefore one of the key sources to fund your growth.

### Capital Availability

It is important to have your capital committed in advance, prior to undertaking any major projects or pursuing any acquisitions.

The capital raising process becomes very difficult if the company is in a weak financial position or yet to reach breakeven.

From an investor’s perspective, the increased financial risk may be a strong negative. The lack of go forward funding may also heighten

the market and operational risks.

The process of determining your capital requirements is an essential part of your strategic and business planning process.

By determining how much you need and when you require it, your business will achieve both strategic and operational effectiveness.

The ability to execute your plans with committed funding in place may give you that extra edge over your competitors.

If you want to create value in your business, plan your capital raising process carefully. Then raise the money before you need it.

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