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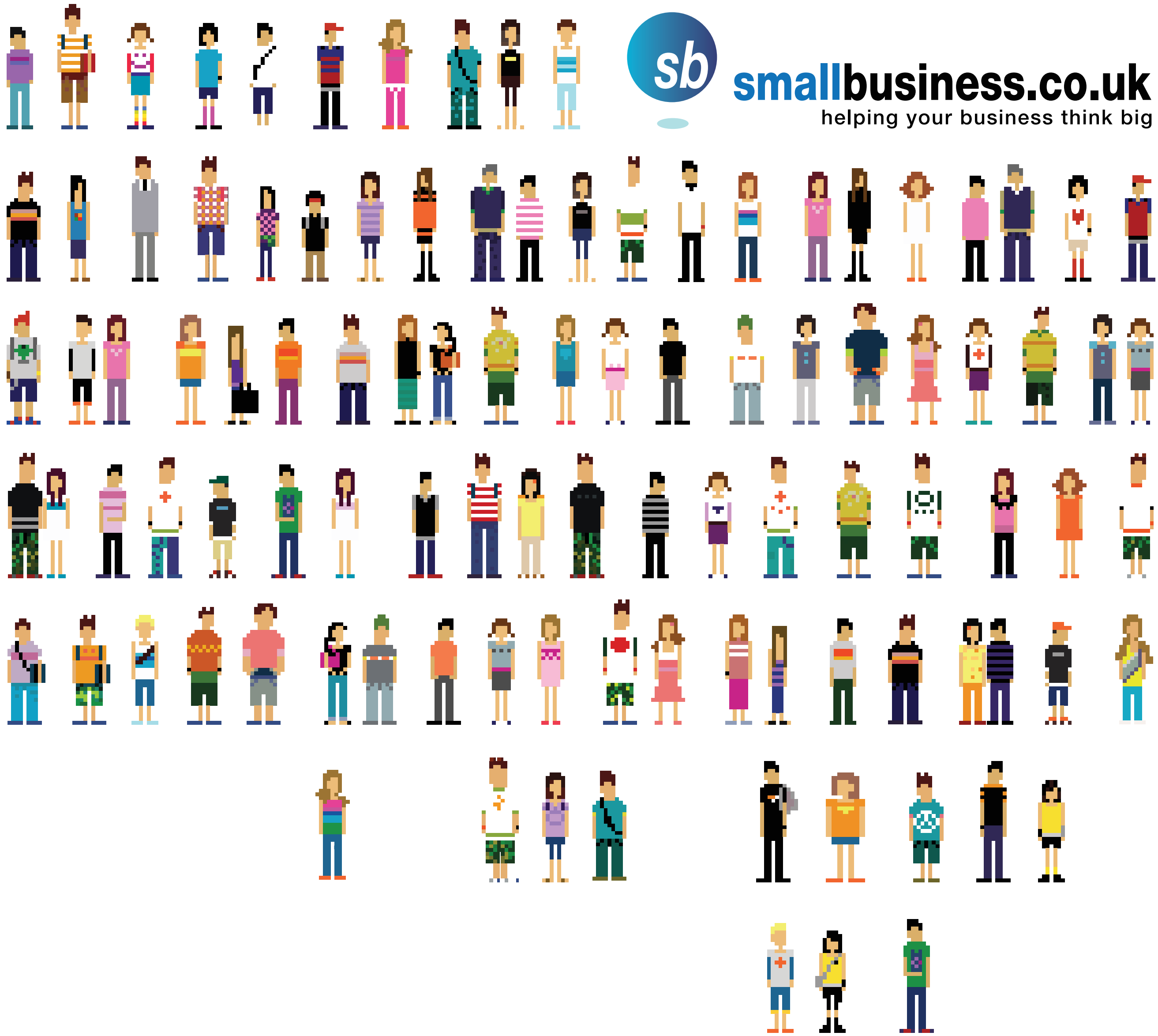
helping your business think big



Raise money through

Crowdfunding

Accessing new sources of finance online

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

foreword

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A big change is happening in business finance. Small companies are no longer tied to the big banks, with new alternatives such as peer-to-peer loans coming to market.

A few years ago, the big four banks were pretty much the only choice for small enterprises. In fact, as a business owner you didn't even get the choice of four banks because you needed a business current account before you could get a loan, leaving you with the choice of one – your main business bank. Comparing our finance landscape to other countries', the UK had the fewest options: small businesses really were at the mercy of the banks.

This just doesn't make sense. When large companies can issue bonds, as John Lewis has done, or list on the stock market to raise funds, why shouldn't small businesses have the same options? This was the thinking that led us to launching Funding Circle, the first marketplace that allowed good businesses to take loans directly from both individual and institutional investors in the UK. Ultimately, we wanted to create a marketplace just like the London Stock Exchange, but for small businesses loans. With over £37 million lent to date, it's a solution that's working.

It's great news that the business finance landscape is changing so quickly, and very exciting to think of the potential of UK SMEs over the coming years, with access to finance becoming a reality again.

'A few years ago, the big four banks were pretty much the only choice for small businesses'

Samir Desai
Co-founder and CEO, Funding Circle

Aside from friends, family, founders and fools – the traditional four sources of funding for a growing company – there aren't many options for financing an early-stage business.

Recently, however, there has been an exciting growth in social funding websites – a new breed of finance provider that allows 'armchair investors' and savers to lend directly to businesses. The rationale is simple. The punters get equity or an attractive rate of interest, and businesses get their cash.

Some believe the model will change the face of small business finance, while others think such platforms need to improve their marketing to even stand a chance of competing with the banks.

It's early days yet for the industry. Perhaps the best-known of the offerings, Funding Circle, only launched in 2010. Promisingly though, it has already funded some 800 businesses to the tune of £37 million.

Those interested in pursuing social funding should be aware that they have a choice of giving away equity in exchange for investment, or simply taking out a loan. This guide looks at the benefits of each, using case studies of businesses that actually achieved investment alongside expert advice from the horse's mouth – the founders of the companies themselves – on how to secure the money.

We hope you find the guide useful, and wish you all the best in your funding endeavours.

Ben Lobel
SmallBusiness.co.uk

'The rationale is simple. The punters get equity or an attractive rate of interest, and businesses get their cash'

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Introducing... Equity finance

Pros

- No requirement to pay the money back
- You choose how big a stake in your business to give away
- Investors may offer advice and contacts

Cons

- You have to give away a portion of the business
- Multiple shareholders can take up management time
- You may not benefit from the level of expertise and contacts that you would be able to access if you accepted larger sums from a smaller number of more committed backers (‘business angels’)

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Equity finance providers

Crowdcube

Launched in 2011 and funding businesses to the tune of almost £3 million so far, Crowdcube is an online crowdfunding platform that allows businesses seeking investment to raise money in exchange for equity. Would-be investees create an online pitch and promote it to people they think might invest. Equity levels are set by the investee. Visit **www.crowdcube.com**

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Seedrs

Seedrs, when live, will allow investors to invest between £10 and £100,000 in startups they choose through an online process. The site will let start-ups raise up to £100,000 in equity capital from friends, family and the crowds. For more information, or to register for free, visit **www.seedrs.com**

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Kamm & Sons

Case study 1

Alex Kammerling founded spirit manufacturer Kamm & Sons in 2011 and raised £180,000 through Crowdcube.

Tell us about your quest for finance pre-Crowdcube.
We had been looking for finance for about ten months before we secured it. We didn't want to take a loan from the bank as they were offering a ridiculous interest rate, so we started with people we knew and friends of friends. We also presented at the London Business School to a room full of angel investors. We must have had around ten to 15 serious meetings, but no-one offered anything decent.

How simple was it to promote yourself through Crowdcube?
We didn't realise quite how good a 'shop window' Crowdcube was and it has brought us a lot of press and external investor interest. People started investing immediately, although we had to push pretty hard to break the 60 per cent [of funds achieved] barrier.

How many investors did you end up with?
We now have 85 investors and plan on designing a separate investor forum on the website which will have updates and financial data that can be downloaded. We still don't know quite how easy this will be yet.

Tell us about the equity stake you gave away. Was it more than you originally planned?
We gave away 23 per cent which was exactly what we intended to give away for the money we had calculated the business was worth. There were no negotiations and no quibbling so it really worked in our favour.

Case study 2

Bubble & Balm

Sue Acton (SA), managing director of bodycare company Bubble & Balm, also sought investment on Crowdcube, with £75,000 raised in exchange for a 15 per cent stake. Oliver Morgan (OM), founder of fuel company Universal Fuels, raised £200,000.

How did you find out about it?
SA: I had heard about the US fundraising platform Kickstarter and found Crowdcube after looking for a UK equivalent.

What are the benefits?
SA: I had had a couple of angel investors on board previously, but angels won't be happy with accepting your valuation. That's the benefit of Crowdcube – you're doing things on your own terms, and overall this option seemed more equitable.

What are the drawbacks?
OM: One problem is that there can be delays in raising money. As an investor, if you are first in with your money, it can be held without earning interest over a period of, say, four months. So it becomes a chicken-and-egg situation, where people want to be the last in with their money before the fundraising is completed.

equity

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Luke Lang, founder, Crowdcube

Innovative ideas and busy entrepreneurs looking for funding are keeping crowdfunding sites like Crowdcube busy. Yet three out of every four businesses that apply to Crowdcube to raise cash do not get their pitch. Of the ones that do, only a select few are backed by the crowd and successfully raise their target funds. These eight tips will help entrepreneurs identify what they need to do to increase their chance of success.

1. Offer a precise pitch summary
The executive summary element of your pitch is the most important – potential investors above all else need to understand what and who they are investing in. The second part of the summary page is the section about you and your management team. Again, put only the most important and relevant information. Other important areas to cover are:

Tips on raising equity

- Use of proceeds: why your company needs investment and how it is going to be spent
- Investment (amount and from whom) already received and how this has been spent to date
- Potential exit strategies and investment horizon for investors
- Consider uploading a video; there is a high correlation between successful pitches and including a good video.

2. Detail your plans and financial forecasts
A detailed business plan and financials are prerequisites to list on Crowdcube and will be vetted by our team prior to your pitch being accepted. There is no set template as each business plan varies so much, but a good place to start is to look at the pitches which are doing well and attracting investors.

3. Select the right investment target
Don't ask for any more than you need. Investors want to know why you need their money, and exactly what and how will you spend it. Getting the initial momentum is the hardest part and you

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Tips on raising equity

will need to rely on your own network to get the ball rolling before the broader crowd will notice you.

4. Value your business realistically
Your company is only worth what investors are willing to pay for it. Many of the businesses we list fall down on over-ambitious valuations. Crowdcube does not offer advice on what the valuation should be, but it strongly encourages companies to be realistic and sound out opinion from people you know with a financial background. You must be able to justify your valuation.

5. Consider rewards
In addition to offering equity in your business, rewards can be a powerful and cost-effective way to attract investors. A reward could consist of a discount or a free offer on your company's product or service, for example. Rewards can be set at different levels and can be a good mechanism to incentivise higher levels of investment, get investors involved in your business after the deal, or even target potential customers.

6. Give regular updates
Providing regular updates on your business as well as pitch progress is a great way to communicate with Crowdcube members and investors. Followers need to be converted into investors. Use updates frequently to keep followers informed about your company and the fundraising process.

7. Provide tax breaks with EIS and SEIS
Registering your company as compliant with the Enterprise Investment Scheme (EIS) or Seed Enterprise Investment Scheme (SEIS) offers investors substantial tax breaks and is a strong incentive for them to invest in your company. It is possible for investors to filter all the pitches on Crowdcube to see only those which are registered. All of the businesses that have funded on Crowdcube so far have been EIS-registered.

8. Use your network
Crowdcube provides you with a platform to raise equity from investors. However, this is an active process for entrepreneurs, not passive! Getting the first 10 per cent of your target is the hardest part. You need to use your network and signpost potential investors to your pitch on Crowdcube. Positive momentum will attract more investors and followers. The companies that work the hardest in the fundraising are successful – however good your idea, business plan or background if you upload your pitch and do nothing you will not reach your target.

debt

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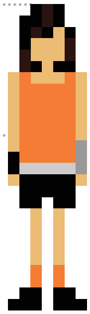

Introducing... Debt finance

Pros

- Retain 100 per cent of business and full control
- Simpler application process than with a bank: if rejected, rejected quickly
- Choose how much to raise
- Traditional form of financing, which everyone understands

Cons

- Interest payments can be costly
- There's a risk of bankruptcy if you can't keep up repayments
- Borrowing can require personal guarantees – your house or other assets could be at risk

debt

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Debt finance providers

Funding Circle

Funding Circle is the best-established of the social funding offerings, having lent in excess of £37 million to some 800 businesses. It was launched in 2010 broadly following the model of social lending sites such as Zopa, but set up to lend to businesses rather than individuals. Loans may be secured or unsecured. See **www.fundingcircle.com**

Go to case study

ThinCats

ThinCats.com is an online market for secured business loans operating throughout the UK. Lenders set their own interest rates and make their own investment decisions, while borrowers can get loans between £50,000 and £1 million for six months to five years. Refer to **www.thincats.com** for more details

Go to case study

First Funding

First Funding is an online matching service, where lenders and borrowers meet. The site has access to 2,000 business angels registered under FSA rules, who are looking for deals to invest in. Entrepreneurs submit an application online specifying how much they need to borrow, how long for and at what rate of interest. For more information, visit **www.firstfunding.org**

Artesano

Case study 3

Knitting wool wholesaler Artesano raised £65,000 on Funding Circle. SmallBusiness talks to managing director Tom Coomber.

What's your company's funding history?
We're with a high street bank and we do have a loan and overdraft in place with them. When they took us on they told us that we're a good business to be lending to, but every year our business is growing and we need more cash for stock. We were in a position where our company directors had securities on the loans in the form of property and there was nowhere else to go in terms of security, so we had to look elsewhere.

How did you find Funding Circle?
It was one of those things that seemed too good to be true in terms of the method and ease of borrowing. But I bit the bullet, went online, looked through the small print and it seemed pretty feasible so we slowly put the deal together and it did turn out to be straightforward.

What were the terms of the loan?
It's a three-year repayment plan and the interest rate is bid for by their lenders. Let's just say the interest rate turned out to be around 2 per cent better than what my bank was offering. They ask you to fill in a profile and you put your details into the website; it's really a platform to sell our business to lenders and demonstrate why we're a safe bet. The process is simple and the underwriting procedure painless.

What's the loan secured against, if anything?
It's not secured, it's under director's guarantee which is a liability for us but we have faith that we would be able to sell our stock and support the repayment of any loan if we had to close the business, whereas a bank would want security on a property.

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Case study 4

Red Advertising

Job advertising network Red Advertising secured a five-year loan of £150,000 through ThinCats. SmallBusiness learns more from managing director Richard Clarke.

What has been your experience of trying to raise funds prior to discovering ThinCats?
Our story must be a common one; trying to get credit out of the main banks was a nightmare. We've got a good track record, a robust, solvent business with solid accounts. We also have a good deal of intellectual property assets but you can't rate them in the same way you would bricks and mortar and it's not easy for the banks to appreciate this kind of value. We've been turned down by pretty much every bank.

Why did you choose ThinCats?
At the time we raised funds, Funding Circle was offering a maximum loan of £100,000, whereas we needed more. Funding Circle also draws on an Experian business credit score, so if you've got an average credit score you're not going to rank well on the rating chart. ThinCats takes more of an analytical view; as long as you have got security, or assets that can cover the loan they will lend to you. ThinCats is also very approachable, you can talk to their people easily.

How would you sum up the new online financing marketplace?
It's brilliant; a lifeline that businesses need and hopefully there will be more of them in the market. Banks aren't interested in lending to businesses, these websites are, it's as simple as that. ■

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Tips on raising debt

James Meekings, co-founder, Funding Circle

To apply for a loan through Funding Circle, businesses complete a short application form, which takes approximately 30 minutes. Here they provide information about their business, including key financial details, management structure of the business and number of staff employed. Any business looking to borrow money must be a limited company with at least two years' worth of accounts posted with Companies House, and have a strong credit score.

Companies don't need high-value assets to get finance. Instead, we allow businesses to borrow based on the quality of the business.

Once a business has been approved, business owners post their loan request page which explains why the business is looking for finance and what it will do with the money.

People lend small amounts to lots of different businesses to spread their risk. Rates are set by investors themselves who bid to become part of the loan by offering an interest rate on their cash.

Unlike most banks there is no early repayment fee, the fee structure is simple and money can be borrowed quickly. Businesses can also keep their identity hidden if they want.

Banks will always exist, in one form or another, but they are no longer the cure-all for every requirement a business now has. Increasingly owners are becoming aware that there is genuine choice when it comes to looking for finance, and that they no longer need to have a one way relationship based on exclusivity with their bank.

Spend time assessing what type of finance your business is best suited to. Funding Circle only lends to limited companies with at least two years' worth of accounts. If your business is a start-up, then alternative finance, such as equity investment, might be a better solution.

For smaller businesses that are more dependent on the owner, we may request personal guarantees. These are not secured against particular personal assets but they are overarching guarantees from a director.

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Going for growth

Three businesses reveal how they got a loan from Funding Circle and their expansion plans.

Funky Junk, a London based supplier of professional recording equipment and services, has been established for 20 years and has branches in Paris and Milan. Earlier this year, the company outlined plans to break into China and Russia, which its loan of £80,000 from Funding Circle has made possible. Mark Thomspon, MD of Funky Junk, liked the concept of borrowing from real human beings: 'It was quite nice to say to the bank, "No thank you, we don't need you."'

Watch the video

Cable & Cotton, founded in 2007, creates strings of lights with handmade, coloured cotton balls to UK vendors, and distributes them to around 200 shops in the UK and Europe. The business, based in Brighton, borrowed £50,000 to increase stock, allowing the company to boost growth in the UK and launch franchises and concessions following successful online expansion into Scandinavia. More than 300 investors lent money to Cable & Cotton, helping the business to double its turnover year-on-year once again.

Watch the video

Video interviews

Guy Davis, founder of Hiltongrove Business Space, found that it was exceptionally difficult to access finance from the banks, despite the size and success of the business. It was great news when he heard there was an alternative. More than 800 people helped Hiltongrove to borrow £70,000 to improve disabled access for the Citizens Advice Bureau, one of its tenants based in Walthamstow. 'Within just a few days, I could see that all the £70,000 had been raised,' says Davis.

Watch the video

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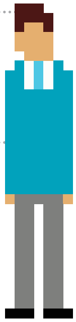
Pros

- You don't give away a stake
- You retain control
- Potentially lower interest rate due to auction system

Cons

- Only available to those with large clients
- Good credit rating needed
- More complex than straight debt or equity



Introducing... Invoice finance

MarketInvoice

MarketInvoice is an online invoice auction platform for small business - an 'eBay for invoices' in simple terms. Businesses can register on the website, and then auction their invoices due. Institutional investors then compete online to provide funding at the lowest cost. Since February 2011, MarketInvoice has advanced £20 million to a host of SMEs in a wide variety of sectors.

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Magnus Walker

Case study 5

Johnny Walker, co-founder of specialist recruiter Magnus Walker & Partners, went for MarketInvoice to remedy the problem of late-paying customers.

What is your cash flow issue?

More than two-thirds of our revenue comes from placing senior level interims, some of whom are paid around £1,000 a day, and at the end of the month our interims expect to be paid on time. That means our financial exposure can be in excess of £20,000 a month per interim. Meanwhile our clients will typically pay us six weeks late so we need credit on demand.

Why did MarketInvoice work better for you than a conventional invoice financier?

[Because of the online bidding process] the cost of credit is quite low and we're not locked into any commitment. Also, some invoice financiers demand the entire debtor book to be financed but MarketInvoice is more flexible there.

Finally, sometimes small businesses don't have the financial accounts to get factoring finance anyway. You often need three years of accounts, director's guarantees and a good credit profile.

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Tips on raising invoice finance

Anil Stocker, founder, MarketInvoice

MarketInvoice allows fast-growing small businesses to overcome the long payment terms insisted upon by large customers. Anyone with a big client will be familiar with this – waiting up to 90 days before you have access to the fee you have earned. Long waits can mean difficulty in growing quickly, seasonal cash flow problems and difficulty paying suppliers. As a small business owner myself, I know what a nightmare that can be.

The way it works is you register with us on the MarketInvoice website, and then auction your invoices due. Big institutional investors – hedge funds, family offices, high net worth individuals – then compete online to provide funding at the lowest cost.

I'm often asked what the difference between us and a traditional factoring provider is. While our model bears a resemblance to traditional factoring, we have no long waits, no monthly fees, no collateral, no lock in, no onerous terms – and our advance and discount rates are much better too. We typically see advance rates of 90 per cent, discount rates of between 1 per cent and 2 per cent, and rates improve as sellers upload more invoices and buyers become familiar with their businesses. We've had a 100 per cent success rate of auctions closing.

final say

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Anil Stocker, founder of MarketInvoice, also heads up the Next Generation Finance Consortium, a body that seeks to educate businesses and work with policymakers on behalf of crowdfunding platforms and peer-to-peer lenders. In this video, he outlines the new opportunities available to businesses seeking finance to start up or expand.

Video