

How Private Markets Help Business Owners Fund Their Growth Ambitions

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Alternatives to traditional equity financing when raising capital

While publicly-traded equity makes up the lion's share in the financial landscape, most mid-sized companies don't rely on IPOs or other public offerings to raise capital. For decades and beyond, business owners have been taking advantage of private capital sources in order to grow.

If you're a business owner considering raising funds, private investment can offer a variety of financing solutions for your company. Family offices in particular have become more significant players in this investment field, and form attractive financial partners for many businesses.

With private markets evolving at a rapid pace, let's take a look at what this means for business owners and how this affects their prospects.



A Brief History of the Private Equity Market

Private investment arguably became all the rage with leveraged buy-out (LBO) transactions in the 1980s. A mainstay of Hollywood thrillers set on Wall Street, an LBO simply meant buying a company with mostly borrowed money — maybe 80-90% bank financing. The goal was to acquire companies at a discount, and flip them for a quick profit fueled by high leverage.

If that sounds unappealing to you as a business owner proud of what you created, we don't blame you. It rightfully earned a reputation as a predatory practice. It didn't have to be, but it often was.

According to Pantheon, the number of private-equity backed companies in the US and Europe has grown by 5% over the past decade, while public ones declined 2%. Fortunately, LBO funds maximizing returns solely through "financial engineering" declined in popularity since then.

LBOs are also still around, but we see more reasonable leverage levels. The focus is not on stripping companies for parts, but on committing for the long haul to add value to the marketplace — in other words, making structural business improvements.

Globally, unallocated capital ("dry powder") in private equity has grown nearly 17% annually since 2015, reaching a new record of $1.8 trillion in 2022. That's a lot of money looking for homes. As a business owner though, adding other sources to your capital raise could open the door to more opportunities faster, with more fulfilling outcomes.



Beyond Private Equity Financing

Sometimes referred to interchangeably as the "alternative" investment space, private investment essentially involves securities or ownership interests which are not publicly traded — an alternative to typical listed stocks and bonds. If it's on a public exchange, by definition it is not private.

While its total size is hard to ascertain due to the assets being, well, private, Goldman Sachs' co-president of Asset Management Alternatives Mike Koester estimates that the value of the private market has doubled from $5 trillion to $10 trillion in the last five years — still limited compared to the public equity market cap of $60 trillion with another $60 trillion in public credit, but increasing significantly nonetheless.

The public markets have been a traditional place to invest or grow your business, but this may not be true for all anymore. Private markets offer an opportunity for investors who want to diversify their portfolios or have access into exciting new growth industries. It's no surprise that they continue to attract capital.

As companies turn away from traditional funding methods and toward private investment, the number of listed companies has been declining. Ironically, more money is being invested into the public markets which are now far less populated than they used to be. This has important implications for the growth profile of public investments.

According to Pantheon, companies that remain on stock markets are typically older and larger with slower growth rates than private companies. They also suggest the potential for increased volatility, making the prospect of going public even less appealing in favor of private funding.

When we look at the entire alternative investment space, private equity dominates by holding roughly two-thirds of the market. This includes LBO funds, venture capital, and growth equity. Behind private equity are real assets. Real estate forms a substantial piece of the pie including its development and / or long-term ownership. Infrastructure (e.g. roads, ports, airports, toll roads, etc.) and natural resources also fall into this category.

Beyond Private Equity Financing
(Continued)

The smallest yet fastest growing segment is private credit or debt. This space originally emerged as a new frontier for investors in their search for yield, and has increased tenfold in the past decade. With a value of $1.2 trillion, the private debt market continues its growth in the US and has gained momentum across Europe.

Alternative debt providers have been shown to be more accessible and flexible than traditional banks. Although they typically charge higher interest rates, they can provide financial resources with minimal share dilution and limited valuation discussions. Term loans, business lines of credit and invoice financing are just some examples that alternative debt providers offer businesses. Other financial products have debt obligations combined with equity characteristics such as mezzanine or convertible debt.

Private markets have a proven track record of outperforming their listed counterparts, even when measured on a risk-adjusted basis. Despite economic headwinds and geopolitical uncertainty, this sector continues to grow in business finance.



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The Democratization of the Private Markets

The private financial markets used to comprise primarily of institutional investors. Nowadays, you don't have to be an institution anymore to pursue the outsized gains available in this sector.

Private individuals and investment groups play an increasing role due to easing of regulations which started in Europe, followed by the US, and the rest of the world. Analysts estimate that 20-30% of private funds originates from "retail investors", compared to 5-10% in the past. According to Koester from Goldman Sachs, going forward this group will overtake institutional investors.

High-net-worth investors could simply be one person (or team) with deep pockets, who has a skill set, network, or significant distribution platform. By contrast, family offices are independent companies that high-net-worth families use to outsource their financial growth.



The Democratization of the Private Markets
(Continued)

More than one family may own one family office, but they can't solicit new investors like a fund can. Because they represent the financial interests of a small and limited number of people, family offices face a lower regulatory burden compared to funds (see our article on the subject for in-depth reading on family offices).

The private space has seen increasing involvement from family offices, an investor class with anywhere from tens of millions to tens of billions of dollars in capital to deploy. According to some estimates, there are ten times as many family offices in the game now compared to ten years ago.



The Benefits of Family Offices for Business Owners

Not only are we seeing the scale tip from public to private financial markets, and institutional to non-institutional investors, but also from traditional investment vehicles to direct investments. For business owners looking to raise capital, these are just some of the dynamics that should be taken into account.

Family offices have many advantages as investment partners for businesses because they don't face the same exit pressure as fund managers. They are in a position to be patient and flexible with the ability to offer alternative financing solutions (equity and / or debt).

Family offices increasingly prefer direct investment over placing capital in a private equity fund to avoid paying fees. This also carries potential benefits for business owners, especially those who have shied away from private equity investors, perceiving them as beholden to profit and unsympathetic to the company's original purpose.

These investor groups tend to be more personally engaged in their investments. They may also be as interested in the value they can add to the company as the impact they can make — not just yield for the sake of yield. High-net-worth families have often built businesses of their own. They may have unique skill sets to contribute to the companies they invest in — the ability to serve as an asset to the company other than just a source of capital.

Likewise, independent sponsors are a natural evolution of the direct investment space. They act like private equity funds, except they source deals before the capital is raised, relying on a network of family offices (and an increasing number of private equity firms) to fund the deal. They provide capital to businesses that might not otherwise be available, and generate value through their involvement and expertise (see our article for a deep dive on independent sponsors).

Key Considerations When Selecting a Financing Partner

As a business owner it may be tempting to accept much-needed capital from whatever available source ... but be careful: a misalignment can have disastrous consequences... The money isn't enough — the strategic contribution and the intention matters just as much, if not more.

Before you pick your funding source, consider:

- **Where are you in the life cycle?** Are you in the ideation phase, launch and traction, scaling and growing, the breakout phase, or the "established" phase? Different funding sources are better for different phases.

- **What's your endgame?** Are you looking for disruptor status and a billion-dollar valuation at exit? Self-sustaining middle-market status? A valuation boost? Different funding sources and structures are better suited for different outcomes as well.

- **How much control are you willing to give up?** How much equity are you offering, or do you prefer not to dilute? Different investors and structures leave you, the owner, with more control. Others will allow the investor broad decision-making power, which isn't necessarily a bad thing.

- **What's your time horizon?** Are you too young to retire and looking to cash in some of your chips while remaining on board? Do you anticipate a quick boost and cash-out, or does your private investment partner have to sit tight for a three-year plan to play out? Or five years? Or ten years? Different investors have different capacities for patience.

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Cap Expand Partners: Experts in Cross-Border M&A Initiatives With Innovative Financing Solutions

Cap Expand Partners specialize in supporting strong cross-border M&A initiatives with innovative financing solutions. We are especially active in the direct-investment field, where we assist businesses and independent sponsors raise the capital that brings their vision to life.

We also provide funding in a wide range of situations. Whether our clients seek to finance growth plans, raise capital without diluting share value, or simply increase liquidity, our analysts and financial experts can identify the best way forward. We offer capital solutions across the entire financing spectrum benefiting privately held mid-market companies, including:

- Direct lending
- Structured credit
- Mezzanine financing
- (Preferred) equity financing
- Project financing



Key Themes

Our direct-investment work is guided by a set of key themes that will continue to shape our world and our economy for the foreseeable future.

For example, we work with businesses which have identified opportunities to advance through digital transformation of their operations. This may involve facilitating remote-work opportunities and reducing the overhead represented by large central offices; more often, it embraces every aspect of a company's operations, from its internal procedures down through its entire supply chain.

We also see great opportunities in the transition to more environmentally sustainable business practices. We seek to actively accelerate this transition, promoting more efficient use of natural resources and exploring more sustainable ways to produce and deliver energy, water, and food.

Opportunities abound for business leaders and entrepreneurs who focus on delivering better physical and mental care, both as preventive measures and as responses to difficulties faced by the elderly and those with long-term medical conditions. We seek companies who deliver innovative solutions to these persistent issues.

In each case, we focus on specific industries and value chains, not broad sectors, to help business leaders make informed investment decisions. This approach allows us to better anticipate and respond to promising developments. Our global network extends to more than five continents, allowing us to quickly and accurately assess promising investment opportunities.

Business owners are particularly fond of our comprehensive service offering. We back our market assessments, strategic planning services, and support for growth initiatives with expert capital advisory and proven M&A guidance. We provide assistance in critical stages of a company's lifecycle, including:

- Corporate Development Acquisitions
- Recapitalization
- Growth Financing
- Exit Planning and Sale

We see the greatest growth opportunities in companies with revenues between € 5 million and € 100 million. Our revenue focus translates to a range of deal valuations that puts our services well within the means of owner-managed businesses in the mid market.

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About Cap Expand Partners

Cap Expand Partners specialize in supporting cross-border M&A initiatives with innovative financing solutions. First established in the 1970s, the family business was founded on the belief that mid-sized companies play a vital role in tackling some of the world's most pressing social and environmental challenges. Under the leadership of Sergio van Luijk, Cap Expand Partners assist companies and independent sponsors through a network of associate partners with cross-border expertise, using modern methodologies more evolved than traditionally used in the industry.

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