

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 80 per cent of those companies obtained the finance they required.

Scotland's businesses secured £6.7 billion of loans from their banks, with a further £1.2bn of finance coming in the

form of overdrafts. Debt wasn't the only game in town for companies; £202m 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 loan

We expect the lifetime value of the investors to be high

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 hand 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 Iomart 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.

MONEY TEAM : The LendingCrowd management team, from left: Fraser Lusty, Seema Paterson, Bill Dobbie, Stuart Lunn, Helen McKay, and Ian Cunningham. PICTURE: NEIL HANNA

Their applications are assessed by a credit team led by Ian Cunningham, who was head of the corporate and SME lending function of the Scottish division of Royal Bank of Scotland between 2001 and 2009.

The team works out the interest rate that should be charged on the loan depending on the risk and the company is then listed on the LendingCrowd website, where members choose whether or not to lend money to the business.

So far, 32 companies have secured 34 loans through the platform, with £1.75 million borrowed in total. The loans have ranged in size from £15,000 to £150,000, with the average amount sitting at £51,500.

The firms applying for cash come from a broad range of sectors. "It is still quite a diverse group, but we do see a lot of high-growth tech businesses looking for capital to drive that growth," explains Lunn.

More than 1,100 people have signed up to the website to offer loans, with the amount each individual offers to the companies varying from £100 to £20,000. "People tend to apply for more funds as they get comfortable with the site," Lunn adds. "We expect the lifetime value

VISION SCOTLAND BUSINESS FUNDING

➔ of the investors to be high. “We do see a mix. In terms of age, they range from individuals in their 20s to those in their 70s and older. The average is about 50. 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 too. Dougal Sharp, managing director at Edinburgh-based brand Innis & Gunn, 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 breweries – notably Tennent’s massive Wellpark facility in Glasgow and Greene King subsidiary Belhaven’s site in Dunbar – to make his beers 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 £3m brewery in Edinburgh. His beer bonds offered 7.25 per cent interest or 9 per cent in beer tokens.

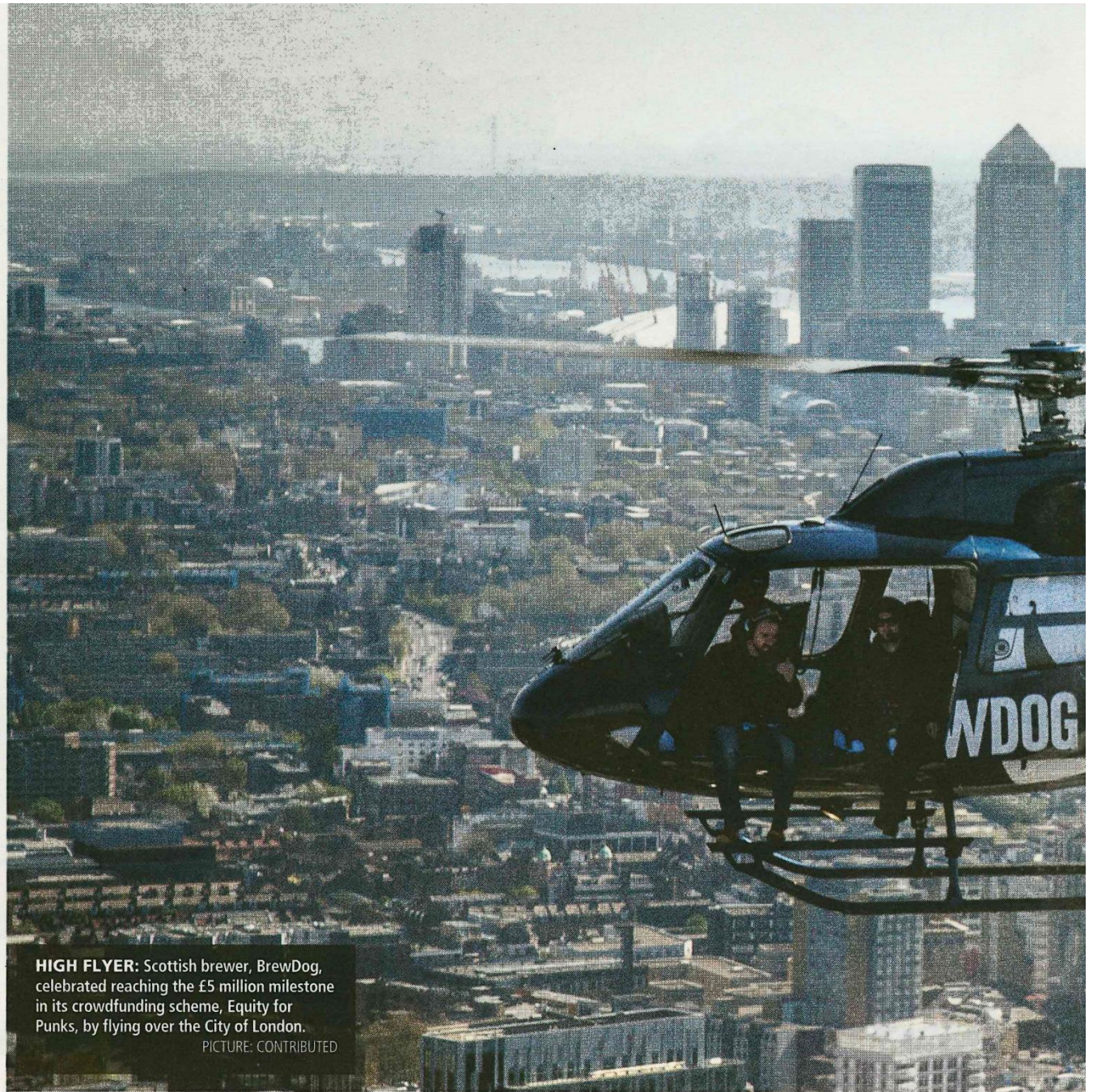
“We knew we had to borrow money to build the brewery, and of course pay interest on that money,” he explains.

“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 brewers they love, the decision was simple – we decided we would rather borrow the money from our fans and pay them the interest.”

Innis & Gunn has followed in the footsteps of BrewDog, the Aberdeenshire-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 have bought shares in the company.

The brewer – renowned for its stunts, such as driving a tank through London and dropping “fat cat” stuffed toys from a helicopter over London – aims to raise £25m through its current funding round, which includes issuing further shares



HIGH FLYER: Scottish brewer, BrewDog, celebrated reaching the £5 million milestone in its crowdfunding scheme, Equity for Punks, by flying over the City of London.

PICTURE: CONTRIBUTED

and also a mini-bond on the Crowdcube website.

At the start of October, the company revealed it had already raised £10m – a crowdfunding record – with the share issue still not due to close until the end of April.

“We’ve not just broken a record, we’ve smashed through it with a monster truck,” says Watt.

“According to MarketWatch, BrewDog is surpassing the current highest equity crowdfunded project in the world to date – \$6,000,000 raised – by over 50 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 worked. 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 monolithic 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 Ellon, 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 Innis & Gunn 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 Borland, 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.

“We can’t forget that, as well as finance, firms also need good banking services. The way that the big banks treat their small enterprise customers can sometimes leave a lot to be desired.”

William McIntosh, a corporate partner and head of international at law firm Brodies, thinks the situation is improving for many companies. “We’re definitely seeing a greater appetite from the banks to lend again,” he says.

“There was a period when bankers were fairly unwilling to lend on a long-term basis because of the capital adequacy rules so the solution was invoice discounting, because you could get a quick turnaround and you weren’t committing a huge amount of capital.

“We’ve definitely seen the landscape change considerably. Inevitably borrowers have noticed a step-change in the lending environment.

“The lending terms are actually getting quite competitive between lenders so I think it’s currently a buyers’ market in terms of debt finance, in whatever form that might take.”

McIntosh has noticed larger companies are now being courted by some new entrants to the market, which are competing to offer them money.

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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 Dobbie 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 at Tag Games, says that the debt finance raised through crowdfunding will be used to fulfil 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 it just wasn't possible to get this sort of funding."

"We urge people to consider financing through crowd-lending, as without the help of platforms like this our plans for further growth simply wouldn't have happened."

Farley setup Tag Games in 2006 and the company now employs 35 staff, with plans to expand its headcount to around 50.

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

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 in at the top end of the market."

McIntosh adds: "There's a greater willingness at the moment to bring in external capital. 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 contagion – the more that some 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."

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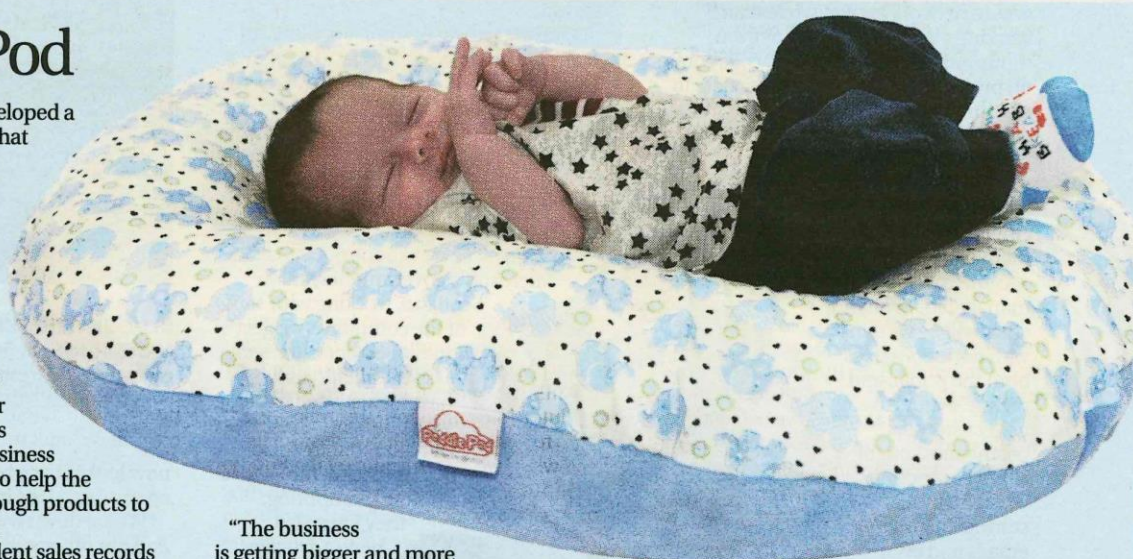
Poddle Pod

PODDLE Pod has developed a unique slumber nest 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 £30,000 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 baby shows across the country," she says.

"It's 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.