



CORPORATE
FINANCE
FACULTY

FINANCING CHANGE

A THOUGHT LEADERSHIP INITIATIVE



BUSINESS WITH CONFIDENCE

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Corporate finance plays a vital role in society because it enables businesses to change and thereby drives overall economic growth. Because of its prominence corporate finance activity will, and should, attract public attention.

Many new business initiatives require additional finance to make them happen. Others require business financing to be realigned so that it matches changes in risks and potential returns. Business transformation is common to corporate finance transactions of all sizes and types: venture capital investments, refinancings, business transfers, turnarounds, mergers and acquisitions, public offerings and private equity buy-outs.

Business transformation delivers a range of outcomes that span from the positive to those that can, on occasion, trigger controversy or result in adverse public perception. Negative publicity can result because economic change imposes costs at the same time as it delivers improvements. This can lead to the overall benefits of the broad spectrum of corporate finance activity being overlooked. Through its thought leadership initiative *Financing Change*, the Corporate Finance Faculty of ICAEW is seeking to advance the economic and social contribution of corporate finance activity by promoting better understanding of the value it can create as well as improving efficiency and practice in capital markets.

Challenges for corporate finance

Public perception of corporate finance can be hard to engage in a systematic way – transactions are often complex and potentially confusing. Thus public appreciation of the positive role of corporate finance in funding new business ideas and enabling aspiring businesses to change, adapt and develop is often incomplete. Moreover while the public reaps the benefits of corporate finance activity, it does not always accept the wider consequences of transactions or acknowledge that the risks to those involved in producing the benefits are only accepted if justified by potential rewards.

Even influential opinion formers can overlook the economic value of a transaction in favour of concerns over the impact on individuals. Public scrutiny and criticism of corporate finance activity in all its forms need to be recognised and addressed. There are dangers in a failure to engage effectively with large sections of society and public opinion. Engagement is an important way of increasing public acceptance which involves communicating strategy, being clear about interests and consequences and being willing to address negative assumptions.

Corporate finance activity transcends business sectors as well as national borders. There is also a trend towards standardised practices and reporting and integration of financial markets. New structures need to be effective and beneficial to long-term economic interests. This requires continuous efforts to identify obstacles to innovation and efficient capital allocation and to be open to the possibility that different market practices and views can help address such blockages.

From time to time markets fail and the aftermath of recrimination can undermine public confidence. In order for corporate finance activity to add economic value in a sustainable way, that confidence must be restored and maintained. Where there are individual failings, collective lessons need to be drawn including from other types of investment strategy, to help build confidence, improve investor protection and enhance trust in markets. This is possible where there are supportive market structures and transparent information.

A way forward

In its *Financing Change* thought leadership programme, the ICAEW Corporate Finance Faculty will consider the full range of corporate finance deals from angel finance to mid market transactions to global deals. It starts from the premise that, from society's point of view, the purpose of corporate finance activity is to allocate capital to business efficiently and equitably and recognises that:

- competitive private sector profit-seeking brings discipline and innovation to capital allocation;
- there nevertheless needs to be active ongoing debate about whether overall corporate finance activity could better deliver economic benefit while serving the public interest; and
- where there are shortcomings, corrective measures should be taken wherever possible by the corporate finance industry itself and other market participants, but government and regulatory action may be necessary where private action is unlikely to be effective.

THREE THOUGHT LEADERSHIP THEMES

Financing Change will explore three themes: imagination, infrastructure and information. Each is an essential pre-condition for successful and sustainable corporate finance activity.

IMAGINATION

Imagination is needed not only to generate business ideas but also to fund them. Matching business people and their ideas with suitable financial backers and deal structures is a creative process that requires commercial awareness and an understanding of the motives and risk appetites of the various parties to a transaction. For want of imagination, good business ideas may not get funded or they may attract inappropriate funding that ends in disappointment and recrimination. The creative aspects of dealmaking are easily overlooked yet the ability to make transactions happen on a sustained basis in a competitive market place is rare.

It nevertheless needs to be backed up by a willingness to keep learning from personal experience and from other people. Imagination is an essential ingredient of financial markets where new business ideas can be brought to fruition.

INFRASTRUCTURE

To flourish and find expression, people with imagination need a supportive environment. Infrastructure is needed to enable transactions to be funded cost-effectively. There needs to be trust and confidence in the markets. Deals are enabled by legal, regulatory and tax frameworks that are stable, certain and proportionate, permitting activity to take place efficiently without unnecessary constraints or distortions. For this to happen, much depends on the willingness of those involved in corporate finance to develop their financial, analytical and negotiation skills, to show due regard for reputation and to demonstrate commitment to ethical behaviour. All these things are helped by transparency.

INFORMATION

Transparency of information serves two key purposes. It supports investment decision-making and it enables the wider impacts of corporate finance activity to be assessed. For the parties to a deal, it can help develop an idea into a viable proposition that attracts the requisite funding. Management needs information to implement business change. Investors rely on information about deals for investment decisions. Providers of finance also use information to make credit decisions and to monitor risk. For the wider public, information addresses scepticism about the value of corporate finance activity and concerns relating to the purpose and consequences of deals. Corporate finance practitioners, policymakers and opinion formers, as well as representatives of other stakeholders, need information to assess effects on wider interests. Transparent reporting is essential if corporate finance activity is to allocate capital efficiently and for the good of society as a whole.

ANTICIPATED BENEFITS

Financing Change will help put corporate finance dealmaking on a firmer base by raising awareness of the economics of such activity.

It will promote corporate finance activity which serves the public interest by encouraging all those involved in effecting deals to:

- have a greater regard to the context and infrastructure in which corporate finance transactions take place;
- raise their own performance, expertise and ethical standards;
- provide affected parties with clear, transparent and objective information; and
- support necessary and proportionate regulation.

The initiative will also provide a safety valve and allow corporate financiers, the wider business community, investors, policymakers and other interested parties to air and share frustrations and concerns about corporate finance activity before they precipitate a crisis.

FUTURE ACTIVITIES

Briefing papers and high-quality research

The initiative will seek to explain corporate finance dealmaking and how it facilitates change and reflects innovation. It will cut through the hype and jargon that make deals ever harder to understand. *Private equity demystified: an explanatory guide* by John Gilligan and Mike Wright, is the first report published as part of this initiative. The report is a response not just to a need for transparency but also to the poor understanding of private equity evident in much public discussion of the subject. It sheds light on the motivations of the main participants in private equity transactions and on their risks and rewards, as well as reviewing academic evidence on the impact of private equity around the world.

Public discussions and debates

Financing Change will draw on ICAEW's power to convene to bring together protagonists with different points of view. In 2007 the Corporate Finance Faculty, together with Sir David Walker, hosted the official public debate of Sir David's disclosure and transparency proposals for private equity. This featured panellists from the private equity industry, business, the investment and regulatory communities, parliament and the trade unions.

Issues papers

Corporate finance activity is played out in the public policy arena and future issues papers will deal with topics of public interest, provide a starting point for public discussion and debate and invite feedback from interested parties. They will provide the basis for presenting findings to policymakers and, where appropriate, developing guidance for corporate finance practitioners.

Guidance for practitioners

Improvements in corporate finance practice are not the exclusive responsibility of legislators and regulators. There is an important role for supporting information and guidance in a proportionate legal and regulatory framework. ICAEW is particularly well placed to develop guidance in relation to infrastructure issues, such as skills and ethics, and information. A body of existing ICAEW technical guidance which is relevant to corporate finance transactions, covering issues such as financial reporting procedures and proforma and prospective financial information, will be re-evaluated taking account of the needs of international markets and the views of market practitioners and commentators.

Role of ICAEW

ICAEW is an independent professional body which is obliged by its Royal Charter to act in the public interest. The breadth, diversity and stature of the ICAEW's 136,000-strong international membership enable it to act as a magnet, leading and shaping debate. It is able to take an objective view, challenging common assumptions, commissioning research and helping to clarify arguments. ICAEW's commitment to corporate finance is evidenced by its pioneering work in developing its Corporate Finance qualification and establishing the Corporate Finance Faculty as the world's largest community of corporate finance practitioners.

In delivering this programme, ICAEW will build on the expertise and experience within its Corporate Finance Faculty, which provides its members with good practice guidance and know-how about different types of transactions and information to help them navigate the relevant legal and regulatory frameworks.

The initiative will also be able to draw on other sources of expertise and thought leadership within ICAEW, for example in business law and better regulation, corporate governance, corporate responsibility, ethics, financial management, financial reporting, financial services, tax, and audit and assurance.

SUMMARY

Corporate finance is an important area of economic activity with wide-ranging consequences that can test public confidence. In the absence of better public understanding and engagement between those involved and wider interests in society, the major benefits that corporate finance activity can bring through its ability to effect change may not be realised. The trend for cross-border corporate finance, standardised practices and integration of financial markets makes transparency and the removal of blockages to efficient capital allocation increasingly necessary. Moreover where individual market failings occur, lessons need to be quickly absorbed by the wider marketplace to help restore trust.

The *Financing Change* thought leadership initiative of the ICAEW Corporate Finance Faculty will take a leading role in fostering inclusive public discussion of corporate finance issues, structures and practices and provide a basis for dialogue between dealmakers and relevant stakeholders. Better understanding of the interaction of private and public interests should help deals of all types to contribute more fully to economic and social wellbeing.

It will also bolster the case for proportionate regulation, aimed at improving the efficiency and fairness of capital markets.

NEXT STEPS

We welcome comments. If you have ideas on the three themes and the challenges facing corporate finance, or if you or your organisation are interested in making a contribution to *Financing Change* in other ways, please contact:

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ICAEW is a professional membership organisation, supporting over 136,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

Because of us, people can do business with confidence.

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