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BUSINESS GROWTH: HOW TO BOOST VALUE AND AVOID A DEBT TRAP

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Insights | Private Equity

EXPANDING BUSINESS AND FINANCING THIS EXPANSION

Equity financing is a strategic tool that helps a business execute an ambitious growth strategy.

If the owners are not planning to sell business in the near future, they need to initiate active steps to develop business further – otherwise, its value will soon begin to deteriorate. The market doesn't stay put: you keep the foot on the gas pedal or else you slow down and risk falling behind the competitors.

Many entrepreneurs understand this concept and invest – they reinvest profits and use bank loans when needed. This approach makes sense when a company is growing gradually and is not facing intense competition – ownership is satisfied with the status quo, and the company top management is focused on stability, not leadership.

Slow and cautious growth may seem safe, but in a dynamic market it leads to losing ground in competition.

While some companies embrace new technologies, enter promising markets, and take the lead, others – those choosing a “comfortable pace” – quietly fall behind. The effects keep piling up, and over time, company's products and services become outdated, customers switch to better appealing competitors, and profits and shareholder value shrink.

This pitfall can be avoided – but only through the implementation of **active growth strategy**. This strategy means not just maintaining current positions, but proactively advancing business, and includes:

- Business scaling – entering new geographical market, expanding branch network, building new production capacities;
- Product line expansion – developing and launching new products, platforms, or ecosystems;
- M&A transactions – aimed at consolidating the main market or entering related markets.

As market competition intensifies, the need for **active growth strategy** becomes ever more apparent. Intense competition also means that potential consequences of delay or inaction become more critical: the loss of market share.

Active growth strategy requires substantial financial resources. Operating cash flows are usually not enough to finance this strategy. That's why companies raise long-term financing from external sources, and this allows them to make a qualitative leap in development.

For most business owners, a bank loan is the most familiar source of financing. But debt has its limitations: debt has to be serviced, it reduces flexibility, and puts pressure on operating cash flows. When implementing **active growth strategy**, higher levels of debt inflate company's financial risks. This is where an alternative source comes in – equity financing from new investors.

➤ A company's success, from the owner's perspective, is measured by its ability to grow at a pace that consistently increases shareholder value. Such a company typically sets ambitious goals and systematically addresses strategic tasks: business scaling, entering new markets, driving technological transformation, staying ahead of competitors.

The goal of an **active growth strategy** is not just revenue growth, but growth in returns for the owners through increased shareholder value and dividends. To achieve this, the company must intensively grow sales and EBITDA, maintain strong return on invested capital (ROIC) that exceeds its cost of capital (WACC).

For an overview of ROIC, WACC, capital structure, their practical applications and related concepts see ink Advisory publication: **“ROIC > WACC: The Formula for Creating Shareholder Value”**.

Companies that choose an active strategy and build an optimal financing structure become market leaders in the long run. If the market is growing faster than your business, that's a strong signal to act: raise capital, strengthen your team, and scale your business.

WHAT IS EQUITY FINANCING AND DO YOU PULL THE TRIGGER?

When considering external financing options, it is crucial for a business owner not to dismiss outright the option of raising equity – and to clearly understand its essence, not in abstract terms, but through the lens of business logic.

Equity financing means attracting external capital in exchange for company share. Unlike debt, this instrument does not involve collaterals or guarantees of repayment of principal and interest on a fixed schedule.

An investor becomes a co-owner of the company, assumes a share in its risks and rewards, and is explicitly interested in seeing the value of his or her share grow along with valuation of the business as a whole. The investor's key source of return is the growth in company valuation, which aligns with the founder's interests. Dividends may also be a source of income, but the company is not legally obliged to pay them.

➤ The investor doesn't just bring money – the investor is a strategic ally to the founder in executing company's vision.

By raising equity financing, the company gains several advantages:

- **Accelerated growth.**
New equity enables the company to outpace the market – scaling sales, production, IT platforms, and geographic reach;
- **Financial resilience and flexibility.**
Equity capital strengthens the company's balance sheet and reduces its debt burden. This is critical when maintaining high growth rates or navigating turbulence and large-scale transformation;
- **Support in business transformation.**
During active growth, companies often need stronger management: a shift from manual control to structured systems. The investor acts as a catalyst for this change, helping to implement new management practices and raise organizational maturity.

From the founder's perspective, equity financing offers several advantages over debt financing:

1. Investors bring in more than just capital – they contribute valuable experience, industry expertise, and management support, accelerating strategic development of the company;
2. Significant amount of funding can be raised to scale the business without breaching debt capacity limits;
3. Partnership with a well-known and respected investor boosts trust in the company and strengthens its reputation;
4. Dividends are paid at the partners' discretion, not automatically like loan interest;
5. Founder's financial risks are reduced through sharing them with the investor.

On the flipside, equity financing also comes with certain drawbacks for the founder:

1. Bringing in an investor dilutes the founder's ownership, reducing the share in capital;
2. External investors demand high levels of transparency and regular reporting;
3. Investors expect the company to deliver results in line with agreed-upon plans;
4. Potential for conflicts: the founder and investors may differ in their views of strategy, timing of exit, or dividend payouts;
5. The shareholders' agreement signed with the investor may restrict the sale of shares, dividend distributions, and raising new capital without investor consent.

If the company has reached the limits of growth using internal funds and debt, equity financing can become the next stage growth driver. It is essential for the founder to understand: this path requires maturity in management and a willingness to enter into a partnership.

EQUITY VS FINANCIAL DEBT

Financial leverage helps a business grow up to a certain point. Beyond that point, the company's financial stability declines, and its value begins to deteriorate.

Bank loans are a familiar and straightforward financing tool for businesses. However, when pursuing **active growth strategy**, debt can become a constraint rather than a solution.

Financial debt is a reasonable and effective tool – as long as it doesn't undermine the company's financial stability. Loans and similar debt instruments help cover corporate needs: maintaining working capital and investing in production assets. However, the potential of debt capital is limited by fundamental factors.

It makes sense to raise debt for a new development project when the company already has a stable and predictable cash flow, and when revenue and margin volatility are low. In such conditions, the Debt/EBITDA ratio (debt relative to operating profit before depreciation) can remain within a safe range of up to 3.0x, without threatening financial health of the company.

But as debt levels rise – once the ratio reaches 3.5x or higher, the situation changes dramatically: leverage starts to work against the business.

The effects of high leverage:

- **Cash flow risk increases.**
Mandatory debt service payments reduce operational flexibility – especially in an unstable market environment;
- **Credit rating worsens.**
Lenders view the company as riskier, offer less favorable financing terms and demand better security on loans;
- **Access to capital shrinks.**
A highly leveraged company becomes unattractive to new lenders and investors;
- **Company valuation plummets.**
Investors factor in the risk of bankruptcy or restructuring, apply a discount, and this directly affects shareholder value and the ability to raise equity capital.

The owner has to recognize when the debt ceiling has been reached. If Debt/EBITDA > 3.0x, then equity financing is no longer just an alternative – it becomes the primary source of funding **active growth strategy**.

Parameter	Financial Debt	Equity
Repayment	Mandatory, with interest, on a strict schedule	No repayment or regular payments required
Impact on Company's Cash Flows	Creates pressure via mandatory interest and principal payments	Minimal impact
Debt / EBITDA	Optimal up to 3.0x	Does not increase leverage
Financial Flexibility	Low	High – adaptable to situation
Suitable for Financing	Working capital, equipment or Capex	Business scaling, entering new markets, R&D, M&A deals
Effect on ROE ¹	Increases ROE with stable profits	Reduces ROE in the short term, increases capitalization
Investor Participation	-	Through shareholder meetings or the Board of Directors

¹ ROE – Return on Equity, calculated as Net Income divided by Shareholder's Equity.

- Debt/EBITDA of 3.0x is not just a debt ceiling – it's the point where a business starts to lose its market appeal to investors and lenders.

Why Debt/EBITDA > 3.0x is a serious risk for businesses

The Debt/EBITDA ratio is widely used in capital markets to assess level of company's leverage. From an investor's perspective, this metric should remain below 3.0 – meaning the company's financial debt should not exceed its three-year EBITDA. Any excess over this threshold significantly increases the financial risk.

The maximum acceptable leverage level has been determined by international rating agencies based on long-term statistics on corporate debt and debt-servicing capacity.

For example, S&P assigns credit ratings and default probabilities based on a company's financial risk profile: minimal, modest, intermediate, significant, aggressive, or highly leveraged.

According to 2024 data, the 3-year default risk by Debt/EBITDA level was:

- Debt/EBITDA < 3.0x – default risk below 0.5%
- Debt/EBITDA between 3.0x–4.0x – risk jumps to 3.2%
- Debt/EBITDA > 5.0x – risk skyrockets to 35.2%

If a company's financial debt exceeds 3.0x EBITDA, banks and other lenders begin imposing additional restrictions: dividend limits, bans on new loans, and requirements to maintain financial covenants. These measures are meant to protect lenders against default risk – but they also limit business freedom and raise the cost of capital. Moreover, the business becomes increasingly dependent on banks.

Company credit quality based on key indicators according to S&P methodology (Standard Industry Volatility Profile, 2024)

Level of Financial Risk & Possible S&P Rating	FFO ¹ / Debt	Debt/ EBITDA	EBITDA/ Interest	CFO ² / Debt	1-Year Default Risk	3-Year Default Risk	Comment
Minimal (AAA, AA+, AA, AA-, A+)	> 60%	< 1.5x	> 15x	> 50%	0,0%	0,0%	Maximum stability, lowest interest rates
Modest (A, A-)	45–60%	1.5–2.0x	10–15x	35–50%	0,1%	0,3%	Strong structure, low risk, high predictability
Intermediate (BBB+, BBB, BBB-)	30–45%	2.0–3.0x	6–10x	25–35%	0,1–0,3%	0,3%	Moderate leverage, minimal risk
Significant (BB+, BB)	20–30%	3.0–4.0x	3–6x	15–25%	0.2%	1.3%	Loss of investment-grade rating, higher cost of debt
Aggressive (B+, B)	12–20%	4.0–5.0x	2–3x	10–15%	1.7%	6.7%	Low stability, high debt cost
Highly Leveraged (CCC+, CCC, CCC-, C)	< 12%	> 5.0x	< 2x	< 10%	28.4%	35.2%	Pre-default state, high risk of debt servicing failure

¹ FFO – Funds From Operations: post-tax operating cash flow before changes in working capital.

² CFO – Cash Flow from Operations: post-tax operating cash flow after changes in working capital.

Source: S&P Global Ratings. Corporate Methodology, November 19, 2013 (last updated January 7, 2024), 2024 Annual Global Corporate Default and Rating Transition Study, April 2025.

HOW DO YOU RAISE NEW EQUITY?

Raising equity is a strategic move that requires thorough preparation. On one hand, the business must be shaped into a form appealing to investors; on the other, it's essential to understand the expectations of investment community regarding potential partnership.

Preparing for the Process

Preparing a company for raising equity capital typically involves two complementary tracks:

1. Strategic Track

Developing long-term growth plans and a solid investment case, essential for investor negotiations. The goal is to provide the investor with:

- A clear and compelling growth strategy, including market analysis and a detailed roadmap;
- A financial model with detailed forecasts of sales, EBITDA, capital structure, and cash flows.

2. Operational Track

Undertaking measures to enhance transparency and improve manageability:

- Streamlining ownership structure, asset ownership, and improving contractual transparency;
- Preparing high-quality financial and management reporting;
- Implementing ERP, CRM, and electronic document management systems;
- Improving organizational structure and employee incentive systems.

It is recommended to launch both strategic and operational tracks 12–18 months before the planned capital raise. This significantly increases the chances of successfully raising new equity at the best possible terms.

Investors Look Deeper: What Do They Assess?



When the strategy is clear and the metrics are convincing, investors move on to the question:

Is the Founder prepared to take the next step? Is he or she ready for institutional development of the company and a true partnership?

Investors assess the Founder's maturity based on three key factors:

1. Management Principles and Founder's View on Partnership

- Does the Founder share modern views on management – delegation of responsibility, process transparency, etc.?
- Does the Founder see the investor not just as a source of capital, but as a partner with experience and strategic thinking?
- Is the Founder prepared to implement structured management with clear responsibilities and control?

2. Corporate Governance

- Does the Founder understand the importance of regulations, decision-making procedures, and reporting?
- Is the Founder ready to separate roles between ownership and the executive team?
- Is the Founder willing to establish a functioning board of directors?

3. Shareholders' Agreement

- Has the Founder ensured a transparent ownership structure – with no hidden shares, options, or verbal agreements?
- Is the Founder ready to sign a shareholder agreement with clear rules?
- Is the Founder prepared to work within the framework of formalized shareholder arrangements?

WHAT'S NEXT?

If you realize that your business needs funding to grow, but your debt is already at its upper limit — don't delay the decision. Raising new equity is a strategic choice that requires time and resources for thorough preparation. A delayed decision often turns out to be the most expensive one.

Where Do We Go From Here?



It can be difficult to independently assess the prospects of raising equity financing — that's why it's important to turn to external experts who can professionally manage the entire process.

With proper assistance, you will be able to:

- Analyze your business and make a professional assessment of the cost of capital and its efficiency;
- Determine which sources of financing are most suitable for your specific situation;
- Conduct a comprehensive business assessment and launch a program to improve its investment appeal;
- Build a compelling investment case and prepare the pitch deck for investors.

Once the company is ready to engage an investor and the investment offer is formulated, your advisor will:

- start marketing the company and present the investment offer to potential investors;
- lead negotiations to secure the best deal terms for the Founder;
- structure and execute the transaction on behalf of the Founder.

ink Advisory team provides end-to-end support in equity raising transactions for business owners and executives.

Our approach:

- Professional expertise — we guide you through every stage, from preparation to deal closing;
- Transparency — you're always informed about the process and decisions being made;
- Full confidentiality — we guarantee the protection of your commercial information.

We speak the language of business and understand what matters to owners. Our mission is to make the process as smooth and effective as possible.

ABOUT US

ink Advisory is an investment banking group founded in 2024 by a team of professionals with decades of experience in the US, CIS and the EU.

Prior to establishing ink Advisory, the team had been known in the investment banking market as Lead Advisory division of Crowe CRS (Russaudit).

ink Advisory advises clients in M&A deals, establishing joint ventures and raising equity, and builds corporate strategies and capital growth strategies.

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