MULLINS business

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CAPITAL RAISING for Small Business
– private equity, are you ready?

By: Olivia Versace

THERE ARE VARIOUS REASONS FOR A BUSINESS TO SEEK CAPITAL. CAPITAL MAY BE SOUGHT TO START-UP A VENTURE, TO EXPAND A BUSINESS OR TO TURNAROUND A BUSINESS IN FINANCIAL DIFFICULTY.

There are also various alternatives for raising capital. Sometimes businesses can find the additional finance internally by cutting costs. However, often times a business must go to third parties to find finance.

Debt finance is the most common form of financing. However, increasingly in the Australian market people are turning to equity finance as a means of injecting capital into their business. Equity finance is the sale of part of the ownership of the business to another person in return for funding, for example, by the sale of shares in the company.

... INCREASINGLY IN THE AUSTRALIAN MARKET PEOPLE ARE TURNING TO EQUITY FINANCE AS A MEANS OF INJECTING CAPITAL INTO THEIR BUSINESS

It is important to get the right mix of debt and equity finance for your business from the outset and to monitor the mix against the fortunes of the business to determine whether rebalancing is required.

A business may choose to list on the Australian Stock Exchange as a means of raising capital. Alternatively, a business may seek to raise capital from outside the public capital market from private equity investors or venture capitalists. The concept of private equity covers investment from sources ranging from family and friends to business "angels" and on a larger scale, fund managers.

According to the Reserve Bank of Australia, the private equity market mainly attracts small companies with limited access to internal funds or bank loans. Such companies normally have insufficient collateral to support debt raisings and the costs of listing on the Australian Stock Exchange are prohibitive for them.

The steps in the private equity capital raising process include:

1. Identifying the need for capital and the required mix of debt and equity for your business – this includes considering the growth strategy, business risks and ownership objectives
2. Preparing a detailed business plan with short term, medium term and long term goals
3. Preparing an information memorandum
4. Researching equity providers before approaching them
5. The private equity investor conducting due diligence investigations of your business
6. Negotiating terms of investment including shareholding structure, valuation of the company, exit mechanisms and the terms of a shareholders' agreement

Of course, the flipside to seeking capital is investing capital in other businesses or growing your business by acquisition. The 2005 Ernst & Young survey of private company transactions found that about 24 percent of small companies (less than $10 million in revenue) intend to grow by acquisition this year. That percentage rose to 46 percent for companies with turnover between $10 million to $50 million.

The considerations in an acquisition are similar to the considerations in a private equity investment situation. The acquirer must identify potential acquisition targets, conduct detailed due diligence investigations of the business and negotiate the terms of the acquisition prior to entering into a purchase contract. However, acquiring a business to achieve growth means you also must consider the fit with your business. In a private equity situation, investors are primarily concerned with returns on investment rather than merging the investment with others.

The Australian Securities and Investments Commission administers the Corporations Act and other laws relating to investments in Australia. There are various rules relating to capital raising. It is important to get professional advice before seeking equity finance or investing in another business.

In our next edition we will include an article on what private equity investors are looking for in an investment and exit mechanisms for such an investor.

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Maintaining **EMPLOYEE COMMITMENT**

By: Andrew Perry

An important aspect of selling a small to medium size enterprise is to make the business attractive to a potential purchaser by being able to demonstrate that the business is not to heavily dependant on the involvement of the owner. Similarly, most prospective purchasers are well aware that businesses are only as good as their employees. These qualities can only be demonstrated to potential purchasers if key employees are still employed by the business at the time of sale and, accordingly, vendors should do all that they can to ensure key employees are part of the business that purchasers are buying.

In recent times we have seen an increasing trend for the settlement of business sales to be delayed by periods of several months whilst necessary approvals and licences are granted or due to other delays which were not expected by the parties. This has created further uncertainty for employees that can be damaging to the business and its eventual sale price.

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There are however some obvious steps that vendors can take to ensure that their staff members remain committed to the business throughout this period and to ensure the successful sale of the business. First, vendors should identify if certain staff members are vital to the future of the business and then ensure that they are firmly contracted for a fixed period of future employment. Vendors will also need to review the employment contracts of key employees to ensure they contain valid and enforceable restraint of trade provisions, to make sure that the vendor and potential purchasers will be protected from the risk of employees setting up competing businesses.

During the sale period it is inevitable that information regarding the sale of a business will make its way into the marketplace, filter back to employees and alert them to the prospect that their employer is selling the business. This can invoke many feelings from the employees towards their employer, the majority of which are not positive or helpful to the employer's interests of maximising their return on the sale of their business. Vendors should refrain from advertising their business for sale without first consulting key employees, advising them that the business is being sold and to sharing pertinent details with them, where possible.

It is increasingly common to see a condition of a sale contract that requires certain key employees to enter fixed term employment agreements securing their services for the purchaser. In order to achieve this and to prevent an exodus of key staff members from leaving the business throughout the sale period, vendors have been developing a number of strategies.

One successful method used by vendors has been to offer key employees a "bonus" upon the successful completion of the sale of the business, ensuring their commitment and positive attitude towards the sale of the business. One of our clients offered all of his key employees a rate of remuneration that was double their normal rate from the time they were told about the prospective sale of the business to the completion of the sale, which was a period of approximately two months. The vendors involved noted that the key employees who were the beneficiaries of the bonus system took care of any negativity surfacing within the business resulting from the prospective sale and actively encouraged the sale process.

SUPERANNUATION CHOICE: Time to Prepare

By: Kylie Torlach

THE SUPERANNUATION "CHOICE-OF-FUND" LAWS WILL COME INTO OPERATION ON 1 JULY 2005.

In summary, the laws oblige most employers to make Superannuation contributions to Superannuation Funds individually chosen by their employees.

However, employees may only choose a fund that will accept contributions from their employer i.e. an "eligible choice fund".

It is estimated that approximately 5 million employees and over 500,000 employers will be covered by the new laws.

However, a number of employees will not be covered by the new laws. For example, some Commonwealth and State public service employees, and some employees whose Superannuation Funds are mandated under an Award, Certified Agreement or Workplace Agreement.

Generally, if an employee does not choose their Superannuation Fund (and there is no "default fund" nominated in an Award, Certified Agreement or Workplace Agreement), then employers can continue to contribute into the employee's existing Superannuation Fund — so long as it is an "eligible choice fund" i.e. it meets the requirements set out by the Government.

For employees employed as at 1 July 2005, employers are required to give each of those employees a "standard choice form" — before 29 July 2005. The standard choice form must contain certain information, including that the employee may choose his/her own eligible Superannuation Fund and the name of the "default fund" chosen by the employer.

For new employees, a standard choice form must be provided within 28 days of commencement of employment.

Further, an employee may ask (at any time) for a standard choice form, which must be given to them within 28 days.

If an employee choses their own eligible Superannuation Fund, the employer must start making contributions to that fund within two months of notification being received from the employee.

Employers will not be able to charge employees for any costs associated with complying with the laws.

However, the Government has recognised that there will be some additional administrative costs (at least initially) in complying with the new laws, and is working with the Superannuation industry to set up a new Superannuation management system designed to simplify and streamline the process.

We recommend that all employers take steps now to confirm that their existing Superannuation Fund/s can continue to be used as the "default fund" after 1 July 2005.

Business acquisitions and the Trade Practices Act 1974 – you don't have to be Qantas

By: Richard Stone

The *Trade Practices Act 1974* ("the Act") applies to the conduct of all businesses, regardless of whether they are the size of Qantas or a small enterprise. The Act is administered and enforced by the ACCC, which aims to ensure that all businesses, both large and small, gain competitive advantages by operating efficiently.

> THE LEGALITY OR OTHERWISE OF COMPETITIVE CONDUCT HINGES ON THE NATURE OF A "MARKET" IN A TRADE PRACTICES SENSE...

The legality or otherwise of competitive conduct hinges on the nature of a "market" in a trade practices sense (which can differ from the common perception of what a "market" is in a business sense). The size of the business is only one consideration.

Very few markets have identical characteristics, and competitors' proportions of market power differ widely. A sole trader may have a substantial degree of market power in a market if, for example, the sole trader's products cannot be substituted for other kinds of products because they are specialised and one needs to travel a great distance to buy an alternative.

Enjoying or acquiring a "substantial degree of power in a market" can have implications for all types and sizes of businesses in terms of the Act. For example, if a business that has a substantial degree of power in a market for its goods or services (or would acquire that degree of power somehow) sought to acquire one of its competitors, the acquisition could be considered by the ACCC to be anti-competitive, if it has the effect or likely effect of substantially lessening competition in a market.

Transactions that offend the Act can be unravelled or a nasty asset divestment arrangement could be required by the ACCC, designed to reduce the business' market power. Obviously, these types of things can result in huge costs to the relevant parties, and in some cases businesses can be reduced back into their pre-merger state, or be drawn through the Courts to face a range of penalties.

It's not all bad news for businesses considering engaging in business acquisitions. The Act permits the ACCC to authorise mergers (and a range of other types of potentially anti-competitive conduct, such as collective bargaining) on the basis that the public benefits outweigh the anti-competitive detriments. For example, in merger cases, the ACCC makes an assessment of market dynamics and balances the public good that would flow from the merger/acquisition (such as reduced prices to consumers), against the bad (such as higher barriers to entry for competitors seeking to enter the market). When the good outweighs the bad the merger is authorised and vice versa (noting the ACCC's ability to impose conditions in this respect).

A business' failure to at least consider the competitive implications of acquiring another business is a very risky strategy at best. This is particularly the case as the ACCC constantly monitors a variety of business sectors, pays particular attention to the way business transactions and behaviour is reported in the media, and routinely informally investigates business conduct according to its enforcement criteria.

How Much deposit should a seller get?

By: Rebecca Castley

It is a harsh reality that sometimes parties to contractual arrangements do not perform their obligations. In the context of property transactions, the issue of whether an adequate deposit was paid then becomes extremely important to a seller.

The main purpose of a deposit is as security for completion of the contract by the buyer. It shows that the buyer means business since the seller can forfeit the deposit if the contract is terminated due to the buyer's failure to perform.

Traditionally, a deposit equal to 10% of the purchase price is required but sellers commonly accept less. In Queensland, it is rare that a deposit exceeds 10% since the restrictions in the Property Law Act 1974 regarding instalment contracts would then apply.

When a seller is deciding how much deposit is required, one important factor to be kept in mind is when and how much commission is payable to the real estate agent under the appointment of agency. Under the approved form of appointment in Queensland (Form 22a), the agent is entitled to commission where "the contract of sale is not completed and the whole or part of the deposit paid is liable to be forfeited". Therefore, if a buyer fails to settle and the seller terminates the contract and forfeits the deposit, the seller will be obliged to pay the commission to the agent in full.

Let's say you have entered into a contract to sell your house for $500,000 and the buyer has paid a deposit of $10,000. If the contract is terminated because of the buyer's default, the agent will be entitled to a commission of $12,950. After the $10,000 deposit is applied to this commission, you will be liable for a further $2,950 to the agent on commission alone. There is then the cost of putting the property back on the market (including advertising) and legal costs incurred on the terminated contract.

While you are legally entitled to recover the commission shortfall and expenses relating to the sale from the buyer as damages, it is certainly preferable to have these costs covered in the deposit rather than having to institute legal proceedings against the buyer to recover these costs (who may not have the assets to be able to satisfy the judgement).

Our tip is: Always assume the worst and get enough deposit to pay for your costs in case the buyer does not live up to its part of the bargain.

RISK MANAGEMENT and Compliance Programme for Schools – meeting the challenge head on

By: Richard Stone

SCHOOLS ARE COMMERCIAL OPERATIONS LIKE ANY OTHER BUSINESS, BUT THEY ALSO HAVE THEIR OWN DISCRETE ADDITIONAL CHARACTERISTICS BASED ON THE ENVIRONMENTS IN WHICH THEY OPERATE. OVER TIME, PUBLIC AND PRIVATE SECTOR SCHOOLS ALIKE HAVE BECOME INCREASINGLY SUBJECT TO EXTERNAL SCRUTINY, CORPORATE GOVERNANCE REQUIREMENTS, REPORTING FRAMEWORKS AND ACCOUNTABILITY.

To assist schools in meeting these challenges, Mullins Lawyers has developed a Risk Management and Compliance Programme for Schools. Our aim is to ensure any school can make effective business decisions in light of risks faced by them and their strategic and operational short, medium and long-term objectives. A Risk Management and Compliance Programme for Schools can be seamlessly integrated into any school's business activities, and allows a school to identify, monitor, control and treat risks on an ongoing basis.

Ultimately, our Risk Management and Compliance Programme for Schools will benefit schools by enabling them to control costs, protect staff and students, and guide the allocation of resources to key areas.

> ULTIMATELY, OUR RISK MANAGEMENT AND COMPLIANCE PROGRAMME FOR SCHOOLS WILL BENEFIT SCHOOLS BY ENABLING THEM TO CONTROL COSTS, PROTECT STAFF AND STUDENTS, AND GUIDE THE ALLOCATION OF RESOURCES TO KEY AREAS.

PROVIDING INSIGHTS AND SOLUTIONS

Assessing the parameters within which a school conducts its business, and how it competes in the marketplace gives each school its risk management and compliance contextual framework- so that risk can be properly identified, analysed, evaluated, treated and controlled on an ongoing basis.

MEETING THE CHALLENGE

Risk management and development of compliance programmes can be a very time-consuming and challenging process, largely due to the range of different variables that a school faces. In our experience, a number of schools are meeting this challenge head-on.

There is no such thing as a quick-fix solution or "one size fits all" risk management programme and the benefits to a school (in terms of efficiency and costs alone) of a thorough risk analysis and comprehensive compliance programme can far outweigh the costs faced when an event occurs that has not been planned for.

Our Risk Management and Compliance Programme for Schools can be implemented as a complete package, or divided into complementary sections. If you would like to discuss any aspect of our Risk Management and Compliance Programme for Schools please contact the following people at our office:

Pat Mullins, Senior Partner 3224 0350
Richard Stone, Associate 3224 0323

EDITORIAL

By: David Williams

We are approaching the anniversary of the establishment of the Business Services group within the firm. You will see from the range of articles in this Newsletter, we cover a multitude of issues that businesses face day in and day out. This indicates the range of skills within the Business Services Group and the firm.

It is hard to believe that the new year has started and we are now at the end of February. Already it looks like this year will be a very interesting one. The first battlefield will be in relation to workplace law and Trade Practices. Our Business Services group has significant expertise in relation to both of these issues. With a changing political environment and the prospect of national workplace legislation in the near future, there are interesting times ahead, once the Federal Government gains control of the Senate in July of this year and the details of the legislation are fully articulated.

It has also been two (2) years since the Dawson Report recommended to the Federal Government that criminal sanctions and onerous financial penalties be imposed upon executives who engage in serious cartel behaviour under the *Trade Practices Act*. The Federal Government has also recently renewed its intention to criminalise such cartel behaviour. In light of this, it is an appropriate time to remind executives and owners of businesses, large or small, that the *Trade Practices Act* has considerable teeth and the widening of criminal sanctions will bring added pressures in the operation of your business. Criminal sanctions and fines aside, navigating the *Trade Practices Act* and competition law generally is a complex exercise and becoming more complex over time. We have included in this newsletter an insight into factors you should consider if you are seeking to acquire other businesses.

Also highlighted in this newsletter is an innovative schools compliance programme directed towards the management of risk within schools that we will soon be launching. This programme has been brought about due to the joint development of such a product between Pat Mullins, who heads the Religious and Educational work group within the firm, and Richard Stone from our Business Services group.

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