FINANCE: Businesses are being more inventive in the way they are sourcing funding. Craig Johnson investigates

RINGING IN THE CHANGES

The 2008 global financial crisis changed the shape of the funding landscape in Scotland. The shockwaves that reverberated around the globe following the collapse of American banking giant Lehman Brothers are still being felt on high streets up and down the country. Businesses that had become used to borrowing money at very cheap rates of interest were suddenly left struggling to find finance following the credit crunch, with the ensuing recession then putting pressure on customer spending too. As the commercial property market collapsed, many companies were squeezed from all angles.

While many firms still voice concerns about the interest rates and other costs that they are asked to pay to obtain loans and overdrafts, the availability of finance does appear to be improving once more.

The Market for SME finance in Scotland, a report issued by the Scottish Government in August, revealed that 14 per cent of the nation’s small and medium-sized enterprises (SMEs) applied for finance during 2014 and that 60 per cent of those companies obtained the finance they required.

Scotland’s businesses secured £8.7 billion of loans from their banks, with a further £2.2bn of finance coming in the form of overdrafts. Debt wasn’t the only game in town for companies: £262mn was raised through equity investments, with those supplying capital including business angels, the Business Growth Fund and the Scottish Investment Bank (SIB).

“Small and medium-sized enterprises are not only the backbone of the Scottish economy, but are essential to delivering our ambition to build a more productive, innovative and fairer Scotland,” says Deputy First Minister John Swinney.

“Along with our enterprise agency and local authority partners, we are already taking forward a range of actions to address gaps in both the supply of and demand for finance.

“The SIB is providing equity investment alongside private sector partners to support early-stage innovative companies access risk capital investment and has recently streamlined and enhanced its funds to make them more flexible and increase their impact,” Swinney adds. “Local authority loans funds provide loans to small and growing businesses that cannot attract all the funding they seek from private sector funders.

“We are also providing a range of financial advice and support, including direct financial readiness support for companies looking to raise finance through the SIB. We will continue to explore all possible avenues to make it as straightforward as possible for SMEs across Scotland to access the funding they require to pursue opportunities in international markets, create jobs and generate inclusive growth.”

The report also highlights the emergence of alternative forms of finance, including crowdfunding – in which investors pick the companies to which they want to lend money or from which they want to buy shares using a website – and peer-to-peer lending, through which businesses or individuals can band out loans.

One platform benefiting from the increased interest in crowdfunding is Edinburgh-based LendingCrowd, launched a year ago by former financial analyst Stuart Lunn and Bill Dobbie, the serial technology entrepreneur who co-founded Glasgow-based cloud computing firm Infratrend with his brother-in-law, Angus MacSween, before founding online dating group Cupid. Businesses seeking funding apply to have their requests listed on LendingCrowd’s online platform.

"We expect the lifetime value of the investors to be high"
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We do see a mix. In terms of age, they range from individuals in their 30s to those in their 70s and older. The average is about 90. Most are male.

"Geographically we have a significant number from the Central Belt, and from London and the south-east of England. Increasingly, we are seeing more from the Midlands, and from Aberdeen and the North-east."

As well as taking out a loan from the lenders on a crowdfunding platform, businesses can also use other methods to raise money. Dunedin Sharp, managing director at Edinburgh-based firm Inns & Guns, opted to issue a "beer bond" when he wanted to raise money to build the company's first brewery.

Sharp has used other people's beer recipes - notably Tennent's massive Wellpark facility in Glasgow and Greener King subsidiary Bellhaven's site in Dunbar - to make his beer since launching the company in 2003 as a joint venture with whisky distiller William Grant & Sons. Grants approached Sharp while he was still head brewer at Edinburgh's Caledonian Brewery when it was looking for a beer to flavour the barrels in which it would age its cask reserve whisky.

The beer took on some of the oak flavours while it was being used to prepare the cask for the whisky and a modern-day legend was born.

Sharp has since broadened his range to include rum cask beers and a Helles-style lager, and now has his sights on building a 1.5m brewpub on Edinburgh's Leith Walk. His beer bonds offered 7.75 per cent interest or 9 per cent in beer shares.

"We knew we had to borrow money to build the brewery, and of course pay interest on that money," he explains.

"The traditional choice would have been to go to a bank. But at a time when craft beer fans are looking for ways to become more involved with the breweries they love, the decision was simple - we decided we would rather borrow the money from our fans and pay them the interest."

Inns & Guns has followed in the footsteps of BrewDog, the Aberdeen-based brewery founded by Martin Dickie and James Watt in 2007, which is now on to its fourth round of Equity for Punks, its own crowdfunding scheme.

Since it launched its first round in 2010, the business has raised £14m from more than 14,500 fans who bought shares in the company.

The brew - renowned for its stunts, such as diving a tank through London and driving "fat cat" stuffed toys from a helicopter over London - aims to raise £25m through its current funding round, which includes issuing further shares and also a mini-bond on the Crowdcube website.

At the start of October, the company revealed it had already raised £13m - a crowdfunding record - with the share issue still not due to close until the end of April.

"We're just breaking a record, we're smashed through it with a monster truck," says Watt.

"According to MarketWatch, BrewDog is surpassing the current highest equity crowdfunding project in the world to date - $16,000,000 raised - by over 30 per cent. We now have an incredible 35,000 equity punks who love beer and support and influence everything we do - we're absolutely buzzing about this milestone."

"We turned traditional business on its head when we first introduced the Equity for Punks business model, and it's working. We've been the fastest-growing food and drinks company in the UK over the past four years, and we've managed to scale purely via this mechanic."

"Equity for Punks is all about shortening the distance between us and the people who drink our beer, and enabling us to keep putting passion in people's beer glasses without resorting to begging funding from big non-durable banks that don't care about the beer. Ten million pounds is phenomenal. But we're not stopping there."

BrewDog plans to use the latest funding for a shopping list of activities, including the expansion of its brewery in Alloa, opening more bars in the UK and overseas, the construction of a craft distillery and establishing a brewing operation in the United States. While companies like BrewDog and Inns & Guns are looking to involve their customers in the funding of their businesses, other firms are wary of dipping their toes back into the financial waters.

"Access and affordability of finance is an ongoing issue for Scotland's small business community," says Colin Berland, the head of external affairs in Scotland at the Federation of Small Business (FSB).

"While the outlook is improving, almost half of Scottish FSB members report that credit is difficult to access and just over a third feel that it is unaffordable."

"Ultimately, what we want to see is a wide variety of credit and investment options for Scotland's businesses - and non-bank finance has a key role to play. While a third of our members are aware of peer-to-peer finance models such as crowdfunding, we think there's still an opportunity to bring more competition and choice into the world of business finance."

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seeing a lot of non-bank providers - like other big financial institutions or debt funds - actively chasing deal-flow, which has made the whole thing much more competitive.

"Some of the big debt fund providers will be pushing fairly aggressive terms as well. So depending on where you sit in the market - if you're one of the bigger players of this world, like Aggreko - then you will attract the attention of these debt funds."

"Debt is definitely back. And the appetite for growth capital has grown again, whereas previously it was all about private equity buy-outs and that's where the funds were fixing their attention.

"A lot of it has been driven by the United States. So you're seeing a lot of money coming into the country in the past, traditional family businesses and manufacturing businesses have never viewed themselves as being part of the same ecosystem as technology businesses, which have been very used to bringing in external capital.

"There's almost an element of caution - the more that businesses have done it, the more others will start to consider it.

"The money they are bringing into the businesses is often being used for geographical expansion and even internationalisation."

Poddle Pod

Poddle Pod has developed a unique product that simulates the feeling of when a baby is being held, helping them rest and sleep comfortably in a natural way.

After starting the company at home in Warwickshire, with a staff of seven, owner and managing director Charlotte Marshall was keen to expand her business and required £20,000 to help the company produce enough products to keep up with demand.

Despite having excellent sales records and feedback, she was advised by her accountant that because Poddle Pod was relatively young, she would struggle to secure the loan she needed from the banks, so she decided to look at alternative ways to finance her plans.

Marshall's research led her to LendingCrowd and, after signing up with the platform and passing its credit and risk assessment checks, she successfully went through the borrowing process.

"The business is getting bigger and more popular every day, and we're now exhibiting at all the big shows across the country," she says.

"It got to the point where we can't afford to manufacture them at the price it was costing us here in the UK and we desperately needed extra funding to help satisfy demand.

"The banks haven't been very forthcoming with us, so we had to look around for other ways to help us grow."

We had hit a brick wall and couldn't grow anymore. Without LendingCrowd we would not have secured the future of our business."

Poddle Pod raised the money it needed within a month and has now outsourced production to Turkey, allowing it to sell its product in major high street retailers and to develop a wipe-clean version for the National Health Service.

Tag Games

Dundee-based Tag Games develops mobile, tablet and handheld video games for a range of global companies, including Electronic Arts, Square-Enix and Ubisoft.

The business, which has been chaired by LendingCrowd co-founder Bill Dobble since 2007, was one of the first companies to use LendingCrowd to raise finance.

LendingCrowd helped Tag Games bring in £150,000 for product development and the commercialisation of its technology suite.

Paul Farley, chief executive of Tag Games, says that the debt finance raised through crowdfunding was used to fund his expansion plans, which would otherwise have been held back.

"The banks wouldn't touch us as they didn't understand our business," Farley says. "We have approached many banks over the years but just wasn't possible to get this sort of funding.

"We urge people to consider financing through crowd-lending, as we have reaped the benefits of platforms like this,

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Farley, who has previously run his own company in 2006, said the company now employs 25 staff, with plans to expand its headcount to around 50.

The money raised through crowdfunding is still used to work on products with existing customers, create games and develop tools and technology to make them more digitally effective.