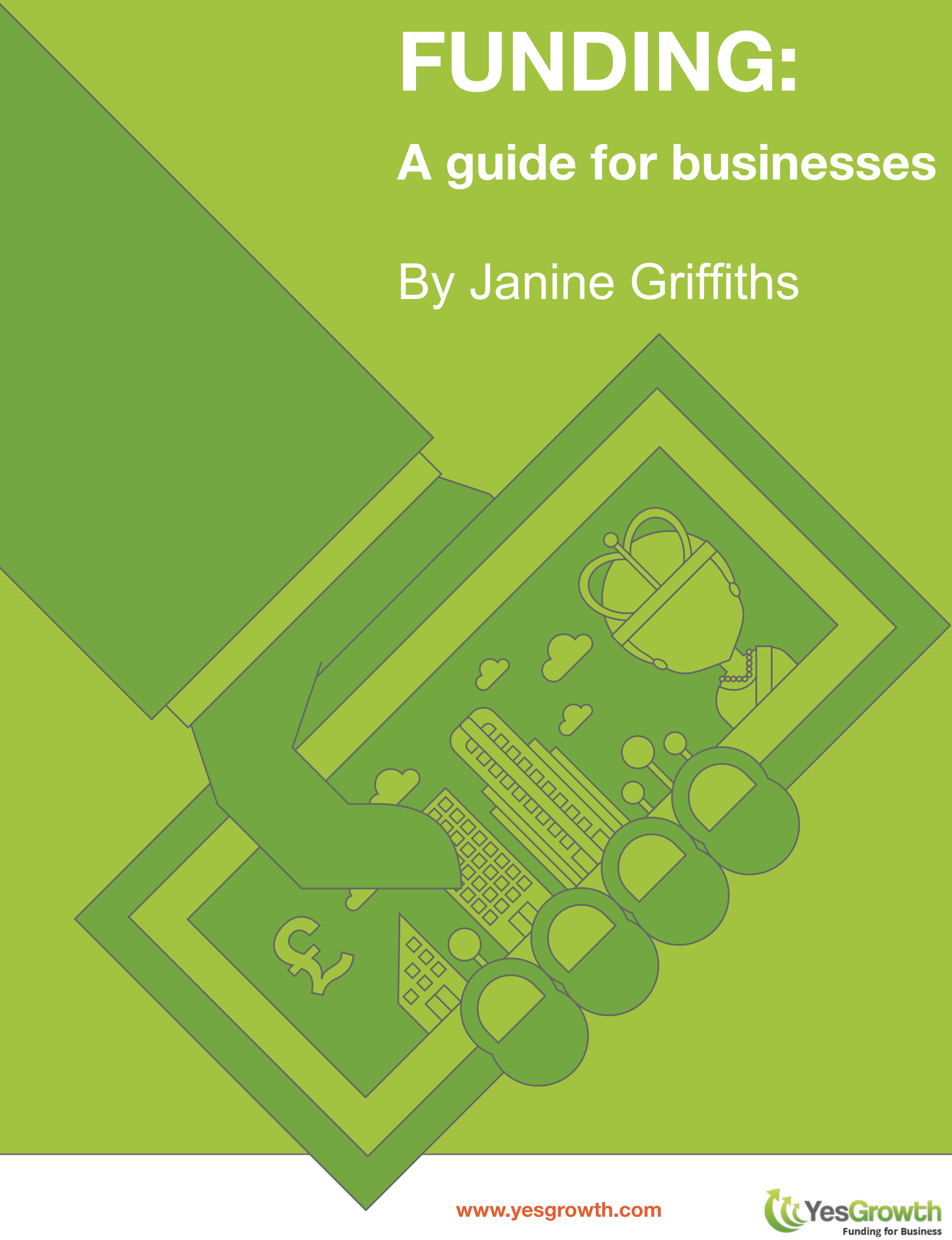
ALTERNATIVE FUNDING:

A guide for businesses

By Janine Griffiths



www.yesgrowth.com

YesGrowth
Funding for Business

The alternative finance industry is quickly becoming an important part of the UK economy.

A growing number of businesses are looking for ways to finance their enterprises, at a time when banks are restricting access to loans and have been squeezed by new lending rules.

Earlier this year, the Federation of Small Businesses (FSB) revealed that the new proposals from the Basel Committee on Banking Supervision the group that sets global banking standards will raise the amount of capital the banks are required to hold against certain loans.

In a nutshell, it means that banks will be forced to pass on the cost to businesses. This, the FSB argues, will put smaller businesses at a disadvantage.

FSB figures also suggest that the lending market in the UK is still currently dominated by the biggest banks. Its data showed that the big four banks controlled 85 per cent of lending to SMEs.[1]

With SMEs making up 99.9 per cent of private sector businesses and 60 per cent of private sector jobs, it is vital that business leaders understand the various funding opportunities available to them.

The Confederation of British Industry estimates that by allowing SMEs to develop to their full potential, it could inject a possible £20 billion into the economy by 2020.[2]

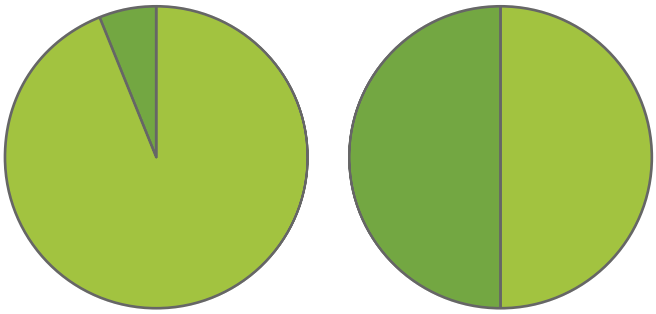
While a significant number of firms will turn to the big banks for financial assistance, there are a number of alternative funding models available.

The last ten years has seen an explosion of new lenders come onto the market, which has meant that despite the fact that big banks still dominate lending practices, SMEs are no longer as reliant upon them as they once were.

The demand for business finance has continued to grow over the years. Figures by UK Bond Network show that over two-thirds of UK small to medium sized businesses said they would consider using alternative finance to raise capital.[3]

This rose to 94 per cent among companies with annual revenue over £1.1 million. In addition, half of the firms questioned said alternative finance has opened up new opportunities for funding.

Firms considering use of alternative finance



94% among companies with annual revenue over **£1.1 million**

50% of the firms questioned said alternative finance has opened up new opportunities for funding

However, despite the growth in the alternative finance sector, some enterprises still fail to obtain funding.

This is quite often not due to a lack of innovation or poor business planning, but rather, a lack of preparation.

Among the most common mistakes that businesses make when applying for finance are applying for the wrong amount relative to the size of their business, failing to observe the eligibility criteria set out in the application, and lack of preparation.

Some businesses also run into difficulty when they fail to read the terms and conditions of a loan agreement fully, underestimate their budget constraints or requirements or fail to submit the required documents.

Therefore, when it comes to applying for any kind of alternative finance, it is essential that businesses prepare adequately.

It is also necessary for firms to ensure that their accounting information, business plans and other financial data are up to date.

[1] http://www.fsb.org.uk/firstvoice/images/pdf%20magazines/december%20january%202014/fv.pdf

[2] http://www.cbi.org.uk/mediacentre/pressreleases/2011/10/futurechampionsreportmediumsized/

[3] https://www.ukbondnetwork.com/

Furthermore, to boost the chances of success, it is necessary to understand the different options available, and the pros and cons of each one.

Many of the alternative finance models available will be more suitable for specific industry sectors such as technology or science, while others will have a broader appeal.

In this eBook, we outline some of the main funding options available for businesses and examine the merits of each.

Summary

The alternative finance market is expected to grow significantly over the next 12 months.

As the economy recovers, a growing number of businesses will be seeking to hire new staff members and look for ways to expand.

To do this, firms will need more access to finance in order to grow and thrive. Unsurprisingly, this has served to heighten the demand for alternative finance in the UK.

Last year, research published jointly by the charity Nesta and the University of Cambridge found that in the UK, the alternative finance market to reach £4.4 billion by end of this year.[4]

In the first three quarters of 2014, alternative finance platforms facilitated loans, investments and donations worth £1.2 billion.

Its figures showed that peer-to-peer business and consumer lending continued to dominate the market with £749 million and £547 million being lent through the models respectively in 2014.

The report also showed that equity-based crowdfunding reached £84 million, which represents a 201 per cent rise year-on-year.

Furthermore, it revealed that the alternative finance market has more than doubled in size year on year from £267 million in 2012 and £666 million in 2013, to £1.74 billion in 2014.

The good news for many businesses is that while demand for alternative finance products is growing, there is also evidence that the appetite for lending is also growing.

Figures by Nesta and the University of Cambridge show that more than half of P2P business lenders for example, plan to lend more in the coming year than last year.

Separate research by the Federation of Small Businesses (FSB) showed that 63.3 per cent of small businesses with over 50 employees were successful when applying for loans.[5]

In addition, 45.8 per cent of sole traders who apply for credit were successful. This has helped to feed into greater optimism and confidence, with its index showing that confidence levels remained steady at +37.9, up from +28.7 in the first quarter of 2015.

Alternative finance covers a variety of new financing models which allow businesses to get access to funding that they may not have been able to obtain through traditional means.

These include models such as pension-led funding, asset-based lending, business angels/private equity, invoice trading, invoice discounting, venture capital, peer-to-peer lending, and corporate venturing.

We will also be discussing the benefits of using Merchant Cash Advance providers and how they work.

In this eBook we will also discuss some of the major data and statistics around the various alternative financing models and helping businesses to determine which model will be most relevant to their enterprise.

We shall also be exploring what the benefits are and some of the pitfalls to look out for, in order to help you make an informed decision.

[4] https://www.nesta.org.uk/sites/default/files/understandingalternativefinance2014.pdf

[5] http://www.fsb.org.uk/firstvoice/images/pdf%20magazines/december%20january%202014/fv.pdf

Pension-Led Funding

Pension-led funding (PLF) is a finance model whereby business owners and directors are given the chance to reinvest their retirement savings in their own companies and ventures.

It raises funds for businesses based upon the use of pension benefits accrued by owners or directors of the business they control.

This type of funding model is often used by small business owners and directors that are seeking to invest in mature, established companies.

It is often used by sole-traders, and is achieved through a commercial loan from a pension scheme to a company, or through the sale of intellectual property to the pension scheme.

BENEFITS OF PENSION-LED FUNDING

There are several key benefits for businesses that opt for this model.

It can facilitate a larger overall funding solution as lenders are normally keen for a business owner to show willingness to back themselves.

Another key advantage with this type of investment is the ability to leverage the value of the business's Intellectual Property (IP).

Existing lenders may already have a charge over the assets of a business, but many allow PLF forums to fund against the IP thereby helping to increase funds for businesses.

With this type of financing, there is no limitation on what the funding is used for, and helps you to monetise your intellectual property.

Pension-led funding also provides credit protection for assets within the pension trust and introduces new capital into a company.

Unlike taking a loan from the banks, a borrower is not going to face punitive charges, or be pursued personally should they default.

The owner, or at least their pension fund, takes on all the risk and those confident of business growth will be similarly confident of paying back the money to their pension fund.

PITFALLS OF PENSION-LED FUNDING

The obvious risk associated with this type of model is if you invest some of your pension money into the business and the firm subsequently fails, borrowers face the double version of losing both the investment and the company.

However, if a firm has sold its IP to the pension then all might not be lost, as this property may still retain an element of value even if the business goes under.

Research published by AccountingWEB Alternative Funding Guide in 2013[6] showed that pension-led funding was more competitive than peer 2 peer funding, a bank overdraft, invoice discounting and factoring.

[6] http://www.accountingweb.co.uk/article/accountingwebalternativefinanceguide2013/547238

When compared to other forms of funding such as a bank overdraft, pension-led funding was almost half of the cost – £11,296 over five years compared with £20,625 for the bank overdraft.

This type of funding can also generate significant amount of funds for businesses, with the average amount of funding secured by those using pension–led finance standing at £70,257, according to a joint report by Nesta and the University of Cambridge.

WHO SHOULD USE PENSION LED FUNDING?

Of course, pension led funding is not suitable for everyone. In order to use PLF, borrowers need to have pension funds set aside, and be willing to accept the risks that come with repurposing them.

If a business owner, director or sole trader does not have a large enough pension pot to make the process viable, they cannot raise funds for their venture in this way.

Similarly, if a company is not in a good financial condition, it is unlikely that the scheme trustee or pension adviser will agree to a loan being made as it may represent a significant risk to the capital.

Therefore this type of funding model would be more suitable for firms with significant pension funds accrued.

Invoice trading/ Invoice discounting

Invoice trading is a system in which small and medium-sized enterprises (SMEs) auction their invoices over the internet to release money rather than having to wait for their clients to pay.

Under this process, firms can sell their invoices to a pool of individual or institutional investors at a discounted price.

Invoice trading grew by 179 per cent in the UK during 2014, following growth of 169 per cent the previous year, according to Nesta.[7]

The main benefit of this type of process is that it allows companies to potentially access large sums of money very quickly. It is more suited to older or slightly more established companies, with Nesta revealing that over two-fifths of the survey respondents had been in business for more than a decade.

Cash flow pressures have resulted in many firms taking up invoice trading, with 14 per cent of firms saying they used invoice trading to fund the expansion of their company.

Previous studies have highlighted a number of significant advantages for businesses using invoice trading.

The Nesta study found that 90 per cent of firms saw an increase in profit, 80 per cent experienced a rise in turnover, while 60 per cent had hired more people as a result.

Impact of Invoice trading

The vast majority of firms find out about invoice trading online, with 43 per cent of companies saying they had learned about this form of alternative finance over the internet.

An additional 29 per cent were told by an adviser and 12 per cent learned about it through print advertising.

[7] https://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf

It is important to distinguish between invoice-based providers and providers who fund the supply chain.

With invoice-based providers, lenders bid to advance money to SMEs based on trade receivables invoices issued.

These lenders are largely made up of institutional investors, such as hedge funds and asset managers, and wealthy individuals.

One of the most recognised invoice-based providers is Market Invoice, which launched in 2011. It works by posting the invoice and all relevant documentation and allows firms to individually auction for it.

An advance of 90 per cent of the invoice value is normally the maximum that is allowed.

On the other hand, Trade Finance is a product that has been designed to allow businesses to fulfil orders they would otherwise struggle with.

Trade Finance providers fund the supply chain and both buyers and sellers can choose to use trade finance to mitigate risks.

Asset based lending

Asset based loans are those which are secured against the assets of a company. They often come in the form of inventory, machinery, equipment, property or accounts receivable and are made on the basis of revolving credit.

Essentially, with these types of agreements, if the borrower fails to make a repayment, then the lender can seize the secured assets of the business.

As with any type of loan agreement, there are pros and cons associated with this type of loan.

ADVANTAGES OF ASSET-BASED LENDING

One of the benefits of asset-based lending is that companies of all sizes, across any industry can benefit from this type of agreement.

They can also offer a vital lifeline for those companies which are unable to obtain loans via the traditional channels.

This type of lending can be ideal for businesses that have poor credit, or have exhausted other options for raising capital.

In many cases, an asset-based loan may be the only way they can generate much needed funds to keep their business afloat.

Sometimes banks will not consider lending to firms that require loans below a certain amount (usually £250,000) and in these cases, such companies may particularly benefit from asset lending.

It is also a way for companies to immediately increase their working capital, with a highly flexible asset-based loan.

They are often easier to obtain than other types of loan and come with fewer contractual obligations.

Usually, a lender will customise asset loans according to the immediate requirements of the borrower, which takes their needs, abilities to repay and requirements into consideration.

DISADVANTAGES OF ASSET BASED LENDING

As with most loans, asset based lending also has its downsides. One of the biggest disadvantages is that these types of loans can often be a more expensive form of borrowing than other types of lending, especially for those firms with bad credit.

This is because lenders will often increase interest rates and fees to mitigate the risks of lending to firms with a poor credit history.

However, it should also be noted that in some cases, companies may be able to obtain a good deal on their interest loans if they have high-value assets.

If this is the case, a lender may decide to lower their interest rates as they will reap the benefits regardless of whether a company defaults on a loan or not.

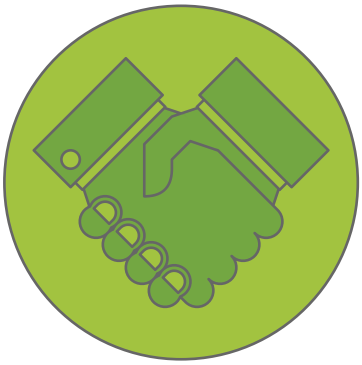
For example, if a firm repays the loan, then it benefits the lender, and if they do not, then the lender will be able to seize some of the high value assets associated with the loan.

Another risk is that if a company fails to pay back the required amount, they may lose key assets as a result and this can make it difficult for companies to continue trading.

For instance, a business which borrows against its premises or important pieces of equipment may have no way to make money should ownership of those assets transfer to another party.

A firm's assets may often be monitored and audited on a regular basis to ensure it has value for a lender.

With this in mind, businesses need to weigh up the risks of losing valuable possessions against the benefits of being able to obtain credit quickly.



Business Angels/ Private equity

Business angels are wealthy individuals who invest money in small and medium-sized enterprises (SMEs) and start-up companies in return for an equity stake.

They come from a range of different sources, and may be a friend or family member, a venture capitalist, angel investor or entreprener.

Their main reason for investing in a company is to make a financial gain from the investment. They may also have an interest in helping the business to progress.

Ideally business angels expect to see a return on investment of around 10-20 times their initial investment between three and seven years.

In order to ensure that a business continues to expand and grow, a business angel may sit on the board of directors as a shareholder and take an active role in a company's direction.

Over the last two decades, these types of investors have played an increasingly important role in providing finance to companies that otherwise may not have been able to realise their expansion plans.

Currently, there are around 18,000 business angels that invest collectively £850 million each year.

Private equity on the other hand is a source of investment capital from funds, family offices and institutions.

Private equity firms invest money in return for equity ownership.

Typically, such entities raise funds and manage these monies to yield favorable returns for their shareholder clients.

WHAT ARE THE BENEFITS OF USING BUSINESS ANGELS?

The main benefits associated with this type of funding is that in many cases, firms will not need to have collateral in order to be eligible for the funding.

It can also be a quick and efficient way for businesses to gain the capital they need, without having to worry about repayments or interest as with other types of funding.

They may also gain access to mentoring or management skills.

BOOSTING YOUR CHANCE OF FUNDING

In order to boost the the chances of being being funde, firms should also do serious research into the type of investors and finance options that would be more appropriate for their organisation.

A good place to start for instance would be the British Business Angels Association, which is comprised of over 100 different organisations and networks.

Another way for companies to get in touch with business angels is networking and attending pitching events or investor networks is a great way of getting in touch with people. Social media sites such as LinkedIn and Google+ are another way for firms to get in touch with business angels.

DIFFERENCES BETWEEN A PRIVATE EQUITY AND BUSINESS ANGEL MODEL

The main difference between angel investors and private equity is that the latter tend to invest in businesses showing considerable traction and the ability to grow into a significantly-sized business.

Venture capital

Venture Capital and corporate venturing are ideal for high-growth businesses with strong earnings potential.

With this type of funding, the venture capital firm will raise money from wealthy individuals and family offices and pension funds.

The firm will then invest that fund into a small number of companies that fit their investment criteria.

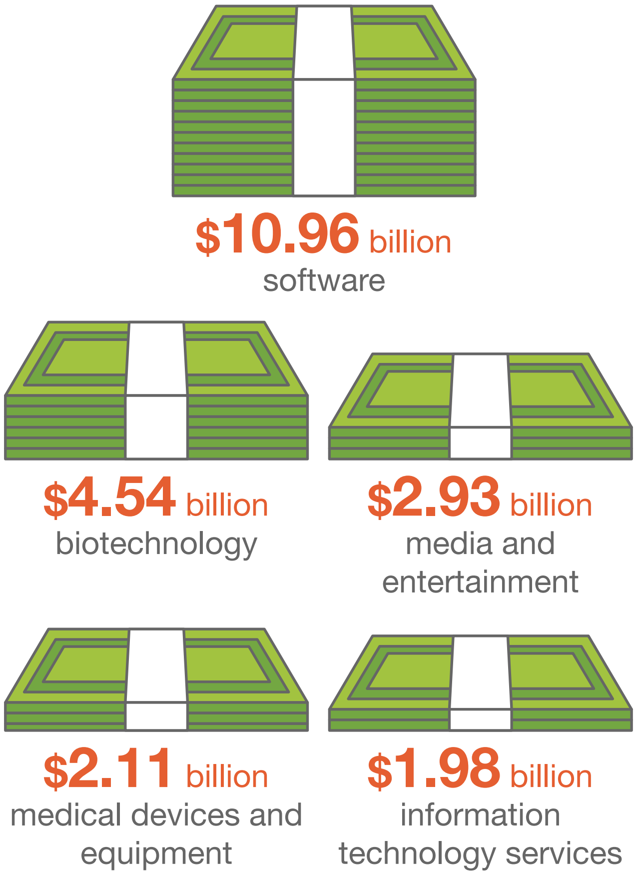
When the firm begins to expand and generate profit, the funds the firm generated are then distributed back to the investors.

WHICH TYPE OF FIRMS ARE MOST LIKELY TO BENEFIT FROM THIS TYPE OF FUND?

This type of funding is ideal for high-growth SMEs unable to access capital markets or large bank loans.

A 2013 report published by PricewaterhouseCoopers (PwC) found that the five largest industries in terms of venture capital investment were software ($10.96 billion, which equates to £7.11 billion), biotechnology ($4.54 billion), media and entertainment ($2.93 billion), medical devices and equipment ($2.11 billion) and information technology services ($1.98 billion).[8]

Venture Capital Investment by Sector



The main reason these sectors tend to reap the most advantages from this type of funding is due to their increased focus on research, testing and product development as opposed to labour and infrastructure.

Research and testing tends to be more mobile and applicable to a number of different markets, whereas physical capital and labour are often more restricted.

[8] http://www.pwc.com/us/en/pressreleases/2015/venturecapitalinvestingexceeds.html

Crowdfunding/ Peer-to-peer lending

Crowdfunding is a way of raising finance by the participation of a large number of people each contributing a small amount of money to a business, product or project.

There are a number of different forms of crowdfunding. These include equity crowdfunding, donation crowdfunding and debt crowdfunding. We discuss these further below.

EQUITY CROWDFUNDING

This is a process whereby individuals invest in an unlisted enterprise in exchange for shares in the company. They then have partial ownership of the enterprise and stand to profit in the future through dividends or by selling their shares if the company does well.

When a company seeks funding through the equity crowdfunding model, they typically give a small amount of equity to each individual in a large pool of investors. Each financial backer provides a small amount of money in return for a minor stake in the company.

Crowdfunding sites such as Crowdcube, SEEDS and Crowdfunder are the main platforms that businesses can raise equity/finance in the UK

DONATION/REWARD CROWDFUNDING

This is when individuals invest in a cause they believe in. Often a reward is offered in exchange for a donation, and may include things such as free gifts, being mentioned on a plaque or album cover, or free videos.

Many donors will not expect anything else or any profits back in exchange for their donation.

DEBT CROWDFUNDING

Debt crowdfunding is where firms or individuals donate some money in exchange for receiving their money back with interest.

This form of crowdfunding is also known as peer-to-peer (P2P) lending, it allows for the lending of money and means that recipients will not have to rely upon high-street banks.

Not only do investors get their money back, they also get to directly contribute to a firm they are interested in.

This differs from microfinancing, where individuals lend to individual firms in developing countries on a charitable basis, and get no interest back on their loan.

Small companies typically turn to P2P business lending to fund expansion, provide working capital or pay for asset purchases. They are attracted to the platform by its speed and ease of use, plus the fact that finance is more accessible via P2P channels than through the banks.

PEER-TO-PEER LENDING

As mentioned, crowdfunding is a form of P2P lending. However, P2P lending falls into two different categories business P2P lending, and consumer P2P lending.

P2P business lending involves debt-based transactions between individuals and existing companies - typically those who are in a growth stage. These firms most commonly operate in the manufacturing, professional and business services, retail, construction, IT, leisure, healthcare, wholesale and finance sectors. But any business, across any industry, can apply for P2P lending - providing it meets lender criteria and meets the loan repayment terms.

It can take hundreds of different micro-transactions - where investors loan a small amount of money - to form a single loan. This can be secured or unsecured depending on the terms of the agreement. An agreed rate of interest is paid over the duration of the contract, ensuring the investor receives a return on their initial capital.

The main reason investors turn to P2P business lending is to make a financial return, but other reasons include the simplicity of the investment platform, the desire to diversify investment portfolios and the ability to exercise control over who borrows their money.

Consumer P2P lending is similar, where consumers use online platforms to borrow from a number of individuals, each of whom lends a small amount as part of an investment pool. Consumers submit an application, specifying how much they wish to borrow and for how long, and then algorithms and automated matching mechanisms determine whether or not the loan is approved.

Borrowers typically access finance through P2P consumer lending to fund major purchases, conduct home improvements and consolidate debts.

Conclusion

There are a large number of resources and alternative funding options available for businesses in the UK.

In a climate when the big high-street banks are tightening the reins on their lending, the alternative finance market gives a much-needed lifeline to British businesses.

Over the years, alternative finance has rapidly evolved into a properly regulated market and a set of well-defined asset classes.

The market has more than doubled in size year-on-year from £267 million in 2012 to £666 million in 2013 to £1.74 billion in 2014, according to Nesta.[9]

It has helped many firms to gain greater control over their money, and allowed them to get access to funds that they may previously not have had access to.

With businesses being the backbone of the British economy, these extra funding options that have been unlocked for firms have undoubtedly helped to contribute to the growth and vitality of the UK economy and encouraged new lenders and investors to come onto the market.

While this is good news for many growing firms, as we have seen above, there is still a need for businesses to do their homework and be properly prepared before submitting applications.

For example, some funding solutions such as asset based lending and pension led funding are only available to certain types of firms, usually those with significant assets or high-growth companies.

HOW CAN ENTERPRISES BOOST THEIR CHANCES OF BEING FUNDED?

With any type of loan application, enterprises need to ensure they meet the requirements of the funding platform.

Typically, lenders look for firms that are profitable, have growth potential and be assured that any funding received will help the recipient to expand, profitably.

Equally, applications are typically supported by financial reports and forecasts, biographies of key people and summaries of intellectual property.

It is also essential for businesses to put together a robust and professional business plan and details of how it intends to meet its goals.

Additionally, a firm will need to consider whether the sector it is operating in is suited to the particular forms of finance it is applying for.

WHERE CAN BUSINESSES GO FOR HELP?

Enterprises can obtain further advice on funding options from YesGrowth at:

https://www.yesgrowth.com/

[9] https://www.nesta.org.uk/sites/default/files/understandingalternativefinance2014.pdf

Alternative Funding Providers

The companies listed below are a selection of alternative funding providers and not intended to be fully comprehensive. The company names, logos, and brands are the property of their respective owners and their inclusion in this document does not imply endorsement.

PENSION-LED FUNDING

pensionled funding.com

www.pensionledfunding.com

INVOICE TRADING/TRADE FINANCE

ArchOver

www.archover.com

catalyst finance

www.catalyst-finance.com

LEGION TRADE FINANCE

www.legiontradefinance.com

marketinvoice

www.marketinvoice.com

Platform Black

www.platformblack.com

WORKING CAPITAL PARTNERS

www.workingcapitalpartners.co.uk

ASSET-BASED LENDING

ABFA ASSET BASED FINANCE ASSOCIATION

Informing • Engaging • Setting Standards

www.abfa.org.uk

PENSION-LED FUNDING

aldermore

www.aldermore.co.uk

LDF

www.ldf.co.uk

SHAWBROOK BANK

www.shawbrook.co.uk

BUSINESS ANGELS, PRIVATE EQUITY AND VENTURE CAPITAL

BVCA British Private Equity & Venture Capital Association

www.bvca.co.uk

BUSINESS GROWTH SERVICE

www.ga.businessgrowthservice.greatbusiness.gov.uk

UK Business Angels Association

www.ukbusinessangelsassociation.org.uk

EQUITY CROWDFUNDING

crowdcube

www.crowdcube.com

SEEDRS

www.seedrs.com

SYNDICATE ROOM
Intelligent Equity Crowdfunding

www.syndicateroom.com

BUSINESS LENDING PLATFORMS

assetz® CAPITAL

www.assetzcapital.co.uk

BOOST CAPITAL

www.boostcapital.co.uk

everline

www.everline.com

fleximize

www.fleximize.com

Funding Circle
Better for business, better for investors, better all round.

www.fundingcircle.com

FundingKnight
CROWDLENDING TO BUSINESSES

www.fundingknight.com

iwoca
instant working capital

www.iwoca.co.uk

NACFB
Helping Fund UK Business

www.smallbusinessfinancedirectory.co.uk

Rate%Setter™

www.ratesetter.com

YesGrowth
Funding for Business

www.yesgrowth.com

www.yesgrowth.com

YesGrowth
Funding for Business