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SUPPLEMENTARY MATERIAL

How to finance a growing business[1]

You can't build a wall without bricks: finding the money required to grow your business can be a challenge CREDIT: BLOOMBERG FINANCE LP/SIMON DAWSON

- Heidi Scrimgeour

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Scale-ups often struggle to get the funding required need to grow – here are some of the options available.
A scale-up is typically defined as a business that grows by an average of 20pc every year for three years and has a minimum of 10 employees at the start of that three-year period.

But while the UK may be an optimum place to start a small business (600 start-ups launched every day in London during the first six months of 2016, according to figures from Startup Britain) it lags behind the US and other leading economies in terms of the number of companies that successfully scale.

Welcome to the scale-up gap. An oft-cited barrier to growth is a lack of access to finance, so what are the current funding options for UK SMEs looking to scale up?

[1] **Extracted from:** http://www.telegraph.co.uk/connect/small-business/scaling-up/how-to-finance-a-growing-business/

Grants and regional funding

A plethora of grants and regional funding options exist, but many are for very early-stage development rather than growth. The ScaleUp Institute is one exception, while the British Business Bank is backed by the Government and exists to complement big bank lending. Additionally, the Business Growth Fund invests equity funding to help all kinds of businesses scale.

For micro-businesses looking to scale, an angel investment network is a good starting point Neeta Patel, The New Entrepreneurs Foundation

Should the Government do more to help close the scale-up gap? "There's lots of support," says Conrad Ford, chief executive of the online business finance supermarket, Funding Options. "The Enterprise Finance Guarantee (EFG) scheme helps lenders lend to SMEs unable to offer adequate security. Traditionally associated with major banks, EFG is now available through dozens of specialist lenders.

"The new bank referral scheme means that firms rejected by their bank for finance are offered alternatives through designated finance platforms, of which Funding Options is one," he adds.

More needs to be done to make funding both transparent and accessible, says Ian Watkinson, chief commercial officer of Clear Funding. "SMEs should be able to trust that there are suitable options available to them that can help support their growth ambitions without being punitive," he says.

"The Government's bank referral scheme is a positive step forward, helping businesses find an alternative provider that meets their business needs through platforms such as Funding Options, and SMEs can also take advantage of advisory services, such as the Federation of Small Businesses, which can give further support to help them run and grow."

Equity funding

Equity funding entails giving up a slice of your business in return for investment. Venture capital and angel investment networks are the two main equity funding routes open to small businesses, but require a clear plan for delivering a return to investors within an agreed time frame.

"For micro-businesses looking to scale, an angel investment network – typically high net-worth individuals who are investing their own money – is a good starting point," says Neeta Patel, founding chief executive of The New Entrepreneurs Foundation, which

has helped 200 aspiring entrepreneurs launch more than 70 ventures and raise more than £12m in early-stage funding over the past six years.

"For slightly more advanced businesses looking for £3-5m in scale-up funding, venture capital is the place to go for equity funding."

Debt funding

A bank loan is an option for companies with solid cash flow that can support the interest payments, but new global capital regulations designed to make banking more stable have made it harder for banks to offer large overdrafts, explains Mr Ford.

Crowdfunding has issues – not least that that you need to appeal to a large number of people online Neeta Patel, The New Entrepreneurs Foundation

"Invoice finance is a popular way for scale-up business-to-business (B2B) firms to unlock vital working capital as it grows with your business," he says. "Working capital finance options for high-growth business-to-consumer (B2C) firms are less obvious, but a new type of lender is emerging where firms repay a fixed percentage of revenues."

Crowdfunding

Many crowdfunding platforms exist, including equity and non-equity options – Seedrs and Crowdcube are two of the most well known.

"Crowdfunding has issues and complications – not least that that you need to appeal to a large number of people online and do a lot of marketing before you even list the business in order to be successful," says Ms Patel. "It's not an easy route. We read about the success stories, but they are few and far between."

Peer-to-peer lending

For scale-up firms seeking long-term loans, traditional high street banks prefer a consistent track record that many high-growth firms simply don't have. "Another challenge is that many high-growth sectors, such as technology and media, lack physical assets such as machinery to offer as security," says Mr Ford.

"Peer-to-peer lending has played a vital role in filling this gap, but the major banks have also launched specialist divisions to lend to their scale-up clients."

Keep it in the family

For Ms Patel, the most favourable finance option remains the one closest to home. “If you can raise the money you need via friends and family, that’s the best option at the early scaling stage,” she says. “There’s no pressure from investors asking for their money back or forcing you to exit before you’re ready. But, of course, the downside is that they may never speak to you again if you lose their money.”

Ultimately, there’s no silver bullet for financing a scale-up. “It all depends on your approach to risk, your attitude to giving away part of business, and your company’s ability to finance a debt,” she adds.

“Whatever funding route you take, remember that investors want to see sound business fundamentals first. Is your idea sound and the market good? Is there credibility in your team? Can you prove a path to serious profitability? Unless the answer is yes, none of the funding options will work.”

Will Crowdfunding Help Financial Inclusion of Unserved Crowds?[2]

18 July 2016

"Crowdfunding" refers to a range of technology-enabled financial innovations that hold great promise to reach the unserved and underserved masses. The term describes market-based financing where small amounts of funds are raised from large numbers of individual sources, typically using online platforms to match supply with demand, thus bypassing traditional financial intermediaries.

Photo Credit: Kailash Mittal, 2015 CGAP Photo Contest

[2] **Extracted from:** http://www.cgap.org/blog/will-crowdfunding-help-financial-inclusion-unserved-crowds

While crowdfunding has the potential to become the next big thing for financial inclusion, it brings along risks for both borrowers and lenders, which need to be better understood and timely addressed.

Two things are sure about crowdfunding: It is evolving, and it is growing at a very fast pace, not just in developed markets but in countries across the income spectrum. Emerging from notions of shared economy and social investment, crowdfunding has evolved into four main categories, distinguished by the promise made to the funder:

- Donations-based crowdfunding, in which funders do not expect any financial return.
- Rewards-based crowdfunding, where funders pre-buy the product or receive special perks as a reward.
- Debt-based crowdfunding, where funders lend money to other individuals or companies in return for interest payments.
- Equity-based crowdfunding, which allows funders to purchase equity in a company and earn a financial return if the company makes an exit through an initial public offering or acquisition.

We see lines blurring among these categories, however, with the creation of many hybrid models, some of which rely mostly on institutional investors rather than appealing directly to "the crowd."

Though growth is uneven by category, overall the volume of funds raised is climbing at a staggering rate, from US$2.7 billion in 2012 to an estimated US$34 billion in 2015 globally. The fast growth is driven by high demand for credit and high supply of savings resulting from a mix of phenomena, including credit shortage in the aftermath of the global financial crisis, low interest yields and technological advancements.

As crowdfunding has become a global phenomenon and is no longer confined exclusively in developed countries, its potential to promote financial inclusion has attracted the attention of the international development community. The G20 Global Partnership for Financial Inclusion's (GPFI's) recently published white paper says that crowdfunding can deepen financial inclusion: "It can be a quick way to raise funds with potentially few regulatory requirements; it can be cost-efficient and can produce a good return for the lender; and its potential market reach is limited only by access barriers to the platform and regulatory restrictions where applicable."

Moreover, crowdfunding has the potential to adapt and incorporate country-specific traditions, reflecting local sociocultural patterns (e.g., M-Changa, a donation-based platform that digitize the practice of "Harambee" – community fundraising) or leveraging development programs (e.g., Cheetah fund – a now-closed experiment combining a donor-based matching fund and locally focused debt crowdfunding).

Policy makers now face a key question: How do you regulate crowdfunding so that it can achieve its market-building potential, while appropriately managing the risks that come with it? And there are many potential risks indeed: lack of transparency, fraud, default of the platform, and cyber-attack to name a few.

A number of countries have tried to answer this question by passing laws and regulations establishing a specific regime for crowdfunding (e.g., France, Germany, Israel, Korea, Malaysia, UK, USA), while others are expected to follow soon (e.g., Australia, Brazil, China, India, Indonesia, Mexico, Vietnam). Although widely diverse, the rules generally aim to balance investor protection and related market conduct concerns against the positive role crowdfunding can play in promoting economic growth. However, thus far they focus predominantly on the risks faced by the supply side (investors, lenders and other suppliers of funds). As crowdfunding reaches scale in lower income countries and begins reaching poorer market segments, more attention will need to be focused on the demand side as well.

In such market contexts, it is worth reflecting that often the platform is the only "professional" in the crowdfunding game – and not a disinterested one – while both the investor and the borrower often are equally vulnerable and inexperienced individuals or small businesses. On the investor's side, because of its social nature and high advertised returns, crowdfunding may attract consumers who lack experience with these types of financial offerings, and for whom crowdfunding is not suitable. Similarly, inexperienced borrowers may underestimate the rules they need to comply with (e.g., disclosure and reporting), and they may not fully appreciate the legal implications of equity distribution and future repercussions of "managing the crowd" of creditors or stockholders. In the case of debt crowdfunding, borrowers may be steered into borrowing beyond their financial means without appreciating the risk of over-indebtedness, credit bureau blacklisting and a range of possible penalties.

Three years ago, the International Organization of Securities Commissions called crowdfunding a nascent industry, and this description still holds true despite the tremendous growth. Crowdfunding has not yet reached systemic dimensions in any market in terms of funds intermediated when compared with more traditional mechanisms. Yet recent developments remind us of the potential serious consequences of platform failure. The prominent case of Ezubao, where 900,000 investors lost more than $7 billion, is an extreme example, but it is likely that it will not remain an isolated case.

Policy makers around the globe will need to monitor closely and be prepared to intervene to close any existing regulatory gaps, to ensure crowdfunding continues to grow because of its innovative and attractive nature, and not because of regulatory arbitrage or lack of consumer protection.

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The Problems With Passive Investing[3]

By Guest Post on March 4, 2017 10:13 am in Business

Passive investing has been in the news lately because more and more investment funds are being placed in passive investments.

Assets managed by passive funds rose 18 percent last year, according to Morningstar. Assets managed by active funds increased just 4 percent in the same period.

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Institutional investors such as large pension funds are also placing more of their money under management in passive strategies. Seventy-nine percent of institutions used active strategies in 2012, reports Greenwich Associates. But three years later, the figure had dropped to 67 percent.

These inflows and changes in investment trends are gradually making passive investing more dominant than it used to be. Moody's estimates that passively managed investments may make up more than 50 percent of all investments by 2024.

What Is Passive Investing?

Before we go on, let's be clear on what both passive investing and active investing mean. The terms do not refer to an investment *style*. They refer to a *method*.

In passive investing, funds are invested in an index or a basket of stocks such as an exchange-traded funds (ETFs). Investors may purchase a fund that tracks the performance of the S&P 500, for example. No single investment manager is reviewing and choosing stocks in the fund based on his or her assessment of their performance and potential. They are buying every stock in the S&P 500 to replicate its performance, or buying one of the funds that do.

[3] **Extracted from:** http://www.valuewalk.com/2017/03/problems-passive-investing/

The “passive” refers to the fact that the fund is not actively managing what’s in their funds. They are simply replicating a larger group of stocks. This is true whether the basket of stocks are all stocks in the banking sector or all stocks in the gold sector. As long as they are replicating an already-existing group of stocks, they are passive investments.

The counterpart to passive investing is active investing. In an actively managed fund, a fund manager pours over financial information and makes a judgement about which stocks to buy. Generally, they do not use passive investment funds, but purchase a specific group of stocks and bonds they decide upon.

What It Isn’t

Investors may hear a term like “aggressive investing” used and believe it is a synonym for active investing. It isn’t. Characterizing investments as aggressive is a style. Aggressive investing means the investor wants the highest return possible and may, for example, choose to invest in high risk start-ups in the hope the stock of such companies will give very high returns at some point. Aggressive refers to the risk versus reward trade-off and its role in outperforming the general market.

Similarly, “conservative investing” is not some sort of synonym for “passive investing.” A more conservative investor wants a very low risk versus reward profile. They don’t like risk! But they would like some reward in stock price appreciation or dividend yield. A conservative investor may, for example, choose bonds or stocks with high dividends. They are hoping for a maximum return with very low risk potential.

3 Problems with Passive Investing

Despite its popularity, there are several issues with passive investing.

1. **Passive Investments Can Drop as Well as Rise**

Many observers think the climbing popular of passive investments is occurring because the markets have done quite well since the Great Recession. Major indexes like the S&P 500 and the Dow Jones Industrial Average has risen robustly on average since the end of 2009.

Stock market averages can also drop, however. When they do, passive investors will ride their indexes or baskets down just as they rode them up. An actively managed fund, by contrast, puts thought and attention into 1) protecting against downside and 2) choosing stocks that have the best chance of going up, regardless of where they are in an index.

2. Passive Investors Can't Beat the Market

Many investors go into the stock market hoping to beat the market averages. If the S&P 500 returns 12 percent in a year, for example, they hope to make 14 percent. If their passive investment is, say, healthcare stocks, and a basket of healthcare stocks makes 20 percent, they hope to make 23 percent. Over time, those gains become significant.

Passive investments can't beat the market. They *are* the market.

3. Good Investing Is Complicated

Passively managed funds require no expertise about the markets they cover. In fact, they can literally be done by a robot.

But active management by people who really know an industry can result in much higher returns. If you are investing in oil stocks, for example, the expertise in comparing royalty and working interests in oil investing can lead to a much more sophisticated understanding of a company's financial picture. The more sophisticated the picture, the more active management can forecast which stocks will do well and which won't. The same with a sector like biotechnology. An aggressive investor focused on the merits of a therapy can predict much more accurately whether the stock is likely to do well.

Despite the popularity of passive investing, it is not always the best strategy. Passive investors may get a rude awakening if the market ever drops. They also can't expect market-beating returns. Finally, the more expertise that goes into picking a stock, the better.

Article by Kayla Matthews