THE DASH FOR CASH

Growing businesses will always face barriers to their ambitions. In the first in our ‘Growing Pains’ series we look at how to get your hands on the hard stuff: cash

There remains a myriad of financing options for small and medium-sized businesses, from business angels or venture capital to bank and alternative finance. New forms of lending having taken a strong foothold over the past few years: cumulative peer-to-peer lending in the UK has exceeded £8bn and by far outstrips other European nations. Crowdfunding also goes from strength to strength.

But there’s still a lack of awareness and understanding, so accessing finance remains a problem for many business leaders. Accountancy firms are the most trusted and most frequently used source of support, according to research by the Federation of Small Businesses.

But companies need an adviser that works with similar scale clients, says Andy Ryder, corporate finance partner at Sheffield’s Shorts Chartered Accountants. His advice is to “find advisers who are right for the stage you are at”. He adds: “A very small accountancy firm probably wouldn’t have the contacts or expertise. It would be same if someone came to us and said they wanted to do a stock market listing. We wouldn’t be the right company. If something isn’t quite right for us to help we can signpost you to someone who will.”

Most advisers want an initial upfront payment from a client and the rest depends on the amount of money the company is looking for. Research by the British Business Bank shows that the supply of finance – particularly the supply of alternative sources of finance – has improved in recent years. Yet demand for finance has fallen. If many SMEs believe the likelihood of successfully raising finance is low, or they are unaware of the alternative funding options available, that is a concern.

When faced with a decline from their incumbent funder, the majority of SMEs are not considering alternative funding options, according to recent surveys. One in three owners of smaller businesses want to grow but are unsure on how best to achieve that growth. Only 5 per cent of businesses have considered angel investment, and only 7 per cent have considered crowdfunding. Christian Mayo, head of the corporate finance team at KPMG in Yorkshire, says early stage businesses will always find it hard to raise funds. “Anyone who looks at the business is trying to form an opinion of whether it is going to win. If you can demonstrate in your pitch that you have great growth prospects then you will do better. [Raising finance] has got easier. But it’s still not easy. “All the banks are active but the real question is how picky is any bank at any point in time to get something through its credit committee? You tend to get the better answer through relationship and trust. At the smaller end, if you have an incumbent relationship banker they will tend to give you a better answer.

“Some of the government schemes on tax incentives, such as EIS funds, are great but it is a matter of how do you tap into them? That’s what organisations like NorthInvest are doing.”

The angel investor market has continued to grow year on year. The UK Business Angels Association says 40 per cent of investors have raised their level of investing in the 2016/17 tax year. But more than half of angels are based in London and the South East.

NorthInvest is a not-for-profit company that connects startups and investors across the north. It came about following a conversation between former Chancellor of the Exchequer George Osborne and Adam Beaumont, founder of Leeds telecoms operator aql. Beaumont tells Insider: “George asked what was the biggest barrier to business. I said it was getting access to finance, which came with mentorship. If you’re not careful a
startup can be spending 30 to 40 per cent of its time trying to raise the next round of funding when it should be spending 100 per cent of its time innovating and driving its product forward.”

Beaumont has built a diverse board of investors including rocket scientists, academics and people within the NHS, and cyber security and media experts. He has also deliberately brought in female investors. He wanted newly exited entrepreneurs, but not those who already had huge portfolios because they wouldn’t have any free time to mentor.

“At the pitch events we tell the startups they can ask anything of us. Maybe they are not ready for investment but they might be ready for help from one of our investors. So we are creating value before investment happens. I think Dragons’ Den has put angel investors in a bad light. The process is not about putting businesses on the spot. There is generally a long, friendly exploration of that business post-presentation. Saying that, it is important to be able to get your pitch over quickly and eloquently, and be able to describe your business in a succinct way.”

The businesses that pitch are generally looking for between £50,000 and £1m. NorthInvest also works alongside many other funds such as Mercia and Maven. Beaumont, who has invested in jet suit-maker Gravity Industries, advises potential applicants to use as little capital as possible to get as far as possible without diluting any equity.

“The further they can de-risk that pitch the better,” he says. “If you can work from your kitchen table, or get to the point where you have a working prototype or you have a minimum viable product to get you to market, that is a much safer place to be and is a lot easier to pitch to an investor. You will get more money for a lower equity release.”

Ryder says crowdfunding is a very active market but businesses still need a track record, certainly for debt. Meanwhile, the Northern Powerhouse Investment Fund struggles to find enough equity deals, possibly because it is growth capital and not change of ownership.

He says: “Traditional banks are quite active. Once you get over £5m to £7m turnover they have a good appetite for transactions. There are a lot of players in the asset-based market competing and trying to differentiate with add-ons such as stock finance, a loan on top, or higher advances. Invoice discounting is a great solution for a growing business. They will go for smaller businesses now and are more innovative for single invoices or single customers.”

But Ryder says the biggest trend so has been the number of London-based debt funds knocking on his door. He name checks particularly active funders such as SME Capital, ThinCats or OakNorth.

Mayo says that companies with revenues of £20m upwards will have plenty of debt possibilities. Private equity also then comes into play at this level, provided the firm can get its two to three-times return over three years.

But he warns: “What is happening as a result is that there are some lovely businesses out there that aren’t growing fast enough to be attractive to private equity. So in a low interest rate environment there are billions looking for yield. If you’re making £50m a year, a bank might lend you £15m, unitranche mezzanine lenders will offer you £25m, all in one chunk so that it looks like bank debt and they’ll charge you the same as a bank will for the first £15m and the extra £10m at a mezzanine rate, say 12 per cent and give you the whole lot at 8 per cent. That lets you take more bank debt. That’s a cheap source of capital and you keep all of your equity and get more leverage than you can from the banks.”

Fintech lender ThinCats was founded in 2011 in the aftermath of the global financial crisis and specialises in helping companies that are looking to borrow £100,000 to £10m. The lender sells itself on having people locally to make credit decisions, and promptly.

Ben Kimball, the lender’s Leeds-based regional development director, says: “We usually issue our first set of terms within 48 hours of getting a call, if we are working on a corporate finance transaction where you have an information memorandum. You don’t want to over-engineer it internally. A lot of SMEs don’t have proper wraparound advice.

“Ninety per cent of the time ThinCats uses introducers – corporate finance houses, brokers, accountants, lawyers. We don’t deal direct with SMEs. If you want to borrow £1m you probably need an adviser to help you.”

ThinCats is “comfortable” with lends between £1m and £10m, says chief executive John Mould, adding: “Banks will lend to SMEs if they are really profitable or they have a pile of assets. But banks won’t lend to an SME that is growing but doesn’t have the assets.

“We call them the deserving undeserved. The majority of SMEs in this country sit in the middle credit worthiness and are having difficulty getting finance from the traditional finance providers. I think in five to ten years’ time the average borrower in the UK will be offered far more choice than they were ten years ago, and even today. There will be insurance companies, asset managers and pension schemes lending money.”