Seeds of Change: Emerging sources of non-bank funding for Britain's SMEs

Andy Davis
The Centre for the Study of Financial Innovation is a non-profit think-tank, established in 1993 to look at future developments in the international financial field – particularly from the point of view of practitioners. Its goals include identifying new areas of business, flagging areas of danger and provoking a debate about key financial issues. The Centre has no ideological brief, beyond a belief in open markets.

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It is widely acknowledged that banks are no longer meeting the funding needs of businesses, particularly of SMEs. The scale of the funding gap is huge, with estimates of £29bn to £59bn cited for SME financing alone. While the debate over exactly why this has happened (and what can be done to reverse it) continues, small businesses need to find the funding that will allow them to deliver growth and jobs. One thing is clear: bank lending to SMEs is not set to increase significantly in the near future - alternatives are required.

The UK has long been at the forefront of the financial services industry and banking (in its broadest sense) in particular. While we are seeing the launch of new banks, such as Metro Bank, Shawbrook and Aldermore, which all lend to SMEs, it is no surprise to see new products are also being developed to fill the gap left by the incumbents. These innovations are occurring at all levels, from the large insurance companies, such as Legal & General and Aviva, which are increasingly looking to provide significant loans directly to large corporates, to the new breed of peer-to-peer lenders, such as Crowdcube and Funding Circle, offering SME financing opportunities directly to investors.

While the Breedon Report and others have been instrumental in framing the scale of the funding gap for UK businesses, there has been a lack of focus on the core SME market. As trusted advisers to the SMEs of today and the corporate giants some will become tomorrow, we are delighted to co-sponsor this important research by Andy Davis. We hope that this report provides a useful contribution for government, investors and SMEs themselves in looking at how to stimulate funding to a sector that, with the right support, will help drive the future growth of the UK economy.

Alasdair Steele
Partner, Head of the Financial Sector Group, Nabarro LLP

Even the storm clouds of the continuing financial crisis have a small silver lining – the general shortage of bank funding for business has been a great spur to innovation and diversification of funding sources. The internet has been a great enabler for much of this through its ability to put new lenders in touch with those wishing to borrow and through technology to do it efficiently, even when the funders may be made up of hundreds of individuals lending small amounts. We hope that the details in this report will help introduce all parties to a selection of what is available and encourage others to develop new and innovative funding alternatives right across the markets from SMEs to large corporates.

The Association of Corporate Treasurers is the leading professional body for individuals working in international treasury or with an interest in treasury. It is very much in the interests of the treasury community and their businesses for there to be a wide choice of flexible and efficient financial markets to suit their businesses - ideally these markets being less burdensome, low cost and offering rapid decisions, transparency and certainty. If the innovative alternative finance sources identified in this report can grow and flourish that must be a good thing.

Many of the arrangements described are aimed at smaller companies and at individual investors but the models developing in this sector will, if suitably adapted, surely have applicability for companies of all sizes. A more graduated set of financing sources appropriate to companies of all sizes would be welcome. The potential is huge and exciting, but not without risk. Assessing credit risk is crucial so that funders must have sufficient information to understand and assess what they are getting themselves into. Borrowers too need to take care not to sign up to too onerous conditions. Education and transparency are prerequisites.

The conditions for these emerging funding sources are good. Investors are looking for diversification of risk and yield pick-up and for the businesses seeking funding, be that capital or debt, the alternatives are limited, especially for SME’s without ready access to the international bond markets that are still open for most large companies. We commend all the innovators and the investors who have been prepared to adjust to changing circumstances.

Colin Tyler
Chief Executive, The Association of Corporate Treasurers
Seeds of Change: Emerging sources of non-bank funding for Britain's SMEs
Andy Davis

Foreword

As this report is going to the printers, the UK's Coalition government is launching its latest “funding for lending” initiative – promising to pump up to £140 billion into the High St banks for on-lending (at effectively subsidized interest rates), primarily to small and medium-sized enterprises.

Maybe it will work. Maybe UK banks that have been signaly unenthusiastic about business lending (for perfectly good commercial reasons) will mend their ways under a combination of government-mandated stick and carrot. One can but hope so. However, there is a downside. Pouring subsidy into this sector is not without its risks. One is that well-meaning politicians may end up strangling at birth one of the most fascinating and vibrant new financial businesses to spring up in this country for decades.

As this survey by Andy Davis makes abundantly clear, a new business is rapidly emerging which effectively disintermediates the old-line commercial banking sector and which offers small businesses a chance to tap investors directly – and vice versa. Yes, things can go wrong – and I am sure Andy is right to point to various regulatory lacunae. Some people will get burned. But (I would argue) it is better that they get burned investing in UK plc than blowing the egg money on Betfred or PokerStars.com. It would be a real tragedy if this burgeoning alternative finance sector were to be snuffed out either because of heavily subsidized competition from old-line banks that (by and large) don’t want the business anyway, or because of an almost inevitable regulatory backlash when the first funding scandal breaks across the red-tops.

Let’s hope my concerns are groundless.

In the meantime, I am delighted that we have been able to publish what I believe to be a really important piece of work by Andy Davis. It stemmed from concerns raised originally by NESTA (the National Endowment for Science, Technology and the Arts) – but I believe it goes well beyond anything that has been published before. Internet-based lending/investment platforms and new forms of supplier finance are springing up all the time. Many will fail (quite rightly); but some will not – and one or two will have become so mainstream in a few years time that we will be unable to comprehend how we did without them. Thanks to Andy – and to our friends at Nabarro and the ACT, who sponsored his work (even journalists have to eat, though not very much) – this is a catalogue raisonné of what is out there and what looks most promising for the future health of the UK’s SME sector.

Andrew Hilton
Director
CSFI

Cover illustration by Joe Cummings
1. Introduction

In the years since the credit crunch, a burst of innovation in business finance has steadily gained momentum. This is true of the UK, of the US (where the JOBS Act to enable the growth of so-called crowdfunding was recently approved) and of many other countries besides. As banks across the developed world have retrenched under the weight of problem loans and new regulations, and as complaints from small businesses about the availability and price of finance have multiplied, so numerous outsiders have set their sights on the various SME funding markets. There can be few businesses today that are attracting as many entrepreneurs as that of providing finance to SMEs – for many years, the bread and butter of Britain’s high street banks.

This report profiles some of the most interesting and innovative companies that are becoming active in the UK’s SME market - some competing directly with banks to lend, others finding new ways to channel equity investment or short-term working capital, for example. Their sense of opportunity will only have been heightened by the conclusions of the Breedon Report in March, which suggested that as the UK economy begins to recover, a gap will open up between the funding that UK businesses need and what the major banks are able to provide. Between 2012 and 2016, Breedon estimated, demand for business finance might exceed supply by between £84bn and £191bn, of which between £26bn and £59bn related to SMEs.

Even at £26bn, the opportunity should be big enough to accommodate quite a few entrepreneurs. Not surprisingly, therefore, SME funding would seem to be a problem with a thousand solutions. A wide range of finance providers is converging on this arena, many of them using the internet’s power to create markets and distribute financial products.

So we have new SME-focused banks such as Shawbrook and Aldermore, promising straightforward, deposit-funded loan finance for SMEs. These are the new challenger brands. There is also a range of alternative asset managers targeting the SME market, including City of London Group, via its Trade Finance Partners division, and Bluehone Secured Assets, a start-up mezzanine debt fund manager seeking to raise £40m. It has also been reported recently that some mainstream banks are proposing to originate and service SME loans on behalf of third parties (such as debt funds) in return for a fee, said to be 3%. The plates are clearly shifting in SME finance.

In certain areas of business lending, the sums available are growing. For instance, Silicon Valley Bank, a US-based specialist in so-called “venture debt” to early-stage high-growth companies in IT, medical and clean technologies, is expanding its operations in the UK and shortly hopes to acquire a full UK banking licence. Established names such as Santander and Clydesdale have also made sums available

under dedicated programmes to lend to high-growth businesses whose owners do not wish to raise equity.

This report, however, sets out to focus on the smaller, non-bank entrants, often internet-based, of which there are many both from the UK and elsewhere.

Among the key trends, Britain has been one of the leading innovators in the emergence of so-called Peer-to-Peer finance – indeed, it seems that Zopa, the world’s first consumer P2P lending website when it launched in 2005, may well have played host to the first attempt to raise a business loan from a P2P site. The owners of Sedlescombe Organic Vineyard advertised for funding on Zopa in 2007, although they ultimately took a cheaper loan from a bank. Five years later, the outcome might well have been very different. Today, businesses such as commercial property lending are becoming the new frontiers in the P2P movement.

The P2P element features in many areas, whether it is retail investors lending directly to businesses or new “crowdfunding” equity-raising sites that are enabling thousands more people to try angel investing. Then there are rather more select groups of “peers”, made up of individuals content to dispense with some of their protections under the Financial Services and Markets Act, 2000, by certifying themselves as either Sophisticated Investors or High Net Worth Individuals. Over time, these groups will be able to participate in an increasing range of investment opportunities in the SME funding market that were previously difficult or impossible to access. Indeed, in some areas of property lending, there is already a degree of concern at the quantity of private money seeking borrowers.

Regulation continues to reshape this market in a wide variety of ways – not always for the better. Basel III and the Vickers Report are forcing deep changes on the banks, while the Solvency II regime may ultimately limit the role of insurers as alternative providers of capital to SMEs. Moreover, the FSA has indicated recently that it intends to investigate whether Unregulated Collective Investment Schemes are being marketed too aggressively - which could in time have an impact on some of the vehicles that are developing to channel finance to SMEs. And as is often pointed out, the regulations governing certain of the new entrants themselves are somewhat hazy, particularly for lending.

On the other side, the UK’s adoption last year of the EU’s Prospectus Directive has increased to E5m the sum that companies can raise in equity without having to issue a prospectus - making the option of selling shares cheaper and quicker for many more companies and offering a fillip to small exchange operators.

In addition, “angel” investment by individuals is in the midst of a big boost, thanks to the introduction of 50% tax relief on investments of up to £150,000 via the Seed Enterprise Investment Scheme, which began in April 2012 - along with the launch of a state-backed fund to co-invest with angel syndicates. At the other end of the scale, the establishment of the Business Growth Fund, backed by up to £2bn from
the UK’s largest banks, will attempt to fill the equity “funding gap” said to exist for deals of between £2m and £10m. Business angel groups believe this could provide an important new potential exit for successful syndicates.

And much of the burgeoning activity in alternative finance for renewable energy projects is being influenced by the availability of state subsidies, notably above-market feed-in tariffs.

Many of the entrants that we cover in this report also have a fair wind from public opinion. Banks remain deeply unpopular in Britain, so it is not surprising that a common theme among the new players is to appeal to savers and customers on the basis of social value and transparency - as well as financial return. From renewable energy schemes to new “traditional banks” to P2P sites such as Funding Circle, the new crop of entrepreneurs are positioning themselves to answer a public desire for social utility as well as profit. Their cause was lent considerable credibility by comments from Andrew Haldane, executive director for financial stability at the Bank of England, who predicted in March that: “Small peer-to-peer lenders like Crowdcube and Funding Circle could in time replace high street banks”.

So far, however, these players remain small - though they are fast-growing. As the Breedon Report suggested, the most likely outcome is that they will form part of a wide variety of solutions to address the funding shortfall that British businesses seem likely to face. These solutions (if that is what they turn out to be) will take many forms – not all of which are obvious to even sophisticated observers of the City scene. Although bond markets will not offer an answer for many smaller businesses owing to the associated costs and the inability of institutions to invest in relatively illiquid issues, considerable efforts are already being made to revive the market for securitised SME loans. Officials at the Department of Business, Innovation and Skills are looking closely at how the state could help to seed the re-emergence of this market. It is therefore worth noting that in April 2012, Lloyds offered £1.45bn of asset-backed notes in five tranches, secured against 9,910 SME loans ranging in size from £25,000 to £3m. About half by value were loans of £200,000 or less. It is this kind of transaction that many feel will be needed to open up really substantial additional sources of funding to small businesses. Progress here will be keenly watched.
P2P platforms - the new model brokers...

The most visible manifestation so far of the burst of innovation now underway in SME finance is the so-called P2P movement – in this case, online platforms that allow individuals or companies with surplus capital to make it available to businesses without a traditional financial institution standing between them.

Although some of these new platforms are mainly notable as alternative ways to mediate a well-established financial product (such as a term loan or an equity investment), it is possible to argue that they are all, to some degree, creating markets where none previously existed - and opening up asset classes to new groups, particularly retail investors, with potentially significant implications.

However, in the context of an outstanding stock of bank lending to SMEs of about £107.7bn at the end of 2011 (according to figures from the British Bankers Association) these platforms so far remain very small, as the table below shows:

<table>
<thead>
<tr>
<th>Loans originated</th>
<th>Value</th>
<th>Defaults</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding Circle</td>
<td>738</td>
<td>£31.6m</td>
<td>7</td>
</tr>
<tr>
<td>ThinCats</td>
<td>33</td>
<td>£4.22m</td>
<td>–</td>
</tr>
</tbody>
</table>

P2P EQUITY CROWDFUNDING SUMMARY

<table>
<thead>
<tr>
<th>Equity investments</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crowdcube</td>
<td>£2.8m</td>
</tr>
</tbody>
</table>

By way of comparison, since its launch in 2009, the start-up bank Aldermore has lent some £850m to UK SMEs.

The P2P platforms concentrate on serving the smaller end of the SME market, which has experienced some of the biggest problems in securing funding from conventional sources. The challenge these sites face initially is to source enough high-quality borrowers or businesses seeking funding to meet demand from investors and enable their markets to grow smoothly. The equity crowdfunding platform Crowdcube, for instance, reports that only about one in 10 of the companies that approach it to raise money is eventually allowed on to the platform.

In some cases, the introduction of an online market-based intermediary has offered important benefits that were not readily available to individual lenders or borrowers - among them increased price competition, cost transparency, flexibility of terms and diversification of various types of risk. Many of the
new entrants also provide a high degree of transparency to the market about their business - for example, the updated online loan book statistics that appear on Funding Circle’s website, or the open online order book provided by GXG Markets.

For certain of these businesses, the potential to deliver wide diversification of risks quickly and cheaply via an online P2P platform may prove enormously important. For example, online tools such as the Autobid function operated by Funding Circle allows lenders to channel small packets of money to dozens or hundreds of borrowers, achieving swift diversification and therefore greatly limiting exposure to individual credit risks. Equally, these platforms allow companies to spread their liquidity risk across multiple counterparties – much as larger companies do via the bond markets – rendering them less vulnerable to sudden changes of policy by any single lender, a risk that many small businesses encountered during the credit crunch.

Similarly, the level of diversification in extremely risky early-stage equity investments that has been made possible by the P2P equity-raising platforms may ultimately prove important. Such are the risks of individual seed investments that diversification via portfolio exposure offers the only practical way to reduce them to acceptable levels. It is quite plausible that these platforms will bring angel-style investment – with all its attendant opportunities and risks – within the reach of a much wider swathe of the sophisticated and retail investor populations.

Diversification of risks in new asset classes such as these is, I believe, a valuable contribution to the market – one that has not previously been readily available either to retail investors or to SMEs seeking debt or equity funding.
2. Main points

Although it was not the main purpose of this exercise to reach specific conclusions, (rather, it was to produce a sort of *catalogue raisonné* of alternative finance vehicles), a number have suggested themselves during the interviews and analysis. Briefly, these are:

- In several areas, the emergence of internet-based auction mechanisms to allocate various types of funding, including debt and working capital, has the potential to introduce wider competition into the pricing of SME funding. This begins to break the traditional closed lender-borrower relationship that has dominated this market and could produce greater transparency on pricing. This is positive, and it should be regarded as one of the crucial gains made possible by recent innovation in this field.

- Regulation of certain new activities is indeed (as some critics have claimed) limited, particularly as regards P2P lending. However, in other areas, it is becoming steadily clearer. For example, the recent decision of the FSA to approve an application by Seedrs, an equity crowdfunding platform, to undertake financial promotions marks a significant step by the P2P sector into the regulated arena. Providing debt finance, whether to consumers or businesses, is still a lightly regulated activity. But efforts to come up with a self-regulatory framework by leading P2P lenders via a trade association are a positive development and show the way forward.

- The new internet platforms that are emerging can offer important benefits to both consumers and businesses - in particular, the ability to diversify their risks quickly and cheaply across a wide group of counterparties, whether these are business borrowers or start-up companies seeking seed investment. This ability to diversify has not previously been easily available to individual investors in these markets, and it represents a powerful additional benefit. The protection that effective diversification of risks can offer may ultimately prove the most important consumer safeguard of all – including regulatory change – and its use should be strongly encouraged.

- Distribution of SME finance is undergoing a huge change. Many of the new entrants to this market are operating without physical distribution networks. Commercial finance brokers are, therefore, becoming a much more important route to market for a wide range of organisations, a trend that looks certain to continue.

- Technology is developing fast - and shows every sign of being able to address many of the problems facing finance providers that wish to enter the SME market in competition with the incumbent banks. In particular, it appears that
in future, holding a business’s current account may no longer offer such a large advantage when it comes to undertaking credit assessment of that business as a potential borrower.

- The development of these alternative sources of SME finance is taking place during a period of extraordinarily low interest rates - which partly explains the willingness of retail investors to lend money via these unconventional channels. A question, therefore, remains as to what might happen when interest rates rise and the “risk-free” returns available from conventional sources (such as bank deposit accounts) normalise. The challenge for providers is to establish their products as alternative asset classes that offer benefits across the cycle, rather than simply at a time when conventional bank credit is scarce and interest rates low.

- There are now big incentives to invest in early-stage equity fundraisings, but nothing equivalent for debt funding. The Breedon Report has rightly argued that the UK government should consider redressing this balance, although it seems probable that any tax incentive to invest in SME debt would be accompanied by a heavier weight of regulation. Striking a balance on this will be critical, and the risks of imposing excessive regulation on nascent market are significant - as Breedon has acknowledged.
3. Debt funding initiatives

A. P2P business lending platforms

The extent of P2P lending to SMEs in the UK remains small, though these are still early days. In particular, under its Business Finance Partnership, the government is inviting bids from platforms such as these for part of the £100m it is making available through “non-traditional lending channels that can reach small businesses (up to £75m turnover)”. Lending will begin in the autumn. Lending capacity of this scale could see the market grow very rapidly. At the moment, loans made via these platforms are typically at the smaller end of the size offered by the clearing banks. Given the fixed costs of the large banking groups, this makes them among the least cost-effective for the big banks to originate and underwrite.

Funding Circle – the UK’s first P2P lending site for SMEs: The leading name among Britain’s P2P SME lending platforms is Funding Circle, which launched in August 2010 to offer small businesses the ability to borrow from a new pool of lenders: individuals and other companies. It now offers loans of between £5,000 and £250,000 with terms ranging from one to five years. To date, it has lent a total of £34.5m via just over 700 loans.

Some 10,000 people have signed up to lend on Funding Circle, about 60% of whom are active. It has so far lent to companies with annual revenues typically between £500k and £1.2m, though they range from as little as £100,000 up to £40m. Its loan book remains small but is showing rapid month-on-month growth, expanding from about £18m last December to almost £32m in mid-May. The current average annual gross yield to investors (before fees and defaults) is 8.5%, and the average APR to borrowers is around two percentage points higher than that. The majority of its loans are backed by a personal guarantee from the directors concerned. Lenders can be private individuals, limited companies, limited liability partnerships or public bodies.

Data published on Funding Circle’s website shows that the highest interest rates that borrowers have agreed to pay have been falling fast as rates have converged around the average for loans in each risk band:

<table>
<thead>
<tr>
<th>FUNDING CIRCLE: LENDING RATES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Last 100 loans:</td>
</tr>
<tr>
<td>A+ (Very low risk)</td>
</tr>
<tr>
<td>A (Low Risk)</td>
</tr>
<tr>
<td>B (Below Average Risk)</td>
</tr>
<tr>
<td>C (Average Risk)</td>
</tr>
</tbody>
</table>
Businesses using Funding Circle must have a trading record of at least two years and must present up-to-date management accounts. Credit risk is assessed using this data, alongside publicly available credit scoring information from providers such as Experian. Each borrower is then assigned a banded risk rating, which helps to determine the interest rate it will be charged. Terms for borrowers are flexible, with no penalty for early repayment.

Borrowers pay an arrangement fee of 3 per cent for the first loan they accept through Funding Circle, and 2 per cent subsequently.

Funding Circle publishes projected annual bad debt percentage rates on its website as follows (note that it does not arrange loans for ‘above average’ risk borrowers):

<table>
<thead>
<tr>
<th></th>
<th>Weighted Average Rate</th>
<th>Highest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>A+ (Very low risk) loans</td>
<td>0.6%</td>
<td></td>
</tr>
<tr>
<td>A (Low Risk) loans</td>
<td>1.5%</td>
<td></td>
</tr>
<tr>
<td>B (Below Average Risk) loans</td>
<td>2.3%</td>
<td></td>
</tr>
<tr>
<td>C (Average Risk) loans</td>
<td>3.3%</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1.7%</td>
<td></td>
</tr>
</tbody>
</table>

Lenders can select individual companies to lend to, using information published on the site (including accounts, credit history and details of the investment plan). Or they can use the Autobid tool, which allows them to bid automatically to fund loans that match their risk and return criteria, and caps their maximum exposure to each loan. Autobid fills each loan by matching it with offers from the pool of lenders on a best-offer-first basis until the loan is fully financed.

Funding Circle charges lenders an annual fee of 1 per cent of the value of their outstanding loan portfolio. It also provides a secondary market that allows lenders to sell the outstanding portions of their loans, and so withdraw their money from the market before full repayment is due. To date, £6.19m of loans or loan parts have been traded on its secondary market. During 2011, half of all loan parts were sold at par within 30 minutes on the secondary market – though it will be interesting to see what happens at a time of market stress. Loan parts can be marked up or down from face value by up to 3%. Funding Circle charges sellers a 0.25 per cent fee.

In spring 2012, Funding Circle raised a total of $16m from Index Ventures and Union Square Ventures in its latest funding round, and is planning a significant expansion in the second half of 2012. In an interview just after the Funding Circle investment,
Neil Rimer, co-founder of Index, said: “I think that’s a very powerful application of a marketplace, and that’s just business finance. There are lots of other financial products we buy, like insurance, that I think could be transformed by these kinds of things. So marketplaces is still something I’m going to put a lot of money into.”

**ThinCats – a peer-to-peer SME loan platform aimed at wealthy investors:**

ThinCats is an online peer-to-peer platform set up to arrange loans from wealthy individuals to SMEs. It launched in January 2011, and is managed (and partly owned) by Kevin Caley - who also runs the government-funded Advantage Early Growth Fund, with a portfolio of early-stage equity investments in West Midlands businesses.

By May 2012, 508 people had signed up to become lenders, of whom 204 have so far made loans - in one case, totalling more than £400,000. The site has lent a total of £4.22m to 33 SMEs for terms of between six months and five years; the average term is 30 months. The average loan size to date is £128,000, though the platform recently raised £500,000 for a single loan in four days, which Caley believes is a record for a P2P lending site. He believes the eventual “sweet spot” for ThinCats will be loans of between £250,000 and £1m.

The minimum sum that can be lent is £1,000, increasing in £1,000 increments. The average interest rate paid to lenders stands at 10.15%, and there have been no defaults so far.

The key feature of the ThinCats model is the way it carries out credit assessment and due diligence on companies that want to borrow. While Funding Circle bases its assessments on publicly available credit scoring information, ThinCats uses a network of “sponsors” – normally commercial finance brokers – who assess would-be borrowers in person and produce an information pack for lenders. Without sign-off from its sponsor, a company cannot post its loan request or information pack on the ThinCats platform. ThinCats takes a charge over the assets of the business wherever possible, but will take personal guarantees from borrowers where they have sufficient unencumbered personal assets. ThinCats insists that sponsors bear no liability for signing off on an investment, and it makes clear on its website that lenders cannot simply rely on a sponsor’s report. However, that has not yet been tested in law.

Lenders bid against each other on loan requests in the ThinCats model, indicating the amount they are willing to lend and the interest rate they are seeking. Bids are aggregated “best first”, until the borrower reaches its target. There are no fees for early repayment of loans.

ThinCats does not grade the companies that use its site by degrees of risk or creditworthiness – lenders make their decisions purely on the basis of the information pack prepared by the borrower’s sponsor, and they therefore remain responsible for managing their own risk exposure. There is currently no equivalent of the Autobid system used by Funding Circle to allow automatic diversification across a wide pool of borrowers. “We’re expecting the lenders to be experienced investors who know what they’re doing and can make their own decisions”, says Caley.
The site is aiming to open up its platform to a wider range of investors via ThinCats Bonds, and is clarifying with the FSA whether these would constitute a Collective Investment Scheme, which would be subject to regulation. If and when approved, the bonds will be marketed to the public with the aim of raising £1m in minimum units of £5,000. Investors in these bonds will make no lending decisions themselves, but instead their money will be invested across the range of available loans by Innnotec, an FSA-authorised Venture Capital firm.

Unlike Funding Circle, there is currently no secondary market in loans on ThinCats. However, the company intends to establish one later this year, both for loans and for ThinCats Bonds.

ThinCats makes no charge to lenders, instead charging borrowers on successful fundraisings. Borrowers pay a £450 listing fee, which is refunded if no acceptable loan offer is forthcoming. The borrower’s sponsor receives 2%-4% of the sum raised as a commission. After an auction has concluded, ThinCats then adds a 1.5 percentage point premium to the final interest rate secured by the borrower – two-thirds of this premium goes to ThinCats, and the remainder to the sponsor for continuing to monitor the performance of the loan through its term.

Caley says ThinCats will need a loan book of about £30m to break even, but believes the company could have a book of up to £100m within two or three years.

**Relendex.com – an online P2P platform for commercial property lending:** Relendex.com aims to become the world’s first lending exchange for commercial property, enabling multiple lenders to bid on and fund loans secured on income-producing offices, shops and industrial property. The business is currently seeking to raise start-up funding.

Relendex’s founding directors include Michael Lynn, CEO, a chartered accountant and former corporate financier with Charterhouse Group, Sam Rosen, co-founder of Burford, a formerly listed property company, and Peter Johns, chairman-designate and retired head of banking at NM Rothschild.

Lynn argues that commercial property offers one of the few markets in which a P2P platform could achieve scale relatively quickly. Banks, he says, are having to reduce their exposure to commercial property lending both because of lower debt-to-equity ratios and because of the higher risk weightings that will apply to commercial property lending under recent regulatory changes. The effect of this will be seen when significant quantities of lending secured on property fall due for refinancing over the next 2-3 years. At the volume end of the spectrum, refinancing deals are expected to attract sovereign wealth funds and large institutional investors. However, Lynn argues that further down the scale, in the £2m-£15m bracket, there are fewer active lenders.

Relendex so far has pre-launch commitments from would-be lenders amounting to around £160m. Lenders will have access to legal documentation on the individual loans via an online platform. Relendex will offer senior debt up to 65% of the
valuation and an additional 10%-20% of mezzanine debt. The business hopes to launch later this year.

It will operate as an Unregulated Collective Investment Scheme under the FSA authorisation held by its Trust Manager and Operator, Real Estate Associates, a regulated firm that establishes and operates collective investment schemes. It expects to appoint Royal Bank of Canada as trustee to monitor compliance. Because UCISs cannot be marketed to the general public, Relendex will focus initially on attracting wealth managers, family offices, insurance companies and Self-Certified High Net Worth Individuals as lenders. Ultimately, the founders aim to offer an exempt Unit Trust vehicle that would allow retail investors to lend, having taken advice from an IFA.

According to the Relendex website, returns to lenders are expected to fall in the range of 5.5%-12%. Higher rates would be expected on mezzanine lending. Lynn expects rates for senior lending to be 5.5%-8%. Relendex will typically charge an arrangement fee of 1%-2% on each new senior loan, an interest rate spread of 100 basis points per year from the loan interest and an exit fee of 1%. Charges on mezzanine and bridging finance would be considerably higher.

See also:

- YouAngel, another P2P lending site, which is in development by its founder, Martin Wright;
- Squurl.com, a start-up site offering crowdfunding of equipment leasing transactions for SMEs and public sector borrowers;
- Encash – an existing P2P consumer lender, which said recently that it would start offering business loans; and
- Wonga – the online payday loan lender, which has announced that it will also offer short-term business loans of up to £10,000.

B. Regulation

Direct regulatory oversight of P2P lending sites is limited, which causes some observers grave concern. Funding Circle, for instance, just holds a licence as a credit broker and debt collector under the Consumer Credit Act. ThinCats is not licensed under the Consumer Credit Act.

Neither company is authorised by the Financial Services Authority - and therefore (although ThinCats makes clear that its lenders must be experienced private investors) neither is obliged to ensure that lenders are Self-Certified Sophisticated Investors or
Self-Certified High Net Worth Individuals. Also, the absence of FSA oversight means that lenders on these platforms are not covered by the Financial Services Compensation Scheme, which protects cash deposits up to a ceiling of £85,000 per authorised institution.

Relendex has a slightly different model. It will operate through FSA-authorised partners, who will oversee areas of operations and compliance. It takes the view that loan parts could be viewed as “transferable securities”, and that therefore the business is subject to FSA oversight. (Note that all P2P platforms are subject to legislation and compliance obligations in areas such as money laundering.)

In 2011, Funding Circle joined with two leading consumer P2P lenders, Zopa and Ratesetter, to form a trade body, the P2P Finance Association, which is concerned with “finance that is facilitated by platforms on which the majority of lenders and borrowers are consumers or small businesses, rather than ‘investment clubs’ or networks of Sophisticated Investors”. The association has published a set of operating principles: http://www.p2pfinanceassociation.org.uk/rules-and-operating-principles

C. Tax incentives for P2P lending

Loans made via platforms such as Funding Circle and ThinCats are not eligible for inclusion in the annual Isa allowance, and so any income is subject to tax. However, ThinCats includes on its site details of how members can lend via a Self-Invested Personal Pension wrapper. A number of commentators, including Simon Deane-Johns, a lawyer specialising in P2P finance, have argued that P2P SME loans require the same tax incentives as other common retail investments in order to become significant contributors to the funding needs of British businesses. The Breedon report also recommended that the government should introduce “additional tax incentives for investing in SMEs”.

One of the chief problems identified by proponents of P2P platforms is that a company that lends money via these platforms does so on better terms than an individual, since companies are able to write off both lending fees and loan defaults against their profits for tax purposes - while individuals can write off only their lending fees. In theory, therefore, it is currently more attractive for companies to lend via these platforms than it is for individuals. Not surprisingly, a small number of Funding Circle users lend via their companies.

The founders of Funding Circle (along with other P2P finance entrepreneurs) say that the quality of information provided to them by would-be borrowers is one of the greatest barriers to expansion. They have even called in the past for mandatory audits of all limited liability companies – a development that seems unlikely in view of government pledges to remove red tape from small business. However, other, technology-led, solutions are appearing that address the problem of how to obtain timely and detailed financial information from SME borrowers. In time, these could alter the market - as discussed later in this report.
4. Equity funding initiatives

A. P2P retail equity investment platforms

There are now two main online platforms in the UK that enable companies to raise equity finance direct from retail investors: Crowdcube.com and Seedrs.com. In Spring 2012, Seedrs was notified that the FSA is “minded to approve” its application to undertake financial promotions to retail investors. It is the first crowdfunding platform to reach this position in the UK. Crowdcube is now seeking FSA approval as well, having operated to date under a structure that is not subject to regulation. This relies on the creation of a temporary shareholding structure that is able to benefit from the intra-group exemption, which covers share issues between companies within the same group.

Typical deals completed via these platforms so far are mostly fairly modest in size, in line with the sort of early-stage investments that angel investor syndicates consider. Thanks to the low cost structure that platforms such as these have and the relatively basic due diligence that is undertaken on companies that seek to raise funds by this route, deals can be contemplated at sizes that would not make sense to professional venture capital firms.

Crowdcube – the UK’s first equity crowdfunding platform: Crowdcube, which launched in February 2011, is Britain’s first peer-to-peer equity funding platform. Darren Westlake, its co-founder (with Luke Lang), says the aim was to “lower the barrier to become an angel”. Users of the Crowdcube platform are able to invest as little as £10 each in small businesses that want to raise equity finance, while benefiting where applicable from Enterprise Investment Scheme tax incentives. Individual commitments are aggregated via the platform until the funding target is reached. Crowdcube caters both for start-up ventures and established businesses, although those that have sought investment so far have been companies with a year or two’s trading behind them - ie that are seeking growth capital rather than seed finance. The first deal – a £75,000 fundraising for Bubble & Balm, a luxury fairtrade personal care products company – took place in July 2011, and to date the site has raised a total of £2.8m for 15 businesses. These have ranged in size from £12,500 up to a £1m deal backed by 143 investors, who collectively bought 10% of London-based bar and club owner Rushmore Group. Businesses using Crowdcube are typically looking to raise about £125,000.

Crowdcube vets the businesses that approach it to raise money, and Westlake says only about 10% of them are ultimately allowed to post their share offers on the site. Potential deals come from a variety of sources including referrals from entrepreneur websites such as startups.co.uk and from Entrepreneur Country, a networking organisation affiliated with the VC firm Ariadne Capital.
Each business must produce a comprehensive business plan and financial forecasts for at least three years. Crowdcube also carries out its own background checks on the company and the individuals behind it. “What we don’t do is what people would call ‘due diligence’,” says Westlake. “We don’t look into the viability of the business. We took a decision early on that we’re going to let our crowd decide that.” In each case, the valuation is fixed by the company raising the funds, and shares are therefore offered at a “take it or leave it” price. Companies can set a minimum level for individual investments.

Crowdcube lists each fundraising proposal for a maximum of three months, after which it is taken down if the total sought has not been achieved. In that case, any money pledged is returned to the investors. Nearly 50 companies so far have failed to reach their fundraising target on Crowdcube within the three-month deadline.

Once an investment has been made, Crowdcube does not provide ongoing reporting from the company to its shareholders - although it plans to add an investor relations section shortly that will enable businesses to provide quarterly accounts and trading updates.

The site has 15,500 registered investors – a figure that is rising by about 2,000 a month – and the average commitment per investor is just under £1,400. Crowdcube makes its money via a 5% levy on successful fundraisings.

**Seedrs – crowdfunding for start-ups seeking seed capital**: Seedrs is an online peer-to-peer platform that aims to allow retail investors to provide seed funding directly to start-ups seeking up to £100,000 of equity capital. The company is awaiting full authorisation from the Financial Services Authority, having had its application to promote investments approved recently subject to final submissions. It aims to launch in June 2012. Seedrs won the start-up competition at the London Web Summit in March.

The platform will enable entrepreneurs to post information about themselves and their business idea on the platform, including a video pitch, and to set a “take it or leave it” valuation for investors who wish to participate. The minimum investment will be £10. Seedrs undertakes basic legal due diligence on the information provided on the start-ups and founders, aggregates the individual investments and provides “portfolio oversight” during the life of the investment.

Seedrs’s proposition, says co-founder Jeff Lynn, rests on two ideas. First, that in deciding on promising start-up ideas, the “wisdom of crowds” - or as Lynn puts it, “200 or 300 people voting with their chequebook” - is more likely to be correct than the views of professional managers. Second, he argues that diversification is critical, since this is an extremely high-risk asset class. For this reason, investors on the Seedrs platform will be strongly encouraged to build a portfolio that spreads their risk across 20-30 businesses, and to put no more than 5-15% of their investible assets into seed investments.
Lynn cites research by the British Business Angels Association and NESTA in 2009 that suggested returns on this kind of investment can be very attractive - on average. But he acknowledges that failure rates will still be high (perhaps 80%), offset by a small number of extremely successful companies.

Seedrs will provide a degree of ongoing “portfolio oversight” of the investments made via its platform – mainly, says Lynn, in the area of protecting minority shareholders’ rights. It will not take board seats on behalf of investors nor become involved in day-to-day operations, although it will provide contacts and introductions as required.

Seedrs’s oversight will instead involve monitoring the companies’ compliance with their shareholder subscription agreements – including an obligation to provide quarterly updates for investors – and with their Companies House obligations in order to reduce the risk of fraud. However, Seedrs will act on behalf of the crowdfunding shareholders in the event that a start-up is successful and needs to raise a further round of funding, which will require a series of legal steps that would be extremely difficult to carry out if 200 or 300 individual early-stage shareholders were all directly involved.

Lynn says Seedrs will also act on behalf of the investors if companies they have backed are sold. But he adds: “The truth is secondary market opportunities tend not to come up. You either have a definitive exit or flotation, or these shares are illiquid.”

The service is open to anyone who wishes to invest, but users will have to complete an online screening process before they can proceed in order to ensure they understand the risks involved.

Seedrs takes a 7.5% fee on each successful fundraising, along with a 7.5% share of the investor’s profit on successful exits - echoing the “carried interest” model used by VC funds.

B. Regulation

The ability of equity-raising sites such as Crowdcube and Seedrs to operate as regulated businesses - and to offer 50% tax relief on qualifying investments via the newly-enhanced Seed Enterprise Investment Scheme - creates a big incentive for retail investors to consider this high-risk asset class.

Neither site requires members to self-certify as sophisticated investors, though there are several other analogous businesses that do specialise in offering early-stage equity investment opportunities to Self-Certified Sophisticated Investors and Self-Certified High Net Worth Individuals (as defined under the FSMA) in much the same way as Business Angel syndicates traditionally do. (See section on Angel Investing.)

2. “Siding with the Angels”, by Robert E Wiltbank, May 2009
For seed investors using any of these services, portfolio diversification is the only practical way to mitigate the high risks involved in early-stage equity investment. Thanks to their low minimum investment size, platforms such as Crowdcube and Seedrs enable investors to create a diversified portfolio of seed investments even though the overall value of the portfolio might be modest. This is a very valuable benefit that those using these platforms should be strongly encouraged to consider.

However, there are questions that arise with equity funding of this sort. Most important, it is possible that the “take-it-or-leave-it” valuation that entrepreneurs are able to put on their businesses when raising equity via this route might lead to problems in subsequent funding rounds if the new investors argue that the previous, crowdfunded valuation was too high, and demand significant dilution of existing shareholders. Seedrs seeks to address this eventuality by including a provision in its subscription agreements that gives it, on behalf of the individual investors, a “consent right” if a company wants to raise a subsequent round of funding at a lower valuation. This will enable it to negotiate on behalf of its investors.

“This issue is just one illustration of why we think that it is so important that any crowdfunding platform stay involved post-investment, and exercise rights on behalf of underlying investors”, says Lynn. “Without a central party to evaluate the situation and make the consent determination, it would be in the hands of all the investors individually, and we think that is a recipe for disaster. The crowds, we believe, will be very good at making their own investment decisions. But handling the legal/admin work like this, that’s a regular part of being an investor in start-ups. It is not nearly as well suited to mass participation.”

C. New Business Angel initiatives

There are thought to be about 15,000 active business angels in the UK today, according to the angel community’s trade body, the British Business Angels Association, which bases its estimate on data from the Enterprise Investment Scheme and its knowledge of non-EIS fundraisings.

The angel community is served by a trade association, the British Business Angels Association, which brings together almost 100 syndicates of investors, mostly local and regionally based groups spread across the UK, among the oldest of which is London Business Angels, which was founded in the early 1980s and has 110 High Net Worth Individuals as members. In recent years, the BBAA says that deal sizes for individual angels have fallen to an average of about £40,000-£50,000 but that growing numbers of angels are now investing in syndicates, where deal sizes now average about £300,000. Lord Young, the government’s enterprise adviser, has called for a significant increase in the size of the UK’s angel community as part of his enterprise strategy, announced at the end of May.
Efforts to recruit newcomers as business angels and incentives to encourage angel investment by small syndicates – as distinct from crowd-funding – have picked up pace following the credit crunch. The BBAA has been involved in the creation of at least one new angel group recently, while a £50m state-backed vehicle, the angel co-investment fund (www.angelcofund.co.uk), was set up in November to invest alongside angel syndicates in promising early-stage businesses. The fund is overseen by Capital for Enterprise, the government-owned fund manager that is responsible for government-funded investment in small businesses under the EU State Aid rules.

Complemented by the new 50% tax relief now available under the Seed Enterprise Investment Scheme for sums up to £150,000, these initiatives should add impetus to angel investing in the years ahead.3 Companies that raise money via London Business Angels pay an upfront pitching fee of £200-£700, which covers mentoring to prepare them for their pitch event, as well as a 5% success fee levied on the sum raised.

**Angels in the City – a new network of City professionals:** The Angels in the City project is a joint initiative between London Business Angels and the City Corporation, which is intended to create a new 125-strong group of angel investors drawn from the Square Mile – predominantly financial and legal professionals who have investible funds coupled with relevant finance and business experience. The initial aim, which dovetails with the City Corporation’s economic development agenda, is to encourage investment by syndicates of business angels in early-stage businesses based in the so-called “fringe-boroughs” that ring the City but often have areas of significant economic deprivation.

The initiative was launched in October 2011 and to date the project has produced a group of 60 people keen to become angel investors. This group is the first to complete the three-stage induction process that covers general areas such as tax incentives, the risks involved and the typical lifespan of an investment (six to eight years being the norm), as well as practical questions such as due diligence, valuation, terms sheets, legal matters and documentation. The first pitch event for the new angels took place at the end of April 2012, when 15 technology-based businesses from London’s Tech City gave presentations. The first deals are now under discussion.

**The Ideas Factory – a 1,000 strong band of angel investors:** Traditional syndicates and networks of angel investors tend to be relatively small in terms of membership and to consist of wealthy and financially experienced entrepreneurs, business people and professionals such as lawyers and accountants. However, there are a number of investor networks that have grown up in recent years to offer Self-Certified

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3. There can, of course, be more benefits in raising finance from angel investors than simply money. Some businesses also wish to draw on the contacts and specific industry experience of their shareholders, particularly if they have themselves built successful businesses. To address this need, a number of initiatives are expected to launch in the coming months that aim to bring together networks of experienced non-executive directors alongside sources of equity funding to offer “investing director” matchmaking services.
Sophisticated Investors access to start-up and early stage equity fund raisings, with far lower minimum investment thresholds than traditional angel-funded deals. One such is the Ideas Factory.

This is a nine-strong company run by Jonathan Willis that promotes investment in a variety of unregulated alternative schemes to a 50,000-strong database. Over the past two and a half years, it has begun offering opportunities to invest in start-up companies to a smaller group of about 1,000 Self-Certified Sophisticated Investors and High Net Worth Individuals, who must renew their certification once a year. People seeking to raise money are subject to background checks.

The company holds regular events at which members can watch businesses pitch for funding and meet the founders. Pitch events are also filmed and made available to registered members online, along with information packs about the investment opportunities. The website has recently been upgraded to allow users to self-certify online as sophisticated investors or High Net Worth Individuals. Minimum investment amounts are typically around £5,000.

The Ideas Factory has raised more than £6m of equity investment in 27 businesses. These fundraisings are generally much smaller than most investment funds will consider, but all attract Enterprise Investment Scheme tax relief.

**Crowdsource Capital**: This venture is being set up by two brothers, Jonathan and James de Rin. The firm has set its sights on a wider approach to crowdsourcing than simply raising finance for entrepreneurial ventures from multiple investors. It wants to arrange crowdsourcing “across the whole range of activities that an entrepreneur can be involved in”, from design and planning to funding and execution. As such, it envisages a wide shareholder base which will provide input into many aspects of a company’s development.

**See also:**

- The High Net Worth Investors Association.
## NEW AND ALTERNATIVE BANKS

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<th>CONTACT</th>
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<tbody>
<tr>
<td>Shawbrook Bank</td>
<td>Savings and lending bank for depositors and SMEs. All lending is done through independent brokers.</td>
<td>Shawbrook Bank Limited, Lutea House, Warley Hill Business Park, The Drive, Great Warley, Brentwood, Essex, CM13 3BE</td>
<td><a href="http://www.shawbrook.co.uk">www.shawbrook.co.uk</a> online contact form</td>
</tr>
<tr>
<td>Aldermore</td>
<td>Offers a range of savings and borrowing products to individuals and businesses. Savings products include cash ISAs, fixed rate bonds and notice accounts. These savings are used to lend to SMEs unable to raise money by conventional means. They also offer mortgages through selected mortgage brokers.</td>
<td>Aldermore, Floor 1, Block B, Western House, Lynch Wood, Peterborough, PE2 6FZ</td>
<td><a href="http://www.aldermore.co.uk">www.aldermore.co.uk</a> <a href="mailto:email@aldermore.co.uk">email@aldermore.co.uk</a></td>
</tr>
<tr>
<td>Silicon Valley Bank</td>
<td>Provides commercial, international and private banking through 34 locations worldwide. Services for start-ups, venture capital firms and funds. Also offers investment and advisory services.</td>
<td>41 Lothbury, London, EC2R 7HF</td>
<td><a href="http://www.svnb.com">www.svnb.com</a> <a href="mailto:clientservice@svb.com">clientservice@svb.com</a></td>
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## ALTERNATIVE ASSET MANAGERS

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<tr>
<td>Trade Finance Partners (TFP)</td>
<td>Established by the City of London Group plc. For SMEs with a facility requirement of circa £250-750k. TFP buys goods on behalf of clients who have received a confirmed order, by issuing letters of credit or paying for the goods.</td>
<td>City of London Group Plc, 30 Cannon Street, London, EC4M 6XH</td>
<td><a href="http://www.cityoflondongroup.com">www.cityoflondongroup.com</a> <a href="mailto:office@cityoflondongroup.com">office@cityoflondongroup.com</a></td>
</tr>
<tr>
<td>Bluehone Secured Assets</td>
<td>Aims to provide secured loan finance to SMEs by exposing investors to loan portfolios that each consist of around 15-20 loans made to &quot;Aim or Main Market Companies&quot;.</td>
<td>Portfolio Adviser, Bluehone Investors LLP, 32 Bedford Row, London, WC1R 4HE</td>
<td><a href="http://www.bluehonesecuredassets.com">www.bluehonesecuredassets.com</a> <a href="mailto:enquiries@bluehone.com">enquiries@bluehone.com</a></td>
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## DEBT FUNDING

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<tr>
<td>Funding Circle</td>
<td>UK's first P2P lending platform for SMEs. Offers small businesses the ability to borrow from a new pool of lenders, including individuals and companies.</td>
<td>Funding Circle Ltd, 99 Southwark Street, London, SE1 0JF</td>
<td><a href="http://www.fundingcircle.com">www.fundingcircle.com</a> <a href="mailto:support@fundingcircle.com">support@fundingcircle.com</a></td>
</tr>
<tr>
<td>ThinCats</td>
<td>On-line market for secured business loans operating throughout the UK, linking experienced investors with established business borrowers. Lenders set their own interest rates and make their own investment decisions.</td>
<td>PO Box 8002, Coalville, Leicestershire, LE67 0AE</td>
<td><a href="http://www.thincats.com">www.thincats.com</a> <a href="mailto:kevin@thincats.com">kevin@thincats.com</a></td>
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<tr>
<td>Relendex</td>
<td>Web-enabled exchange for secured loans on income-producing properties of all types. Lenders bid the amount they are prepared to lend on a property and the interest rate they want.</td>
<td>n/a</td>
<td><a href="http://www.relendex.com">www.relendex.com</a> <a href="mailto:michael@relendex.com">michael@relendex.com</a></td>
</tr>
<tr>
<td>YouAngel</td>
<td>Internet based social lending community. Currently in development.</td>
<td>YouAngel (UK) Limited, Argyll House, All Saints Passage, London, SW18 1EP</td>
<td><a href="http://www.youangel.com">www.youangel.com</a> <a href="mailto:martin.wright@youangel.com">martin.wright@youangel.com</a></td>
</tr>
<tr>
<td>Encash</td>
<td>Offers a business loans platform for SMEs to create online loan applications. Applications are then listed on the website and auctioned off to bidders offering partial/full funding of the loan.</td>
<td>Checknet House, 153 East Barnet Road, Barnet, Hertfordshire, EN4 8QZ</td>
<td><a href="http://www.yes-secure.com">www.yes-secure.com</a> <a href="mailto:support@yes-secure.com">support@yes-secure.com</a></td>
</tr>
<tr>
<td>Wonga</td>
<td>Businesses may borrow between £3,000 and £10,000 for up to a year. For now only limited-liability companies and partnerships, not sole traders, may apply. They must have revenues of at least £20,000 a month and must have been in business for three years. The interest rate depends on Wonga’s automated assessment of risk.</td>
<td>88 Crawford Street, London, W1H 2EJ</td>
<td><a href="http://www.wonga.com">www.wonga.com</a> <a href="mailto:victoria.ward@wonga.com">victoria.ward@wonga.com</a></td>
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### Online Financial Matchmakers

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<tr>
<td>Fundingstore</td>
<td>Online service which matches businesses needing funding to appropriate funders and advisors. Covers business funding, including business angels, loans, bank funding, asset finance, leasing, equity and other sources including public sector finance.</td>
<td>Booths Park House, Chelford Road, Knutsford, Cheshire, UK, WA16 8WZ +44 (0)844 877 4171</td>
<td><a href="http://www.fundingstore.com">www.fundingstore.com</a> <a href="mailto:contact@fundingstore.com">contact@fundingstore.com</a></td>
</tr>
<tr>
<td>Finpoint (Aims to launch in the UK in summer 2012)</td>
<td>Financing platform for SME corporations in Germany that enables the creation of financing projects and a structured presentation for approximately 100 German and Austrian banks on the platforms. Projects are anonymous and banks are required to submit interest indications and confirm an NDA before gaining access to the project data rooms.</td>
<td>UK Contact: Rainer Plentl, Double A Corporate Finance Advisers, One Queen Anne’s Gate, London, SW1H 9BT +49 (0)895 404 2610 +44 (0)207 799 2866</td>
<td><a href="http://www.finpoint.de">www.finpoint.de</a> <a href="mailto:rainer.plentl@double-acf.com">rainer.plentl@double-acf.com</a></td>
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### Equity Funding

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<tr>
<td>Crowdcube</td>
<td>Business investment platform that aims to connect entrepreneurs with investors willing to invest smaller amounts of money into a person, company, product or idea.</td>
<td>Crowdcube Limited, The Innovation Centre, University of Exeter, Exeter, EX4 4RN +44 (0)1392 241319</td>
<td><a href="http://www.crowdcube.com">www.crowdcube.com</a> <a href="mailto:support@crowdcube.com">support@crowdcube.com</a></td>
</tr>
<tr>
<td>Seedrs</td>
<td>Online platform that allows direct, on-line investment in the equity of seed-stage start-ups seeking up to £100,000 of equity capital. Start-ups post information about themselves and their business idea on the platform, including a ‘take it or leave it’ valuation for potential investors.</td>
<td>Seedrs Limited, Sophia House, 76-80 City Road, London, EC1Y 2BJ +44 (0)20 8638 0650</td>
<td><a href="http://www.seedrs.com">www.seedrs.com</a> <a href="mailto:team@seedrs.com">team@seedrs.com</a></td>
</tr>
<tr>
<td>startups.co.uk</td>
<td>Website offering a broad range of advice for individuals looking to start their own business from scratch.</td>
<td>Crimson Publishing Ltd, Westminster House, Kew Road, Richmond, Surrey, TW9 2ND +44 (0)20 8334 1600</td>
<td><a href="http://www.startups.co.uk">www.startups.co.uk</a> <a href="mailto:editor@crimsonpublishing.co.uk">editor@crimsonpublishing.co.uk</a></td>
</tr>
</tbody>
</table>

### New Business Angel Initiatives

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Description</th>
<th>Contact Information</th>
<th>Website</th>
</tr>
</thead>
<tbody>
<tr>
<td>Angel Co-investment fund</td>
<td>The £50m Business Angel Co Investment Fund makes initial equity investments of between £100K and £1M in to SMEs alongside syndicates of business angels. Investment decisions are made by the independent Investment Committee of the fund based on the detailed proposals put forward by business angel syndicates.</td>
<td>Angel CoFund, 1 Broadfield Close, Broadfield Business Park, Sheffield, S8 0XN</td>
<td><a href="http://www.angelcofund.co.uk">www.angelcofund.co.uk</a> <a href="mailto:info@angelcofund.co.uk">info@angelcofund.co.uk</a></td>
</tr>
<tr>
<td>London Business Angels</td>
<td>Aim to select companies seeking between £100K and £1m to then present to members of their private investor club. So far, 40% of the companies selected to pitch to LBA's investors have secured funding and £50m has been lent to over 200 companies</td>
<td>London Business Angels, 100 Pall Mall, London, SW1Y 5NQ +44 (0)20 7321 5672</td>
<td><a href="http://www.lbangels.co.uk">www.lbangels.co.uk</a> <a href="mailto:enquiries@lbangels.co.uk">enquiries@lbangels.co.uk</a></td>
</tr>
<tr>
<td>Angels in the City</td>
<td>The City of London Corporation is working with London Business Angels on a programme (launched in April 2012) that aims to produce 125 new angel investors by March 2013. Aims to increase the awareness of individuals who have the potential to become angel investors.</td>
<td>100 Pall Mall, St James, London, SW1Y 5NQ +44 (0)20 7321 5673</td>
<td><a href="http://www.angelcapital.co.uk/content/angels-city">www.angelcapital.co.uk/content/angels-city</a> <a href="mailto:angelsinthecity@angelcapital.co.uk">angelsinthecity@angelcapital.co.uk</a></td>
</tr>
<tr>
<td>British Business Angels Association</td>
<td>The British Business Angels Association (BBAA) is the national trade association dedicated to promoting angel investing and supporting early stage investment in the UK.</td>
<td>British Business Angels Association, 1st Floor, 100 Pall Mall, London, SW1Y 5NQ +44 (0)207 321 5669</td>
<td><a href="http://www.bbaa.org.uk">www.bbaa.org.uk</a> <a href="mailto:info@bbaa.org.uk">info@bbaa.org.uk</a></td>
</tr>
<tr>
<td>The Ideas Factory</td>
<td>The Ideas Factory keeps its members informed of outstanding and timely business, property and other investment opportunities through a combination of regular newsletters, live events and website updates. It also provides an informal forum for people to get together to form business partnerships and lifelong friendships.</td>
<td>The Ideas Factory, 2 Orange Row, Brighton, BN1 1UQ +44 (0)1273 956 140</td>
<td><a href="http://www.theideafactory.com">www.theideafactory.com</a> <a href="mailto:info@theideafactory.com">info@theideafactory.com</a></td>
</tr>
<tr>
<td>Crowdsource Capital</td>
<td>Crowd Source Capital has evolved into an open interactive information hub for crowd sourcing everything and anything. A new funding platform is being created and branded FundaBrand.com, which launches later this year.</td>
<td>Crowd Source Capital Ltd, 277-279 Chiswick High Road, London, W4 4PU +44 (0) 207 193 3604</td>
<td><a href="http://www.crowdsourcemarket.com">www.crowdsourcemarket.com</a> FundaBrand.com <a href="mailto:info@crowdsourcemarket.com">info@crowdsourcemarket.com</a></td>
</tr>
<tr>
<td>The High Net Worth Investors Association</td>
<td>Website for High-Net-Worth Investors in the UK and across the world. Aims to attract investment listings from start-ups through to conservative investment funds, giving members a wide choice of investment categories and risk profiles.</td>
<td>HNWI (Management) Limited, 29 High Street, Ewell, KT17 1SB  +44 (0)845 450 4009</td>
<td><a href="http://www.hnwi-association.co.uk">www.hnwi-association.co.uk</a> online contact form</td>
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<tr>
<td>ALTERNATIVE SME STOCK MARKETS</td>
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<tr>
<td>GXG Markets</td>
<td>Specialist market offering shares in SMEs, enabling them to find the necessary capital in order to grow. Owned by the Global Exchange Group of Sweden.</td>
<td>GXG Markets UK, 49 Queen Victoria Street, London, EC4N 4SA  +44 (0)20 7653 1935</td>
<td><a href="http://www.gxgmarkets.co.uk">www.gxgmarkets.co.uk</a> <a href="mailto:info@gxgmarkets.co.uk">info@gxgmarkets.co.uk</a></td>
</tr>
<tr>
<td>ShareMark</td>
<td>Stock market for smaller companies, providing both a fundraising solution and a secondary market trading facility.</td>
<td>Oxford House, Oxford Road, Aylesbury, Bucks, HP21 8SZ  +44 (0)1296 439435</td>
<td><a href="http://www.sharemark.com">www.sharemark.com</a> <a href="mailto:nikki.beale@share.co.uk">nikki.beale@share.co.uk</a></td>
</tr>
<tr>
<td>AltCapX</td>
<td>Online exchange which aims to provide an exit for existing shareholders in unlisted SMEs via its secondary market.</td>
<td>Alternative Capital Europe LTD, TechHub, 76-80 City Road, London, EC1Y 2BJ</td>
<td><a href="http://www.altcapx.com">www.altcapx.com</a></td>
</tr>
<tr>
<td>WORKING CAPITAL FUNDING - FACTORING AND INVOICE DISCOUNTING</td>
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<tr>
<td>Receivables Exchange</td>
<td>Online marketplace for selling accounts receivable. Businesses seeking working capital are connected to a global network of accredited institutional investors.</td>
<td>935 Gravier Street, 12th Floor, New Orleans, LA 70112  +1 504.208.1924</td>
<td><a href="http://www.receivablesexchange.com">www.receivablesexchange.com</a> <a href="mailto:memberservices@receivablesexchange.com">memberservices@receivablesexchange.com</a></td>
</tr>
<tr>
<td>MarketInvoice</td>
<td>Online marketplace where growing companies selectively auction their invoices due to large customers to a network of High-Net Worth and institutional buyers raising flexible working capital.</td>
<td>MarketInvoice Limited, 50 Featherstone Street, London, EC1Y 8RT  +44 (0)20 7078 7621</td>
<td><a href="http://www.marketinvoice.com">www.marketinvoice.com</a> <a href="mailto:info@marketinvoice.com">info@marketinvoice.com</a></td>
</tr>
<tr>
<td>Platform Black Invoice Trading</td>
<td>Online auction trading platform where sellers post invoices they wish to obtain finance for (individually or in bundles), selecting the percentage of the invoice they wish to receive (the advance), and how much they are willing to pay for it (the discount fee).</td>
<td>Platform Black Ltd, Basepoint Business Centre, 1 Winnall Valley Road, Winchester, Hants, SO23 0LD  +44 (0)8434 610100</td>
<td><a href="http://www.platformblack.com">www.platformblack.com</a> <a href="mailto:info@platformblack.com">info@platformblack.com</a></td>
</tr>
<tr>
<td>Urica Finance</td>
<td>Invoice discounting service, currently in development.</td>
<td>Exchange Tower, 19 Canning Street, Edinburgh, EH3 8EH</td>
<td><a href="http://www.uricafinance.com">www.uricafinance.com</a> <a href="mailto:info@uricafinance.com">info@uricafinance.com</a></td>
</tr>
<tr>
<td>Interface Financial Group</td>
<td>Invoice discounted system for SMEs typically between six months and four years old and have a turnover ranging from 250,000 to £4m-plus.</td>
<td>Unit 31, The Old Wood Yard, Hall Drive Hagley, Worcestershire, DY9 9LQ</td>
<td><a href="http://www.interfacefinancial.co.uk">www.interfacefinancial.co.uk</a> <a href="mailto:request@interfacefinancial.com">request@interfacefinancial.com</a></td>
</tr>
<tr>
<td>Manufacturers’ Capital Ltd</td>
<td>Developed a legal and financing structure that seeks to address manufacturing companies’ difficulties in accessing working capital to finance the cost of making the items that have been ordered.</td>
<td>n/a</td>
<td>no website no email address</td>
</tr>
<tr>
<td>SUPPLY CHAIN FINANCE</td>
<td></td>
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<tr>
<td>Demica</td>
<td>Specialises in providing trade receivables securitization, supply chain finance, invoice discounting and all forms of asset based lending, enhancing working capital management for a multi-national client base.</td>
<td>Demica Limited, Crowne House, 55-58 Southwark Street, London, SE1 1UN  +44 (0) 20 7450 2500</td>
<td><a href="http://www.demica.com">www.demica.com</a> <a href="mailto:phillip.kerle@demica.com">phillip.kerle@demica.com</a></td>
</tr>
<tr>
<td>PrimeRevenue</td>
<td>Open interchange for financing the supply chain that is globally accessible on the Cloud for buyers and suppliers, in multiple languages and currencies, with funding provided by multiple financial institutions.</td>
<td>PrimeRevenue, 111 Buckingham Palace Road, Victoria, Westminster, London, SW1W 0SR</td>
<td><a href="http://www.primerevenue.com">www.primerevenue.com</a> <a href="mailto:info@primerevenue.com">info@primerevenue.com</a></td>
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<tr>
<td>INNOVATIVE FINANCIAL INSTRUMENTS</td>
<td></td>
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<tr>
<td>Orbian</td>
<td>Currently the largest supply chain finance provider in the world. Provides both e-invoicing technology and lending capacity to its clients.</td>
<td>Orbian, New Broad Street House, 35 New Broad Street, London, EC2M 1NH</td>
<td><a href="http://www.orbian.com">www.orbian.com</a> <a href="mailto:thomas.dunn@orbian.com">thomas.dunn@orbian.com</a></td>
</tr>
<tr>
<td>Company</td>
<td>Description</td>
<td>Address</td>
<td>Phone</td>
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<tr>
<td>Obilisk Supplier Finance</td>
<td>Aim to partner with e-invoicing technology to create a proprietary security, the O-Bill – a three way legal agreement between supplier, customer and financier that is backed by an underlying e-invoice that has been confirmed for payment.</td>
<td>Obilisk Supplier Finance (UK) Ltd, Richmond House, Oldbury, Bracknell, Berks, RG12 8TQ</td>
<td>+44 (0)702 409 7142</td>
</tr>
<tr>
<td>Entrex</td>
<td>Enables private companies to issue high-yield securities to US institutional and High-Net Worth clients.</td>
<td>Entrex Inc., Willis Tower, Suite 300, Chicago, IL 60606, USA</td>
<td>+1 877.436.8739</td>
</tr>
<tr>
<td>Abundance Generation</td>
<td>FSA-regulated business set up to promote retail investments in individual renewable power projects via debentures.</td>
<td>Abundance NRG Ltd, Threshold House, 65-69 Shepherd's Bush Green, London, W12 8TX</td>
<td>+44 (0)845 862 1722</td>
</tr>
<tr>
<td>Kantox</td>
<td>Web platform which allows companies to directly find counterparties to match and net their future cash-flows in foreign currencies at an agreed fixed exchange rate, and thus hedge their foreign exchange risk.</td>
<td>3 More London Riverside, London, SE1 2RE</td>
<td>+44 (0)20 8133 3531</td>
</tr>
<tr>
<td>Currency Cloud</td>
<td>Online FX payments automation service, set up in 2009.</td>
<td>Ground Floor, 6-8 Fenchurch Buildings, London, EC3M 5HT</td>
<td>+44 (0)20 3326 8173</td>
</tr>
<tr>
<td>Future Route</td>
<td>Launched CreditPal, a software tool that exploits data mining and artificial intelligence in order to identify patterns in large bodies of data. Used for covenant monitoring and fraud protection.</td>
<td>CreditPal c/o Future Route, Enterprise House, 1-2 Hatfields, London, UK SE1 9PG</td>
<td>+44 (0) 844 375 9090</td>
</tr>
<tr>
<td>Covarity</td>
<td>Provides covenant monitoring software to financial institutions that offer working capital lending products.</td>
<td>2300-30 Duke St. W (3rd floor, Ontario Tower), Kitchener, Ontario, Canada, N2H 3W5</td>
<td>+1 519.749.9424</td>
</tr>
<tr>
<td>Funding Options</td>
<td>Online data collection tool that enables users to create standardised and detailed loan applications. Targeted at accountancy practices who serve SMEs.</td>
<td>Funding Options Ltd, 130 Old Street, London, EC1V 9BD</td>
<td>+44 (0)845 366 4199</td>
</tr>
<tr>
<td>Business Finance For You</td>
<td>Online database with details of about 500 funding organisations for debt, equity, asset finance and grant funding.</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td>Ukfunders</td>
<td>Subscription-based online database aimed at professional advisers working with SMEs to raise equity, debt, asset finance, and grant funding.</td>
<td>Unit 105, 156 Blackfriars Road, London, SE1 8EN</td>
<td>+44 (0)800 612 6768</td>
</tr>
<tr>
<td>Businessfunding</td>
<td>Online database targeted at SME owners, covering a wide range of funding sources including equity, debt, grants, invoice discounting, commercial mortgages and leasing.</td>
<td>Cheribourne House, 45a Station Road, Willington, Bedford, MK44 3QL</td>
<td></td>
</tr>
</tbody>
</table>

**TECHNOLOGY, DISTRIBUTION AND THE INFORMATION GAP**

**Brokers**

| National Association of Commercial Finance Brokers (NACFB) | UK trade body for business finance brokers. Members can source commercial mortgages, bridging finance, vehicle finance, invoice finance or equipment finance for business. | 3 Silverdown Office Park, Fair Oak Close, Exeter, Devon, EX5 2UX | +44 (0)1392 440040 | www.nacfb.org/www.smallbusinessfinancedirectory.co.uk/admin@nacfb.org.uk |                                               |
| Bridging Lenders               | Industry focused tool designed to help brokers source short-term bridging finance for clients.                                                                                                             | +44 (0)1173 704231                            |                   | www.bridginglenders.com/ed.payne@bridginglenders.com |                                               |
| Strata Finance Ltd.            | Online platform that enables companies and high-net-worth individuals to lend mezzanine finance for property projects, normally with a second charge on the property after the bank. | Strata Finance Ltd., Unit 10, Wheatcroft Business Park, Landmere Lane, Edwalton, Nottingham, NG12 4DG | +44 (0)115 9849807 | www.stratafinance.co.uk/Online contact form |                                               |
5. Online financial matchmakers

It is tempting to see the new breed of P2P platforms as in some way a breed apart. In reality, however, they are simply one variant of the new types of commercial finance broking operation that are springing up - albeit an eyecatching variant, since they are marketed directly to individuals and in effect turn what has previously been a business-to-business activity into a consumer-to-business activity. Alongside the P2P platforms, there are numerous other companies seeking to broker finance between lenders and SMEs by creating online exchanges where institutional lenders and business borrowers can meet. Several are worth a look.

**Fundingstore.com – a business brokerage:** This site, set up in March 2011, operates a conventional brokerage model that matches businesses that want to raise equity, debt and/or asset-based finance with potential funders, in return for a fee of 2%-5% on successful fundraisings. Businesses are able to view online profiles of brokers and finance providers that register with the site, while registered financiers and brokers can view funding requests lodged on the site by business owners.

**Finpoint UK – a German initiative:** Finpoint was launched in Germany in October 2010 by Michael Klein, a former employee of Deutsche Bank. So far, it has attracted €4m of equity investment from a group of backers. It is a matchmaking service that aims to bring together businesses that wish to borrow and financial institutions with capital to lend. It has already signed up more than 90 banks and financial institutions in Germany, and has registered about 1,000 companies as potential borrowers. Funding sought so far ranges from €20,000 to €70m. Lending requests are listed anonymously, with only generic information on the business’s size and sector made available. The would-be borrower’s identity is only revealed to the lender once it expresses a firm interest in making an offer to the borrower.

Completed loans to date stand at €100m, with a further €250m of borrowing under discussion. Finpoint charges a 0.75% fee on each loan, payable by the borrower.

The company aims to launch in the UK in summer 2012, and has obtained a licence under the Consumer Credit Act to enable it to operate as a commercial finance broker.
6. Alternative SME stock markets

Although the London Stock Exchange’s AIM is by far the best-known exchange through which SMEs can sell their shares to the UK public, there are several other smaller markets that are trying to attract SME business. It is, however, a tough sector and, in May, it was reported that the owners of Plus Markets had decided to close after six years of losses (though talks on a possible sale are continuing).

**GXG Markets – an example of European ‘passporting’**: GXG is a specialist market for shares in SMEs that launched in the UK in September 2011. The company is owned by the Global Exchange Group of Sweden. It is believed to be the first market operator to use the EU’s “passporting” rules under the Markets in Financial Instruments Directive (MiFid) to establish an operation in a second EU country that is subject to regulation from its home market, in this case Denmark. GXG’s aim over time is to set up similar SME securities markets in Germany, France and other EU countries.

The company operates three markets in London, with varying levels of regulation. Its Over-the-Counter market is not open to retail investors, restricting dealing to professionals and Self-Certified Sophisticated Investors. Joining this market costs companies £6,000 a year, plus an application fee of £6,000. GXG also operates a Multilateral Trading Facility, which uses matched bargain trading between brokers, rather than one or more market-makers. Finally, there is a regulated market that enables a full listing involving a prospectus (to be approved by Danish regulators) and accounts prepared using IFRS. Under the Prospectus Directive, if a company plans to raise more than £5m, its prospectus will also have to be approved by the FSA.

So far, 24 companies have had their shares quoted on GXG’s markets, with a further 15 or so going through the application process. They typically raise between £500,000 and £1m.

Simon Kiero-Watson, GXG’s head of markets in the UK, says the company is keen to begin trading SME debt instruments in due course. The market currently has 10 UK and Irish brokers.

**ShareMark – an early mover in this space**: ShareMark was set up in 2000, originally to enable the owners of The Share Centre, an independent online and telephone-based retail stockbroker, to distribute shares in the business to staff and customers. In 2002, the market was opened up to enable shareholders in other private companies to trade their holdings. It is open to retail investors.
Today, shares in 22 companies are traded in regular online auctions on the platform, ranging from quarterly trading days for companies with small shareholder bases of perhaps 100 people, through monthly to weekly auctions for larger groups of shareholders. ShareMark also operates closed markets, where shares can only be traded among a fixed group of shareholders.

ShareMark has received greater promotion since the launch last July of a primary fundraising facility, which will enable companies to raise money by selling shares via ShareMark to retail clients of The Share Centre who have registered their interest in these offerings. However, the market has yet to complete its first primary fundraising. The introduction of primary fundraising via ShareMark was made possible by the UK’s adoption of the EU Prospectus Directive. As noted, this increased the maximum sum that companies can raise without issuing a prospectus to E5m, thereby opening up the market to many more potential users.

ShareMark says the maximum cost of a primary fundraising will be £99,000. Companies that wish to raise money on the market must work with its preferred partner law firms and corporate financiers, who carry out a standardised due diligence process. The market is classed as a Multilateral Trading Facility, rather than a recognised investment exchange under Mifid, and so companies using it are not permitted to say that they are “listed”. Approximately 30 brokers, mainly in the UK and Ireland, are registered to deal via ShareMark.

**AltCapX – a secondary market for stakes in unlisted companies:** AltCapX is an online exchange that is being developed to provide an exit for existing shareholders in unlisted SMEs via its secondary market. The company behind the exchange, Alternative Capital Holdings, is based in New York and is currently seeking regulatory approval to operate in the US. The founders are known to be keen to expand to the UK in due course.
7. Working capital funding initiatives

There is no doubt, on the basis of the interviews that have informed this report, that the financial crisis and its effects on the banking system have prompted a widespread rethink about how to finance working capital in businesses of all sizes. This is encouraging the emergence of a range of initiatives from existing providers - as well as from new financial services entrepreneurs who are targeting this market.

There are two main reasons for this trend:

- First, some retrenching banks have become increasingly keen to promote their invoice discounting and factoring operations (as opposed to overdraft lending) as a source of working capital for SME customers. In their April 2012 report, the Bank of England’s Agents say: “Small and medium-sized firms typically found it more difficult than large ones to secure credit. And they continued to be encouraged to use asset-backed forms of lending rather than overdrafts, which many were reluctant to do.”

The reason is that discounting offers attractive annualised rates of return to lenders – and, at the same time, banks are required to hold less capital against this type of lending than is the case for SME overdrafts. The major banks have an overwhelming share of SME overdraft lending and a share of about 70%-75% of the UK factoring and invoice discounting market.

- The second reason for the ongoing rethink is the sudden loss of bank liquidity at the end of 2008. This event had an impact on many large companies because it revealed the potential insecurity and instability of their supply chains – when bank liquidity dried up they could no longer be sure that their smaller suppliers would have access to the working capital necessary to fill their orders, and were simultaneously squeezed for working capital themselves. This prompted an effort by big companies to make their own supply chains more financially efficient - and therefore less capital-intensive.

In part, this has been achieved by large companies lengthening their payment terms – conserving cash by draining liquidity from their suppliers. Again, the Bank of England Agents observe: “Smaller businesses also often reported that corporate liquidity was being squeezed by larger business partners: suppliers were tightening up on payment terms, while customers pushed to extend them.”

Small companies have responded both by increasing their cash holdings to ensure they are better able to fund themselves and, in a few cases, by searching for alternative sources of working capital finance.

4. The author owns shares in the online invoice discounting start-up Platform Black Invoice Trading (qv).
A. New forms of factoring and invoice discounting

Factoring and invoice discounting are two closely related services that enable businesses to raise short-term funds against their outstanding invoices or trade receivables, typically for 30-60 days:

- **With factoring agreements**, under which a finance company takes over the job of chasing up payments, the debtor is made aware that the invoice has been sold on to a third party.

- **With invoice discounting**, the debtor is not aware that the invoice has been sold - and therefore the supplier remains responsible for ensuring the invoice is paid, so that it can in turn repay its advance. The confidentiality of invoice discounting makes it the more popular choice among SMEs.

However, these services are not widely understood, and they are regarded as relatively expensive forms of finance. They are currently used by fewer than 4% of UK SMEs, according to figures published by the British Bankers Association in October 2010, cited in the Breedon Report. Where they are available, conventional factoring and discounting are usually offered under long-term exclusive agreements with a single finance house that commits the SME borrower to a series of fees and charges, whether or not it uses the service.

Over the past 18 months, inspired by the growth of www.receivablesxchange.com, which was founded in the US in late 2008, several online platforms for invoice discounting by SMEs have appeared in the UK to offer invoice finance under a different model from that used by the banks and other existing providers.

The key feature of all these sites is their use of auction systems to enable bidding from multiple lenders. This has the effect of competing down the ultimate cost of working capital to the business borrower, by arriving at the highest percentage of the face value of the invoice that lenders are willing to advance, coupled with the lowest percentage fee they will accept. The advance is normally for 30-60 days.

These auction-based services also operate more flexibly than regular discounting facilities, enabling users to avoid lock-ins, arrangement fees and other ancillary charges, and charging only a fee for each transaction.

**MarketInvoice.com – the UK’s first auction-based discounting platform:**

MarketInvoice, set up by former bankers Anil Stocker and Charles Delingpole, completed its first invoice auction in February 2011, and in April 2012 auctioned invoices with a face value of £2.86m - a slight dip from its record month of March 2012, when completed auctions totalled £3.42m. Since its launch, 92 businesses have
auctioned invoices on the platform, and the total value of business transacted stands at £13.3m. There are now 41 registered lenders, comprising hedge funds, family offices and High Net Worth Individuals.

Having opened an account and satisfied MarketInvoice’s checks, a company that decides to auction an invoice will set the range of discount to the face value of the invoice that it is willing to accept, along with a ‘buy it now’ rate. Bidders compete to offer the largest advance and the lowest fee on individual invoices, but are also able to diversify their risks by bidding to acquire portions of multiple invoices. MarketInvoice charges 0.5 per cent of the face value of each invoice as a fee from the seller, plus a percentage of the buyer’s profit, typically around one-fifth. The service is confidential, so that those who owe money against an invoice do not know that it has been sold to someone else - an important consideration for many SMEs.

The volume of business being transacted on the MarketInvoice platform has risen steadily each month (as the accompanying table shows), and continues to climb rapidly:

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<table>
<thead>
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<td>Feb 2011:</td>
<td>£35,598</td>
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<tr>
<td>Mar 2011:</td>
<td>£124,495</td>
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<tr>
<td>Apr 2011:</td>
<td>£193,345</td>
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<td>May 2011:</td>
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<td>Jun 2011:</td>
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<tr>
<td>Apr 2012:</td>
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</table>

Auction results are beginning to show that over time, repeat users see the fees they are being charged fall on successive transactions and the percentage advance on offer increase as they develop a trading record. This suggests that the key benefit of this approach can be delivered in practice – a gradual decline in the cost of working capital to creditworthy businesses:
MARKET INVOICE AUCTION RECORD: MACKESYS SOLICITORS AND JESSNIC HANDBAGS

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<thead>
<tr>
<th></th>
<th>Mackesys</th>
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<th>Jessnic</th>
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<td></td>
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<td>days</td>
<td>days</td>
<td></td>
<td>days</td>
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</tr>
<tr>
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<td>85%</td>
<td>1st Auction:</td>
<td>1.45%</td>
</tr>
<tr>
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<td>90%</td>
<td>3rd Auction:</td>
<td>1.20%</td>
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<tr>
<td>6th Auction:</td>
<td>0.50%</td>
<td>90%</td>
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<td></td>
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<td>5th Auction:</td>
<td>0.90%</td>
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<td></td>
<td></td>
<td></td>
<td>6th Auction:</td>
<td>0.75%</td>
</tr>
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</table>

Manufacturers’ Capital Ltd – a working capital provider: Where conventional invoice finance involves discounting receivables for goods that have already been provided, the problem for smaller manufacturing companies is rather different. They will often need significant working capital to finance the cost of making the items that have been ordered – long before any invoice can be submitted and sold to a discounter. Manufacturers Capital Ltd, set up by former venture capitalist Richard Muir-Simpson, has developed a legal and financing structure that seeks to address manufacturing companies’ difficulties in accessing this type of finance. He is currently seeking equity funding to bring the product to market.

Interface Financial Group – a franchised factoring network. Interface was established in the US in 1972 and expanded into the UK and Ireland in 2010, setting up its head office in Hagley, Worcestershire. From its US roots the business has grown into an international network of factoring franchises that also operates in Canada, Australia, New Zealand and Singapore. It currently has 13 franchisees in the UK and Ireland, who fund transactions with their own working capital. Customers are not subject to lock-ins and can use the IFG service on an ad hoc basis. The company says it “primarily serves those SMEs who do not meet banks’ lending criteria because of a lack of financial history or the absence of a strong balance sheet”. It takes personal guarantees from the company owners. The businesses it serves are typically between six months and four years old and have turnover ranging from £250,000 to £4m-plus.

See also:

- Platform Black Invoice Trading, an online auction-based invoice discounting service launched in spring 2012, led by CEO Christopher Shaw; and

- Urica Finance, a new platform that is currently in development.
B. Regulation

Factoring and invoice discounting are not regulated activities. Lenders are typically Self-Certified High Net Worth Individuals, family offices and institutional investors such as hedge funds, who are seeking diversified portfolio exposure, coupled with potential annualised returns of 20% or more.

C: Supply chain finance – “invoice discounting on steroids”

Invoice discounting offers smaller companies quick access to working capital while they await payment of their outstanding invoices. But the cost of the finance can be high on an annualised basis, in part because of the structure of the transaction.

When a lender advances money under an invoice discounting facility, it takes the risk that if the invoice is not paid, it will have to recover its money from the SME supplier, rather than from the ultimate customer to whom the invoice was issued. Customers are often larger and more creditworthy companies than their suppliers. If lenders could instead have recourse to the ultimate customer, they should be able to advance money at lower risk - and therefore at lower cost to the borrower. In recent years, and particularly since the credit crunch of 2008, supply chain finance has emerged as a potential solution to this problem.

Supply chain finance uses the same basic mechanism as conventional invoice finance – a short-term advance against an outstanding receivable in return for a percentage fee. But it adds a number of additional features that can reduce the cost of borrowing.

The most important is that in a supply chain finance transaction, the invoice has already been approved for payment by the customer at a fixed future date. This converts a simple receivable into a “confirmed payable”, granting any lender recourse to the customer rather than the supplier. The cost of this finance therefore depends on the customer’s credit rating rather than the supplier’s, enabling lenders to provide larger advances at lower cost.

According to Thomas Dunn, majority owner of Orbian, the world’s biggest provider of supply chain finance, the advance is typically 99% of the invoice’s face value, against 90% in a conventional discounting transaction, and Orbian’s interest rate to the borrower is currently Libor plus 200 basis points per year, or about 50 basis points for a 60-day advance. This is considerably cheaper than conventional invoice finance.

At the heart of a supply chain finance programme is an electronic invoicing system that links together suppliers and customers, and that enables invoices to be electronically confirmed for payment on a fixed date within an agreed legal framework between the
supplier, the customer and the lender. In most cases, a technology company provides the e-invoicing system, while a bank or institution provides the short-term lending capacity. Leading suppliers of e-invoicing systems include Orbian, Demica and Prime Revenue. Orbian is unique in that it supplies both the technology platform and the financing capacity to its clients.

The benefits of the system are that it enables large customers to extend their payment terms to smaller suppliers, often up to 120 days – on the basis that they have legally committed to settle the invoice on an agreed future date – while at the same time enabling those suppliers to access short-term working capital in the interim at rates of interest lower than they could secure on their own account. Its adoption therefore holds out the prospect, according to the Breedon Report, that “the UK economy should be able to operate at a lower level of credit intensity which should, over time result in a net benefit to economic growth and financial stability”.

In the years since the credit crunch, the impetus for the spread of supply chain finance has come in large part from big companies, which have established these programmes as a way of protecting themselves and ensuring that key suppliers have continuing access to working capital.

However, although supply chain finance programmes offer clear advantages to both large companies and their smaller suppliers, these are unlikely to be available to most small businesses in the near future.

First, supply chain finance programmes are complicated and time-consuming to establish, which tends to mean that large companies only include their biggest, tier 1, suppliers. Smaller companies tend not to be invited to take part, says Phillip Kerle, CEO of Demica - partly because of the work needed to implement the technology and also because as deal sizes fall the margins on them become less financially attractive to potential lenders. Even in the Nordic countries, where supply chain finance is much more widespread than in the UK, its use extends down only to companies with revenues of about £200m a year.

It is therefore possible that supply chain finance will not prove applicable to a large percentage of small businesses.

The second issue is that conventional supply chain finance deals remain captive relationships in which suppliers must deal with only one lender in the same way as they typically would in a factoring or invoice discounting arrangement. The absence of a market-based mechanism to set lending rates – as operates on online discounting platforms, such as MarketInvoice, for example – is a potential drawback.

Supply chain finance has not been adopted as rapidly in the UK as in some other countries, particularly the Nordics. This is variously put down to the desire of the main UK banks to protect their invoice discounting and factoring business (which widespread adoption of lower-margin supply chain finance might threaten) and generally poor relations between many large UK businesses and their suppliers, who frequently feel squeezed by their big customers. Nevertheless, there are thought to be a few hundred supply chain finance programmes currently running in the UK.
8. Innovative financial instruments

A major part of most kinds of financial innovation tends to be the creation (or rediscovery) of financial instruments suited to the problem at hand. There are several examples that are presently emerging as alternatives to conventional funding structures.

Early in the process of researching this report, the author was contacted by Christopher Fildes, the veteran financial journalist, and David Potter, the veteran City financier. “Bring back the bill”, they wrote, referring to the bill of exchange, a standard instrument used in Victorian times. In view of what follows, it is worth quoting their contribution at length.

“The chronic ailment of small businesses is a shortage of working capital. When they try to expand, this ailment can become acute. Money runs short and runs out, and they collapse as they wait to be paid.

“Their customers may well be perfectly creditworthy. It is just that as a matter of habit or policy they give themselves time to settle. Their muscle protects them and their treasurers earn brownie points. Their suppliers might, in desperation, try their luck with invoice discounting, but they need a straightforward way to turn distant expectations into cash on the nail.

“They did so, without thinking, for centuries, by drawing a bill of exchange on their customer. This was a promise to pay at a fixed date in the future. The bill could then be sold in the market, for cash, at a discount. Better still if some rich and well-informed backer would lend his name to the bill. He would take his commission, of course, but the discount would narrow.

“If only today’s small businesses could draw bills on their solid but slow-moving customers! That, so Ministers might now think, would be a useful discipline – but they may find that the slowest payers of all are close to home. At Defra, the farmers’ friends are notorious for paying when they get around to it. The town halls, too, should let their outsourced suppliers of goods and services introduce them to bills of exchange. A liability with a fixed date would serve to concentrate minds.

“Who would buy these bills? They would be a natural home for the shadow banking sector’s spare cash. Money market funds would lap them up. Who would back them? Why not the company treasurers, thus earning more brownie points for themselves? This was how, in the Victorian City, the merchants became bankers.

Back to the future...
“At that City’s heart, the Bank of England itself would discount the finest bills, and its discount office was known as the Bank’s window on the world. Bring back the bill and reopen the window!”

Orbian – the beginnings of a modern bill of exchange: Orbian, set up in 1998 and once co-owned by Citigroup and SAP, the German business software vendor, is the biggest supply chain finance provider in the world. Uniquely, it provides both e-invoicing technology and lending capacity to its clients. Since Q1 2010, its lending book has grown at a compound rate of 35% quarter-on-quarter. Orbian is currently financing $6bn of transactions on an annualised basis, and is active in some 53 countries. Thomas Dunn, its chairman and majority shareholder, says the smallest company so far included in a supply chain finance programme had annual revenues of $400,000, but was able to raise working capital on the basis of its larger customer’s credit rating.

The company finances its clients’ supply chains by issuing notes – short term commercial paper up to 120 days – to banks and other institutional and corporate buyers. These notes differ from traditional bills of exchange since the deals are routed through clearing houses such as Clearstream, Euroclear or the DTCC. However, by issuing tradable notes linked to its individual supply chain finance programmes, Orbian effectively begins to open up the closed structure of conventional supply chain finance to multiple providers of funding. This enables a market to emerge for short-term working capital.

In addition, because corporate treasurers can invest spare short-term cash in these notes on much the same basis as they would in money market funds, Orbian is beginning to harness the cash held by large companies and put it to use in financing economic activity. The effect is to increase the funding capacity available to finance corporate supply chains and reduce borrowers’ dependence on individual funders.

Obilisk Supplier Finance – the O-Bill: Obilisk Supplier Finance is a start-up company founded by Damian Crowe, a former banker at Citigroup and ABN-Amro (subsequently RBS), and before that a corporate treasury specialist at PwC. The company is chaired and backed by Les Halpin, co-founder (with Neil Record) of Record plc, and former CEO of software company Integrity Treasury Solutions, which was sold to SunGard of the US in 2005. The company expects to launch in summer 2012.

Obilisk also aims to take the spread of financing based on e-invoices a stage further than the captive systems operated by conventional supply chain finance programmes. The intention is to partner with e-invoicing technology providers to create a proprietary security, the O-Bill – a set of bilateral legal agreements between the supplier and customer, and between the supplier and the financier, backed by an underlying e-invoice that has been confirmed by the customer for payment.

Companies would be able to sell their “confirmed payables” as O-Bills via Obilisk’s platform - and therefore receive multiple offers of finance from brokers operating on
the platform. Crowe says there will be two finance providers committed by the time of
the launch, with the intention of adding more. He estimates the annual APR of finance
raised via this route at three-month sterling Libor plus about 100-200 basis points.

Crowe argues that European Union initiatives to promote electronic invoicing,
particularly the Peppol Programme, will see much more widespread adoption of
e-invoicing systems as governments and public authorities introduce them for their
own procurement. This process could accelerate take-up significantly and provide
substantial benefits, he argues, since state procurement budgets are so large – E2tn
a year across the EU, with some E200bn-E300bn owing at any time. Allowing
suppliers to raise working capital based on the credit rating of governments and
public authorities would, he believes, provide a substantial stimulus to the economy
in the form of extremely cheap funding.

Entrex – high-yield “revenue participation” instruments: Entrex is a Chicago-
based business that enables private companies to issue high-yield securities to US
institutional and High-Net Worth clients. These securities, which Entrex brands
TIGRcubs – Top-line Income Generation Rights Certificates – pay a monthly yield
to the investor based on a fixed percentage of the issuing company’s revenues.
Stephen Watkins, the company’s founder and chairman, says that in 2011 Entrex
handled 41 TIGRcub issues that raised a total of $1.3bn, some $150m of which went
to companies in Europe. To date, Watkins says Entrex has issued some $4.8bn of
TIGRcubs.

Using these securities, a private company can raise money from investors that will
be repaid with interest over seven years via the levy on revenues. The securities are
normally priced to produce an initial amortising yield of 9 per cent, says Watkins.
But as the company’s revenues grow over the life of the security, so the yield will
increase because the percentage paid to the lender remains constant. Returns are
typically in the mid to high-teens, he says.

The minimum size of issue that has so far proved practical is about $2m, given the
level of associated fees the borrower must pay. These include fees for brokers on the
buy and sell side, syndication costs and Entrex’s fees, which comprise a 1.5% fee on
the initial amount raised, and an ongoing annual 50bp servicing fee, again based on
the original sum raised.

The main buyers of TIGRcubs so far have been the high-yield desks of US
institutional investment houses, which assess the attractiveness of individual
company issues on the basis of information similar to that provided for a private
placing. The terms of the issue give the trustee that receives payments from the
company on behalf of the end-investors automatic audit rights on the issuer’s
revenue at any time. The securities are automatically redeemed if there is a change of
ownership at the issuing company, or if there is a significant corporate event, such as
the sale of a division.
TIGRcubs will normally have a call option for the issuing company that can be exercised after two to three years. This enables companies whose revenues are growing quickly to refinance early, since the faster their revenues grow, the higher the cost to them becomes of the capital they have raised.

Among the potential benefits of this approach are that company owners can raise significant capital without diluting their equity interest, and that a structure of this sort might act as a disincentive for companies to increase revenues at the expense of profitability.

Entrex aims to open a London-based operation in the third quarter of 2012, to serve the UK and European SME markets. It has approached the Swedish Global Exchange Group to create a European secondary market in its securities.

**Abundance Generation – using debentures to fund renewable energy projects:** Abundance Generation is an FSA-regulated business set up to promote retail investments in individual renewable power projects via debentures. These are unsecured debt instruments that pay a return based (in this case) on the surplus cash flows from the electricity generated and sold over the life of a project. Its first offering, arranged on behalf of Resilient Energy Ltd, was to be a retail debenture to fund a £1.4m wind turbine project on a farm in Gloucestershire. The turbine was intended to benefit from renewable energy subsidies (which tend to be index-linked), debenture holders receiving regular (but variable) payments over the 20-year-life of the project on the basis of the amount of energy generated and sold. However, this offering has had to be suspended after the project’s turbine supplier filed for insolvency in the German courts. Further projects are in progress.

**Kantox.com – an alternative to using derivatives for FX hedging:** Kantox.com is an online P2P platform that enables companies to manage their foreign exchange exposure by agreeing forward FX deals among themselves, without the need to go through a bank or broker. The platform lets companies agree to swap currencies among themselves at an agreed future date and at an agreed exchange rate, thereby removing the uncertainty over what their ultimate income will be from transactions undertaken in foreign currencies.

As with other P2P platforms, there is no traditional financial institution standing between the two parties. Therefore, the risks remain with the counterparties and are not assumed by an intermediary such as a bank or FX broker.

Kantox was set up by Phillipe Gelis and Antonio Rami, two former consultants from Deloitte in Barcelona. The company, which has six staff, is based in London and gained its FSA authorisation in September 2011. It hopes to finalise its first funding round during summer 2012.

Kantox has so far signed up 40 companies to its service, and to date has traded nearly $1m, mainly against the euro. The company charges a sliding percentage fee of the
annual amount bartered, starting at 0.48% for up to £100,000 and falling to 0.05% by the time the sums top £100m. Gelis argues that while banks provide FX services to large customers at very tight spreads and competitive prices, charges to SMEs are frequently higher, amounting to 1%-2% of the amount hedged.

Kantox clearly stands at a huge disadvantage when it comes to liquidity, compared with the vast sums turning over in the global FX markets every day. However, it argues that companies will not approach using its platform in the same way as they would a standard FX transaction with a bank. Instead, it believes they will use Kantox to identify a small circle of counterparties whose needs more or less match their own and with whom they will build a trading relationship over time.

See also:

- Currency Cloud – an online FX payments service set up in 2009.
9 “Retail bonds” – unsecured term loans to private companies

Since the credit crunch, several companies have raised money direct from the public by issuing what have often been called “retail bonds”. Because there is no secondary market in these instruments, issuers are not required to publish a prospectus, which greatly reduces the cost of raising funds by this route. In effect, these are long-term fixed-rate unsecured loans, mainly to SME borrowers.

These “bonds” are normally marketed by companies that have large retail customer bases or that support popular causes such as renewable energy. For instance, in November 2011, Ecotricity, a renewable energy company, announced its second offering of £10m of Ecobonds, paying an annual fixed-rate of 6% over an initial four-year period. The company says its first offering was oversubscribed by some 50%. As with the planned debenture offering by Abundance Generation above, Ecotricity’s projects aim to benefit from government renewable energy subsidies.

The largest recent example of a “retail bond” issue was by John Lewis, which raised £50m from its customers in March 2011, offering a fixed rate of 4.5% plus 2% in gift vouchers over five years. In addition, foreign exchange broker Caxton FX raised £4m in October 2011 over four years, offering 7.25% gross. Most recently, the boutique hotel chain Mrs & Mrs Smith is seeking to raise up to £5m with a retail bond that offers a 7.5% cash return per year, or a 9.5% return paid in hotel stays.
10. Technology, distribution and the information gap:

There are three big (and related) information problems in the SME funding market:

- How do lenders ensure that they have access to high quality information on the businesses that want to borrow from them?
- How do businesses find out about the range of funding sources that are potentially open to them?
- How do providers ensure that the SME population is aware of their services and that they can be distributed effectively?

One of the key problems in lending to SMEs is gathering sufficient information about the business and its performance to assess the credit risk with confidence. This is traditionally an expensive and specialised process that can make lending relatively small sums unprofitable.

In carrying out SME credit assessments, access to the business’s current account records provides a crucial insight into its cash flow - and therefore into its ability to service loan finance. Normally, this information is available only to the company’s main bank, which puts any other organisation that wishes to lend to that company at a big information disadvantage. Among the Breedon Report’s recommendations was that “the British Bankers Association should explore greater credit data sharing with non-bank providers, and this should be considered by the Financial Conduct Authority”.

Whether this might include such details as cash flow information is uncertain. However, there are signs that technology-led companies are beginning to offer alternative ways to solve this problem.

A. Data mining initiatives

**Future Route – CreditPal:** A key development in this area is the work of Future Route, a UK technology business founded by Chris Poll, a former investment manager, banker and stockbroker. Future Route’s main product is CreditPal, a software tool that exploits data mining and artificial intelligence in order to identify patterns in large bodies of data. Its main uses so far are for activities such as covenant monitoring and fraud prevention. The software is used by Experian, the credit rating agency, and Bibby Financial, the UK’s largest independent factoring and invoice discounting provider.
CreditPal is able to extract data from the business software systems used by borrowers and assemble it to provide a timely record of how a business is performing. The technology was among the winners at the British Computing Society’s 2010 UK IT industry awards, and has been adapted more recently in order to offer a potential solution to the problem of understanding an SME’s cash flow without having access to its current account records.

**Funding Options – A data-gathering tool for SME credit applications:** Funding Options, set up by Conrad Ford, is an online data collection tool that enables users to create loan applications in a standardised and detailed form. It is initially targeted at accountancy practices who serve SME customers, and aims to make it faster and cheaper for advisers to research and apply for term loans, commercial mortgages and invoice finance on behalf of their clients.

Problems in assembling robust business data to support credit applications are among the main obstacles to decision-making on SME loan applications; fewer than 40% have a business plan when they apply for a loan, according to the SME Finance Monitor.

The critical attribute of the Funding Options platform is its ability to extract data automatically from a wide range of business software packages used by SMEs and reassemble it to create detailed financial information – P&L, balance sheet and the business’s transaction history. This last element is particularly important since in effect it allows a picture of the SME’s current account activity – and therefore its cash flow – to be “reverse-engineered”, using the data extracted from the business software package. Access to this information is vital in assessing loan applications by small businesses and is traditionally the preserve of the bank that holds their current account. Opening up access to this would significantly enhance the competitive strength of alternative lenders.

Ford also argues that the data his company’s software assembles could help to enable the securitisation of SME loan pools, since standard information is held on each individual loan. Moreover, software such as this can be used to carry out regular covenant monitoring over the life of the loan.

The Funding Options service was due to go live in May. It has Ric Traynor, executive chairman of Begbies Traynor Group, the corporate restructuring firm, and Alan Morgan, an early investor in Funding Circle, among its founding shareholders. The business aims initially to recruit 1,000 accountancy practices and process the funding applications they originate. “By our estimates that would generate around 5% of all new lending volume in the UK”, says Ford. “One of the things that people haven’t twigged is how much technology has allowed you to do with data.”

**See also:**

- Covarirty, a ten-year-old Canadian company that provides covenant monitoring software to lenders.
B. Database construction

Many of the people interviewed for this report identified the absence of a comprehensive, central and publicly available database of the wide range of possible funding sources as one of the chief problems facing businesses that want to raise finance, be it debt, equity, asset-based finance or grants. There are several initiatives aimed at providing business owners with a more comprehensive view of the market - and thereby of improving the visibility and awareness of a wide variety of funding providers.

**Business Finance For You – a BBA initiative:** An online database that launched in May, Business Finance For You brings together details of about 500 funding organisations for debt, equity, asset finance and grant funding. It was developed by the British Bankers Association in order to replace the current, government-run Business Finance Finder tool that forms part of the Business Link website. The BFFY database contains the same material as the Business Finance Finder, but in addition has a larger number of VCs and banks, as well as angel networks, Community Development Finance Institutions and providers of various types of asset-based finance. The database can be searched using a simple set of criteria - including region, business sector and life-stage, and the quantity of finance sought.

**Ukfunders.co.uk – for professional advisers:** Ukfunders is a subscription-based online database set up four years ago by business partners Toby Austin and Stephen Bence. It is aimed at professional advisers of all sorts who work with SMEs to raise equity, debt, asset finance and grant funding. It now has more than 100 subscribers drawn from corporate financiers, business consultants, local authority business advisers, universities, science parks and business incubators.

The site’s intention is to provide a comprehensive, high-quality and up-to-date database of funding sources that has been independently compiled. Stephen Bence argues that the independent sourcing of information is vital because most organisations that compile databases are membership-based and will not therefore carry details of non-members. “Two thirds of the VCs we list are not members of the BVCA”, he says. The database allows subscribers to search it using a large number of criteria - which Bence says is important since many funding organisations have specific eligibility criteria, whether connected to the size of business, its sector, location or stage of development.

**Businessfunding.co.uk:** This is an online database that launched in late 2011. It is targeted at SME owners themselves, rather than professional advisers. The site covers a wide range of funding sources including equity, debt, grants, invoice discounting, commercial mortgages and leasing. Most areas of the site are free to the user, although there is a charge to access the section covering equity finance.

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5. That, of course, was also the reason the CSFI commissioned Andy to produce this paper. AH.
Users answer a series of questions to establish how big and developed their business is, where it is located, what assets it owns, and what its aims are. The site will then suggest a range of types of funding that may be suitable, and under each heading a list of possible providers.

Businessfunding’s income is derived from referral fees charged to finance providers when users click through to their website. The site aims to provide a comprehensive list of funding sources, and inclusion does not depend on the finance provider’s willingness to pay an “affiliate fee” for referrals. To date, it has attracted several thousand users.

C. Distribution

One result of the entry of a large number of new bank and non-bank finance providers into the SME funding market is that distribution has become an increasingly important problem for entrants. It is not surprising, therefore, that the UK’s existing network of commercial finance brokers has assumed a significant profile. Commercial finance brokers are unregulated, but members of their trade body, the National Association of Commercial Finance Brokers, now number over one thousand and operate according to the NACFB’s guidelines. The association is consulted by a wide range of finance providers who wish to serve small business owners.

At least one P2P lending platform, ThinCats, has formed relationships with commercial finance brokers to become the “sponsors” of companies that seek to raise money via its platform. The sponsors are responsible for compiling the information in the business’s loan application and monitor the performance of the loan through its life in return for a share of ThinCats’ interest rate premium.

<table>
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<tr>
<td>Leasing Finance</td>
<td>£1.112bn</td>
<td>£997m</td>
<td>£992m</td>
<td>£1.027bn</td>
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<tr>
<td>Vehicle Finance</td>
<td>£1.085bn</td>
<td>£759m</td>
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</table>

The NACFB has launched several initiatives recently aimed at increasing awareness of its members among SME owners and managers. These include the Small Business Finance Directory, which enables users to search among members of the NACFB, the Asset Based Finance Association and the Finance & Leasing Association, for suitable funding sources.

The association has also recently launched a telephone service to direct businesses towards brokers who offer the appropriate forms of finance.
See also:

There are also several examples among the broking community of online platforms intended to aid the distribution of certain sorts of lending. For example, www.bridginglenders.com is a specialist site designed to help brokers source short-term bridging finance for clients. Market contacts suggest that a growing quantity of private capital from wealthy investors is being made available in high-yield areas such as bridging and mezzanine lending, perhaps partly as a result of growing difficulty in refinancing commercial property lending through the major banks.

In a similar vein, the Nottingham-based finance broker Sterling Capital Reserve, which is a member of the NACFB, has launched www.stratafinance.co.uk, an online platform that enables companies and Self-Certified High Net Worth Individuals to lend mezzanine finance for property projects, normally with a second charge on the property. This differs from a conventional P2P platform in that it simply aims to provide a matchmaking service between individual lenders and borrowers, rather than breaking up loans among multiple lenders - as Relendex, for example, plans to do.
Andy Davis is a writer on investment, finance and business. He spent 15 years as a journalist on the *Financial Times*, most recently as editor of *FT Weekend*. Before that, he was Development Editor, leading a redesign in spring 2007 that saw the *FT* win three Newspaper of the Year awards in early 2008.

He is an associate editor and investment columnist for Prospect, the monthly current affairs magazine - and in May 2012 was named Personal Financial Journalist of the year in the Wincott Awards on the strength of his columns for Prospect. He writes regularly for a range of publications and is the author of the first Beyond the Banks report, published by Nesta in September 2011.
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