



Funding the Future
The Rise of Alternative Funding

A REPORT ON THE RISE OF ALTERNATIVE FINANCE & ITS
IMPACT ON VENTURE CAPITAL AND THE BANKS



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INTRODUCTION

It is clear that the Internet, nineteen years since its advent, sometimes transforms and sometimes destroys existing industries. Joseph Schumpeter, the noted economist said, *“There is a process of industrial mutation [...] that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism.”*¹

The rise in the last few years of alternative finance platforms on the web begins to look, as Yogi Berra said, like *“deja vu all over again.”* This paper asks the question: what is the potential scope of impact of these complementary alternative finance platforms? Who do they displace, and to what effect for young companies and the economy as a whole?

According to Allen Simpson, Barclay’s Vice President of Public Policy & Government Relations, *“These alternative finance platforms aren’t going to change the dial; they are marginal.”*

The language the banks use is the same language all incumbents use when faced with very small disruptive innovators.² It is the same language they would use whether they turn out to be correct or not. Furthermore, the position is understandable.

*By the end of 2014 it is expected that the UK alternative finance market will provide over £1bn worth of business finance to over 7,000 SMEs, equivalent to 2.4% of cross national bank lending to SMEs based on Bank of England’s 2013 baseline figures (£39.27bn).*³

It is impossible at the outset for us to know whether this growth is the beginning of the destruction of banking as we know it, the mere reformation of the banks as more efficient intermediaries beginning to compete in specific lines of business, or whether there are other competitors on the horizon who create substitution risk⁴ for the whole sector. To paraphrase Bill Gates; we many need banking but we don’t necessarily need banks.

The goal of this report is to look at the rise of alternative finance providers through the lens of young company finance and to explore the potential impact on the funding of new or fast growing young companies, the incumbent players and the greater UK economy.

Historically there have been two funding paths for young businesses that wish to grow and need finance to do so. The first, and most common, approach is for the business to grow organically. They commonly bootstrap or get a small amount of capital from family and friends and reinvest their profits to grow the business. Eventually, they can show a trading history and the ability to repay and can access bank finance. The bank finance they access is trading finance. The capital that few small businesses manage to acquire through retained profits is growth finance.

¹ Capitalism, Socialism & Democracy, 1942

² In the 1940’s then president of IBM Thomas Watson famously said, *“I think there is a world market for about 5 computers.”*

³ Zhang, A., Collins, L., Baeck, P. Nesta, 2014

⁴ Porter’s threat of substitutes definition is the availability of a product that the consumer can purchase instead of the industry’s product. A substitute product is a product from another industry that offers similar benefits to the consumer as the product produced by the firms within the industry. According to Porter’s 5 forces, threat of substitutes shapes the competitive structure of an industry. (StrategicCFO.com)

Yet companies need growth capital at each stage of the business and historically growth capital has been very constrained outside of the US. In fact, it has been so limited as to stunt entrepreneurial growth in the UK.

In some countries, there is more access to growth capital than in others. In the US there is more of it; in the UK there is a market gap for established small businesses that are trying to grow beyond their trading needs. These businesses will ultimately move towards mezzanine debt or they will throw all of their profit back into the company for growth, meaning that they run 'skinny' or lean until they get to a point where they can access real markets. It's a slow path and slow to the point that it can take decades.

The second path is one of seed funding, angel funding and venture funding. Only a small percentage of companies in the UK take this path simply because there is very little capital available through Angels and venture capitalists (VCs). Though this form of funding attracts outsized attention, it is only available to the smallest percentage of young companies.

What has historically not been an option for young companies is bank finance for growth. As mentioned above, banks are very good at trading finance and not good at all at growth finance.

Traditional finance is typically finance delivered by banks and capital markets and those financiers themselves would tell you that they are very good at supporting the current trading requirements of existing businesses, but very bad at financing growth. In order to finance growth you have to assess risk and the banks are not in the business of assessing risk. As Allen Simpson of Barclay's explains:

"Bank lending is a very good mechanism for supporting small businesses which have a trading record – we know how to support 'smallness' and the distribution channels which the banks provide are very effective, low cost ways of doing that. What banks are very bad at is judging risk, and the regulation and capital requirements make it impossible to fund risk.

From a banker's perspective, if you want to fund a business with a trading record and assets you can make the loan because there is more certainty that a customer can afford to repay that loan. We may need to hold a lot of capital behind it but it can be priced and money for a loan is as available as it has ever been.

What has always been difficult in the UK and has become more so, is risk finance. A high growth company that needs working capital but also development capital to grow is unlikely to have assets or revenues or certainty of revenues being delivered. A loan is basically impossible from a bank. For development finance and startup finance, you can't realistically look to the banks."

What is needed, then, is special expertise. Any proposition that has a certain quantum of risk - a new business, a young business or an existing business that wants to grow very quickly beyond its capital resources - is going to be difficult (if not impossible) for a bank to finance because the bank is being asked to finance an uncertain future.

"We can't make decisions about the future of a market and what that might look like." (Barclays)

It's well recognised that banks only do certain things. We cannot ask the banks to undertake activities that their business models don't permit them to. It's naïve and foolish to think that core economic issues of the UK economy are going to be solved by berating the wrong institution for activities that they've never undertaken.

This is a key concern because the impact of alternative finance, to the degree it helps with growth capital rather than trading capital, means that the various alternative finance platforms are not competing with the banks but are largely complementary to it.

The other key question that arises is whether the alternative finance platforms are new competitive distribution channels for the same capital or a separate class of new money that grows the available total.

The total stock of money available for small businesses in the UK has been largely unchanged from domestic sources, for the past 15 years or so. Quoting Barclays:

“If you look at the last few years in the UK, going back to 2001 and 2008 up until 2014, traditional small business lending by the high street banks (traditional term lending) then you’re looking at a stock of £100bn which never really varies more than +/- 4% around the mean. From the top to the bottom of the market the funding pool has stayed flat.

For a period of time before the recession, there was an international inflow of capital that has now diminished. Overseas lenders or peripheral lenders in the UK now contribute about £75bn but at its peak it was about £100bn.

So what you had in the run off from its peak was £25bn of stock that disappeared. What remains in short supply is capital to fund risk. It was organisations lending at higher interest rates, higher risk and it was international money. It’s also trending downwards – or has been. We predict that it will level out at about £30bn loss.”

Perhaps the reason the banks are being berated for not lending to small businesses is the pain and impact of the loss of around £30bn in the market. Even so, as Barclays have ably argued, these young, high-risk businesses are never going to sit within the bank’s remit.

We must then address the question, what types of disruption have these new forms of alternative funding created? And what impact do they have? We would contend that there are two forms: They create new competitive distribution channels and they create access to new capital. If it is merely a distribution impact, then these platforms would be improving the price that people pay for money that they would have been able to get elsewhere. If they provide access to new capital, they are creating opportunities for people to get money who would not have been able to get money before. From a societal point of view, the former distribution impact is of modest benefit (it’s just an efficiency improvement in the market). The latter, the access to new capital, is a change in the state of the nation. It means that there is more money available and this is incredibly important.

This paper looks at four types of alternative finance: reward-based crowdfunding, equity crowdfunding, P2P lending (to consumers and to businesses) and invoice discounting. The conclusions we draw, and futures we envision, differ considerably depending on the type of crowdfunding examined.

But the intriguing question that is implicit behind the analysis is whether we are about to witness a case of ‘leapfrogging’ where a new form of product or service is adopted before the traditional product or service has had a chance to take root and flourish. In Africa, for example, mobile phones leapfrogged the landline. Will alternative finance portals replace the need for the UK to establish better angel networks, increase the size and number of venture firms or create new instruments that capture the need of established businesses to fund their growth needs? We turn first to reward-based crowd funding.

CHAPTER 1: REWARD OR PERK-BASED CROWDFUNDING

Reward-based crowdfunding has quickly become part of our business vernacular. It is now starting to take the main stage for early stage business growth. Young businesses need to source funding in their early stages to launch into a life cycle of growth.

The premise of these platforms is simple: Fund a project or venture by raising small amounts of money from a large number of people, often in exchange for ‘perks’ or ‘rewards’. Rewards, tangible or intangible, are items given in return for the contribution. They can range from informal social media shout-outs to pre-orders of products or even fully customised offers.

There are two stalwarts in the reward or perk-based crowdfunding industry: Indiegogo and Kickstarter. Their difference is simple: Indiegogo allows for ‘flex funding’⁵ and looser campaign restrictions⁶, whereas Kickstarter only allows ‘all or nothing’ campaigns⁷ and their platform focuses on creative projects⁸.

Crowdfunding is a relatively new addition to the alternative finance landscape. Indiegogo started raising funds to support filmmakers in 2007 with Kickstarter joining shortly after in 2009. One month after launching Kickstarter, there were 26 projects featured with an average target of \$2,770.⁹ In its first month, Kickstarter’s largest campaign asked for \$10,000 for support to complete a documentary but the campaign failed to raise the required amount and thus was not funded at all.

Despite their humble beginnings, Kickstarter have recently surpassed \$1 billion in pledges, from over 5.7 million people.¹⁰ The early failures are a far cry from the recent success of *Cooler Cooler*, which raised \$13,285,226 and surpassed the previous record for most-funded held by the team at *Pebble Watch*¹¹, who pioneered ‘wearable technology’ more than two years before the launch of the iWatch.

Currently, crowdfunding lends itself to certain strengths and some business models have seen bigger successes than others. Hardware products that have direct consumer relevance or appeal have seen their business models revolutionised through the process of pre-orders; creative projects which would otherwise have gone unfunded have had the opportunity to access stable finance, lowering the risk of empty seats in theatres and increasing accessibility of art. This has the effect of bypassing state control of arts funding and mobilises a broad audience for projects that has its own implications beyond the remit of this report.

Whilst these two platforms dominate across the horizontal, mass market of the crowd, some niche platforms specifically designed to serve the needs of smaller groups have started to emerge. *Casefunder*, for example, founded in Australia, is an online platform that tackles the global justice affordability crisis by enabling people, groups and organisations to crowdfund their legal costs.

⁵ Flex funding: where campaigns keep all money raised regardless of whether or not they meet a specific target

⁶ Indiegogo allows projects from industries such as medical, or even representing individuals, etc. Additionally, Indiegogo allows for a one-off project extension, if requested more than 3 working days before a projects’ completion.

⁷ All-or-nothing: where money is only kept by the project owner if it achieves the original target

⁸ The Kickstarter definition of a project is something with a start, middle and end.

⁹ Calculated from Wayback Machine snapshot of the Kickstarter homepage on May 28th 2009. 26 projects were featured.

¹⁰ <https://www.kickstarter.com/1billion>

¹¹ Pebble Watch raised \$10,266,845 in 2012

As young businesses start to venture into the world of finance, it is becoming natural to look towards crowdfunding to, as it says on the tin, “kickstart” a business. We saw it happen with *Pebble*, *Formlabs* 3D printer and *Occulus Rift* – companies who all used crowdfunding to begin their journey, and went on to build brands, raise further finance and build large customer bases.

But something slightly different is starting to occur. Not only are businesses looking for this funding very early on in their business cycle but crowdfunding is also becoming an entirely separate alternative to traditional finance options that would normally come later in the business lifecycle.

As William Gibson said, “the future is already here – it’s just not very evenly distributed.” We have seen the start of this future in the business *TrackR*, lead by CEO Chris Herbert.

TrackR case study

Herbert tells us “It’s about the people, not the dollars.” TrackR was founded in 2009, with the goal of taking the database of items in your head, storing it on a phone and sharing it across technology. With remote sensors they keep track of your personal possessions and create your own personal “internet of things.” They now have thousands of customers connected to the things they value most.

In the early days of their business, they bootstrapped along, selling a few thousand units and providing software to large manufacturing companies. Herbert saw the value in becoming their own brand, however, financing was very difficult for hardware companies in 2010. They saw crowdfunding as a potential new route to finance and to the market itself.

*TrackR initially raised \$47,915 with *Wallet TrackR*: their first proof of concept and test of the market. Since then, they have built crowdfunding into the very business model of their organisation. TrackR have launched a total of four campaigns with their most recent raising over 1.2million on *Indiegogo* and sourced from over 18,000 backers.*

Crowdfunding is not simply a catalyst for TrackR, its embedded into the very heartbeat of their business.

*For some industries crowdfunding has been revolutionary. Before crowdfunding was available, there were no financing options, other than ‘friends and family’ that were frequently no more than vain attempts to overcome the significant financial commitment involved in hardware manufacture. Crowdfunding, alternatively, proved the demand for their product in the market, secured early customers and provided the required amount of finance. As a result, TrackR now only accept inbound calls from investors, who have also discovered them through their success on *IndieGogo* - eliminating the costly need for them to actively seek investment. With cash flowing through their business they have been afforded security and the ability to absorb enough R&D costs for the campaign, where funding follows to allow them to manage finance through to production.*

The TrackR journey must not be retold as one of continual, consecutive successes. Herbert has experienced a failed campaign, but with crowdfunding, financial failure can translate into business benefit. TrackR do their best to manage failure when it comes and set boundaries for campaigns before they begin.

*They use the crowd to test higher-risk products, like *Glasses TrackR*, which they launched a campaign for in 2013. After realising that whilst they were driving traffic, they were only converting few into sales, they made the quick decision to shut down the campaign within three days. The few thousands dollars they lost in R&D costs were truly a significant win for a risky hardware proposition. Before crowdfunding, a similar business would have had to spend commit hundreds of thousands of dollars in capital towards R&D to achieve the same failure.*

In this new world of reward-based crowdfunding, companies can afford to a much broader range of propositions and reduce the risk that is always attendant on new product introductions.

TrackR is proudly located in Santa Barbara – away from the traditional tech hub of Silicon Valley. Herbert proves that with crowdfunding, businesses can be born everywhere, not just in Palo Alto.

TrackR made a commitment to being part of their community and they are reaping significant value from this commitment. Under the traditional model of San Francisco financiers – moving all the capital to one geographical area simply drives prices up (wages, in particular) making burn rate quicker for young businesses. In a world where ‘cashflow is king’ this is an important gain. Crowdfunding has allowed TrackR to make the most of hyper-locality, by attracting customers, finance and talent to them. The power of crowdfunding lies, in part, in its ability to change perceptions about geography. It is creating market power where it was not before – taking the power away from the venture capitalists to decide on such issues as company location potentially having an impact on value of clusters and, what causes their growth.

Herbert confirmed that crowdfunding will always be a part of TrackR. They believe that by *showing* their numbers (supporters, products sold, development, scale, etc) crowdfunding brings a transparency and strength to their business that no other form of finance could.

This begs the question: what company is crowdfunding *not* good for? The reality is that the name itself doesn’t necessarily denote the business activity. It can be used to fund scientific research (through platforms like Wallacea); fulfil a lifelong dream (in the case of Coolest Cooler); make a joke (this year \$55,492 was raised to make a Potato Salad); build a community around an innovative product (in the case of TrackR Bravo) or support charities (through JustGiving or WhatLeads.To).

Crowdfunding has shown that significant funds can be successfully raised from the private individuals for projects people care about. We might ask what this could mean for developing nations? Could reward based crowdfunding have a real impact on supporting innovative entrepreneurs or those driving social change in markets where the infrastructure for funding is not developed and the local wealth is inadequate?

Could our economic areas be transformed by the power of the crowd? Flint & Tinder, now a fully-fledged brand, launched their ‘10 Year Hoodie’ that guarantees domestically produced, high quality clothing. Over the years Flint & Tinder have injected millions into domestic manufacturing in the USA. The power of crowdfunding is significant. It is not out of the realms of possibility that a campaign using manufacturing in Cardigan, Wales could reignite the textiles industry in a small, yet historic, British town.

The reality is that wherever you are in the world, you are always equi-distant from the crowd: one click. From San Francisco to Lagos, funders are no longer bound by geography, time zone, distance or politics – individuals are given the opportunity to gather their collective voice and their pockets, to act as catalysts in the future of businesses, economies and nations.

The potential for crowdfunding to change markets throughout the world is not separate to our own. In July 2014, London was the worldwide capital of crowdfunding with local businesses and startups creating more campaigns than any other city.¹² With a fully funded success rate of 32% (and an average amount raised of \$17,834) crowdfunding offers a statistical rate of success that is unique to any other form of finance – made clear against chances of success in angel deals at 2.68%.

The total sum of crowdfunding during 2013 in the UK was 20.5million¹³ and has grown an incredible 370% year-on-year. In comparison, the total amount of visible angel funding¹⁴ 2012-2013 was £76.2 million – with

¹² <http://www.forbes.com/sites/jasonhesse/2014/08/15/forget-nyc-or-san-francisco-london-is-the-worlds-crowdfunding-capital>

¹³ Nesta Report: *The Rise of Future Finance*, Page 9

¹⁴ The angel funding market is hard to quantify due to the disparate nature of deals. The ‘visible market’ is funding through established Angel Networks (BBAA and LINC), and does not take into account any informal or adhoc deals that occur outside of these networks.

only a 20% growth rate over a four-year period.¹⁵ Arguably, much of this funding comes from potential customers, interested individuals and supporters – making the injection of over £20.5 million into the economy that would not have otherwise entered. There is a genuine possibility that the crowdfunding market could overtake the entire angel market within the next 3 years, making this a far more mainstream way of raising investment and a potentially profound impact on our economy.

Some businesses, like TrackR, have already begun a hybrid model: where they use crowdfunding to attract customers, raise finance specific to a project or product and respond to market needs – thereby strengthening their position amongst formal finance rounds. There is an opportunity for Angels to embrace crowdfunding in a way that has not been fully realised: to augment, support and develop the businesses they invest in. Having a business that can more easily attract finance – without giving away equity – is good for both investor and entrepreneur. If we see angels embrace crowdfunding into the finance lifecycle of young businesses, they will see their investments empowered.

However, in the case of Venture Capital the story is not quite the same. In our new world of crowdfunding, VCs no longer have a lock on innovation. With validation, funding and support from the crowd they must now compete to invest. Companies can now, without the help of venture capital, reach out to significant markets and scale on their own. Venture capital traditionally has made many claims of connections, mentorship and access to deals; whereas crowdfunding does the same 100 times over without taking most of the business away from the founders in the form of equity.

In light of the incredible growth seen across the alternative finance market, do we really believe that the only companies worth funding are the one-in-a-thousand that a Venture Capital firm chooses? The crowd has been proved to make high quality decisions: picking the winners more often than the analysts.¹⁶ What does this rise of crowdfunding mean for countries where there is no venture capital, or where VCs have not been historically ‘good’ at investing in the winners. This new model allows for our business, markets and economies to grow in a safer, more sustainable way than ever before.

Crucially, reward based crowdfunding has some profound consequences: the biggest is that it preserves equity with the founders. It permits founders to run their business for longer and takes the demand from investors to fly or burn out of the equation. Many of the famous shortcomings of venture capital are removed; there is evidence to suggest that founder run businesses offer the stability, vision and endurance to grow to a much larger size. There is volatility in Venture Capital, because companies that would have otherwise succeeded if they had grown slightly more slowly are pushed to spend faster, win quicker and fail larger. This model simply doesn’t suit all companies.

¹⁵ 2012-2013: £76.2 million compared to 2008-2009: £62.8 million

¹⁶ NEED TO FIND THIS REPORT....

CHAPTER 2: EQUITY CROWDFUNDING

Equity crowdfunding is a relatively new way for the entrepreneur to sell equity in their business. As the name implies, the funds come from the crowd and with most of the crowdfunding sites, the crowd could be anyone: an experienced investor, a neighbour, a friend, a stranger wanting to invest some of their money.

The general consensus is that the UK is a market leader in equity crowdfunding. Syndicate Room, Crowdcube and Seedrs are the most significant platforms for equity crowdfunding. Equity crowdfunding began to gain popularity in 2012 and has since grown from strength to strength. In the UK, equity crowdfunding makes up 20% of the total of the Alternative Finance market and experienced the biggest year-on-year growth, at an impressive 410%.¹⁷

The Equity crowdfunding industry is starting to shift towards becoming a mainstream investment option, as seen in the recent advertising campaigns for Seedrs and CrowdCube throughout London and the UK, and it is now also starting to emerge in economies throughout the world. Ultimately, those giving money to these platforms are motivated by the prospect of financial return.¹⁸

These sites are typically online marketplaces with equity deals posted by the entrepreneurs (having passed a vetting stage by the relevant platform) and the crowd are able to see the pitches and grill the entrepreneurs on areas such as the business model, the valuation and the equity on offer. Crowdcube allows its funders to hold shares directly in the company, whereas Seedrs – who have built their model from small corporate finance deals – holds voting and direction power over the shares, on behalf of all the investors.

The platforms empower people to take more control over their finances and make investments. However, the FCA has imposed restrictions and guidelines to ensure individuals understand the level of risk they are exposing capital to.

Syndicate Room:

SyndicateRoom is an online equity crowdfunding platform that helps its members to co-invest in startups alongside seasoned investors. The startups seeking funding on the SyndicateRoom website have already been backed by an experienced angel investor, who has invested at least 25% of the funding round. Syndicate Room works with sophisticated investors (minimum investment is £1,000 across an expected portfolio of 10 investments). By July 2014, Syndicate Room had done £6m in deals since the beginning of the year making it the fastest growing equity crowdfunding platform in the UK and the second largest.

Founder Goncalo de Vasconcelos, has said that Syndicate Room was, in part, born out of a situation he saw emerging among angel investors, firstly in struggling to close funding rounds and secondly with VCs coming into their funding rounds and changing the set-up. Typically less supportive of the entrepreneur - a hallmark of the VC based on their needs from the investment – this often creates tension between angels and VCs as investors working together on a funding round.

¹⁷ Ibid.

¹⁸ “the prospect of obtaining financial return was ‘important’ or ‘very important’ to...96 per cent of investors in equity-based crowdfunding”

But what if the VC was removed from the table and replaced with a 'crowd' of sophisticated, experienced investors? This is the market gap filled by Syndicate Room. Entrepreneurs are drawn to the platform because they know they'll benefit by not having to pay management fees to a VC fund and by not giving preference shares away. In essence, they have more chance of staying in control of the company, they get final vetting of the investors who want to invest in their company, and they can check for any conflict of interest.

Goncalo would argue that Syndicate Room's effect on the industry is disrupting the VC. Like pension fund managers, VC fund managers traditionally walk away taking a huge amount of money out of the system in bonuses. Now, there is an alternative. In five years time, Syndicate Room predicts that any company wanting to raise sub £5m will be able to do so quickly and easily on their platform, where there will be hundreds of private investors all with the same class of share, investing in a way that is both clean and transparent. Perhaps most importantly, it will allow the entrepreneur to remain in control.

Goncalo predicts a shift from fund managers taking the cream of profit from the investment to individuals managing their money with the aid of some of the new advisory platforms that are popping up in the alternative finance space. Goncalo sees a total failure in the market. Why do some bankers or fund managers make millions of pounds in profit and bonuses in return for managing an investment?

I would argue it's primarily because there is no one there to regulate what comes in. If I, as an individual with money to invest, manage my own money or I use online brokers to help me pick my choices, that role of fund manager becomes obsolete. To the degree that information becomes more transparent and people have more choice, the investment banks in particular will find themselves under pressure. Investment banks look for big companies, big money and big yields so I see the low and the middle market getting hollowed out in the near future.

If we look at the adopter curve for equity crowdfunding, the early adopters in this case are the investors. Crossing the great chasm to get to a point where equity crowdfunding platforms are used not just by early adopters but by the mainstream, will only take place when the most conservative funds - such as pension funds - are being used on these platforms and that's what we'll start to see.

Goncalo predicts a period of confusion among consumers, investors and businesses. Confusion about what opportunities there are for getting money and for investing money. But where there is confusion there is an opportunity to resolve that confusion. That means a rise of intermediaries to help make sense of the options available. If I'm a small business and I need money, where do I go and who helps me get there? It's the rise of the portals for buying money, where alternative finance platforms will pay for leads. It's the aggregators. There are aggregators for backers to find the campaigns that interest them, aggregators for investors to compare interest rates and aggregators for businesses wanting to know which platform is most likely to give them the finance they need at a price they can afford. I see their future as both disruptive and profitable.

The interaction between these alternative finance platforms and existing channels – such as angel investors - is very interesting. It's argued that these platforms will ultimately become the manner by which most angel investing happens, whether that's because of the Syndicate Room or JustInvesting, where they are actually creating tools to support the sophisticated angel, Crowdcube, where they are collecting great deals, or Seedrs, who solely focus on startups requiring seed rounds. In the long term, one or more of these platforms will become the traditional route for angel investing and the angel societies and clubs of old, will be supplanted.

There is already evidence to suggest that some of these platforms are starting to do deals that are larger than angel rounds. As of July 2014, Crowdcube had funded 4 businesses for around the £1m mark and one deal for £1.6m; Syndicate Room had completed a deal for £1.8m. VentureFounders - a newer platform that launched in

2014 and uses the founders' expertise to shape bespoke investment deals for HNWs - has already completed a deal at £1.7m.

What this suggests, is that there is the possibility of smaller A-series rounds that would, historically perhaps, have gone to a VC, now going onto a crowdfunding platform. That route is advantageous to the entrepreneur because the terms on the crowdfunding platforms tend to be more egalitarian than the terms of the VCs; terms such as common equity versus preferred shares and other preferences.

With equity crowdfunding, the entrepreneur gets to keep control of more of their business in a way that better protects long term growth. They don't get railroaded by a fund manager's agenda and pressures to grow very big, very fast. In the longer term, they save money. They test their idea, get traction in the market and if they go on to seek funding from an angel or VC after a successful crowdfunding campaign, they have a better foothold in the market and a better understanding of their company valuation, from which to negotiate a deal.

Crowdcube:

Founded in 2010, Crowdcube is an equity crowdfunding platform that enables entrepreneurs to raise funding for their businesses, from their personal and professional networks. With over 120,000 registered investors, Crowdcube has funded more than 172 businesses, raising almost £50m. Crowdcube supports companies from startups to very established businesses and will accept investment from as little as £10.

In 2014 Crowdcube created a debt product - mini-bonds. These mini-bonds provide growth capital of £1m and above to UK businesses; typically these businesses are more established than many of those seeking equity on the site. Currently the mini-bonds are unsecured, non-transferable and non-convertible.

Crowdcube's mini-bond was snapped up by River Cottage, a big-name brand, and something we've heard a lot from the equity crowdfunding platforms is that they are witnessing an increase in brand interest from big name companies that want to use these platforms. Brands are spotting an opportunity not simply for equity funding but for customer engagement, reaching out to the tens of thousands of members actively using crowdfunding sites. As the crowdfunding platform's databases increase in size, as data becomes ever more useful, inevitably these sites will pique the interest of more and more high profile and household brands.

Crowdcube's sense is that the angel networks have had a tough time since these alternative finance platforms appeared and to some extent they haven't reacted or changed; a response that might prove fatal in the future. Crowdcube has had interest from VCs and founder, Luke Lang, predicts one of the possible future trends will be the public being able to invest alongside a VC firm. Maybe VC firms will eventually allow people to invest directly. Imagine if Facebook - before they floated - had sourced funding via the crowd. At this point, in July 2014, Crowdcube has raised funding for 3-4 businesses at around the £1m mark - still outside VC territory. However with its recent injection of £5m (£3.8m from VC firm, Balderton Capital, and £1.6m from the crowd via its own platform) who is to say in years to come that Crowdcube won't be doing £5m, £10m or £20m deals for big brands? The relationship between VCs and crowdfunding will change in the next 3-5 years as VCs get more comfortable with the platforms and the platforms get more traction.

Seedrs:

Seedrs is an equity crowdfunding platform that specialises in seed and early-stage finance for startup businesses. With a headquarters in the UK and operations throughout Europe,

Seedrs provides an easy-to-use platform for entrepreneurs to invite friends, family, angels, institutions and the crowds to invest from as little as £10.

Seedrs announced in 2014 a move into convertibles, where investors stump up funding early and in return get first refusal on equity, essentially buying an option. Convertibles are useful when an entrepreneur isn't ready to raise A-series funding because they're very early stage, but they do have a killer idea and they just need enough money to get them to that A-series round. They can offer investors a preference over everyone else - a discounted A-series - on the condition that the investment is made and the money goes into the company immediately. Convertibles are popular in a very hot market - a seller's market - where everyone wants in on a great deal. For that reason, as you'd expect, they're familiar territory in Silicon Valley, California.

Personally, I think convertibles are great for the entrepreneur but not necessarily for the investor. As an example, if a company is worth £100k today as a pre-money valuation and I want to invest £50k, the post-money valuation is £150k (i.e. I want to buy one third of the company). Then let's say because of my investment and the entrepreneur's effort, the company goes up in value to another round of investment. That next round - the increase in value of the company - is now in dispute. I'm discounted from the next round. All that growth means my cost is going up even though I have already paid. My cost keeps going up as their value goes up. If I just invested on ordinary terms, my value would go with them. Instead I'm paying now and not getting the reward for my risk.

With angels being empowered through platforms like Syndicate Room, Crowdcube and Seedrs, they stand to cause some disruption. Ultimately, this is the space at most risk in the Venture Capital firms. If it's correct that Crowdcube, VentureFounders and Syndicate Room all see very real possibilities and are already beginning to see deals in the millions of pounds - which are squarely in early stage VC activity - what type of co-existence and competition do we envision taking place?

It is a complex landscape, but initially we think we will see that VCs might partner. For example, Balderton Capital invested £3.8m in Crowdcube itself and then raised the rest of the money from the crowd. They raised £1.2m from the crowd to help fund their own platform, in a mere sixteen minutes. Darren Westlake, CEO and co-founder commented:

*"We're delighted to have **given everyday investors the opportunity to invest in our fast growing business.** This record-breaking fundraising from our crowd of registered investors at the same time as backing by an established VC firm is a huge thumbs up for our business, team and the growth path that we outlined.*

This is the first time that any sizeable fundraising has meshed traditional and alternative finance methods and we expect to see more of this in the future. Crowdcube is in a fantastic position to pursue our growth plans and continue to support both investors and small and growing businesses in their investment and finance requirements."

Vcs in the market turn down perfectly good opportunities every day because they only have so much capital to spend and are spoilt for choice. This suggests that both the VCs and the platforms can, for quite a time, succeed, if the platforms are bringing new money to the table.

We are already starting to see the reverse as well. In June 2012, startup *Escape the City* turned down offers from two well-known VCs and instead raised £600,000 from Crowdcube in just two weeks. It is this activity that shows not a redistribution of existing VC funds, but new opportunity for individuals to contribute finance that would not otherwise have entered the ecosystem.

76% of investors on Crowdcube only have one investment with the platform¹⁹ and almost all are taking advantage of the SEIS and EIS tax opportunities. Throughout the industry, “the average investment portfolio size is £5,414 with an average diversification rate of 2.48 (i.e. on average, one investor has invested in 2.48 equity-crowdfunding deals)”²⁰. The recent survey in the Nesta report on Alternative Finance showed that 62% of investors were “retail investors with no previous investment experience”. Whilst this accounts for £52m of new investment capital entering the equity market, this money would otherwise, at least partly, have been invested elsewhere (68 per cent of respondents) or saved (44 per cent of respondents).²¹

What no one is certain of is the degree to which these platforms will push the VCs further up the funding chain over a longer period, by becoming the substitute for the smaller A-series investment rounds. Equally, with the level of new investors and engagement in SEIS and EIS opportunities – the traditional angel routes are also at risk. Some businesses, such as *Pip and Nut*, went directly to the equity crowdfunding and are well on track to join the three quarters of those who receive equity crowdfunding to launch a new product after their round.

Most of the evidence available so far is merely anecdotal. However patterns are starting to emerge. Platforms such as Crowdcube and Seedrs are inherently disruptive and therefore inevitably will take a larger and larger share of the early A-series market, and give the traditional Angel access to tools and software to allow them to invest more effectively. These platforms will experience even greater growth and gain profile and credibility. Entrepreneurs are already starting to look to them as default.

A number of the equity crowdfunding platforms have experienced considerable success in a very short space of time in their domestic market and naturally are looking at opportunities overseas.

Seedrs operates pan-Europe; Crowdcube is currently in Sweden, Spain and Poland, with plans to open in another 20 countries by the end of the 2014. Luke Lang, Crowdcube’s co-founder, has big ambitions – to be the “Google of equity finance” – defining a vision for Crowdcube where cross-border investing is the norm, where someone in Brazil, for example, can invest (by which I mean buy equity) in a company in Sweden and a whole ecosystem develops from it. Borders become obsolete, in this utopian vision of the future of equity crowdfunding.

With this cross-border investment on the horizon, what might it mean for emerging economies?

The ability for the platforms to deal with cross-border investment is a huge challenge, but if managed successfully, it creates an even greater utopian vision: the opportunity for the developing world to tap into the developed world. By way of example, let’s say tomorrow I set up a new company in Colombia that helped local farmers to operate as Fairtrade. Through equity crowdfunding my Colombian company, I could immediately allow the public to invest in an individual farmer instead of donating money via a charity or intermediary where that farmer is nameless, distant, anonymous.

Whilst this has been achieved through the established peer-to-peer microfinance programmes that have enabled tiny loans to be given to individuals throughout the world, it is yet to break into the equity model (allowing for larger deals, bigger growth and sharing of wealth and development). This is a significant change, moving from charity or loans to investment and equity; from the impersonal, detached investment to a personal, focused, individual funding.

There is a very real opportunity to leapfrog traditional finance in the developing world although at this point, the pathway is not entirely clear - where does the money go? How? Who gets it? But this vision has the possibility of creating honesty. We’re all aware of the enormous amount of money lost in corruption in the

¹⁹ <https://www.crowdcube.com/infographic>

²⁰ Page 52 <http://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf>

²¹ Page 53 <http://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf>

developing world. Imagine if that money went straight to those who needed it, without intervention or diversion.

Investment is well behind other industries in terms of globalisation. There are pockets developing, obviously within the UK and Asia and investments across borders between Asia and Europe and Asia and the USA, for example. For places like Estonia, that's starting to appear on the map as a hotbed for entrepreneurship, there are smaller ecosystems developing that are independent of China, the UK and the US and have great potential for alternative finance as those countries are moving more and more online.

In equity crowdfunding, you have all the classic players of a disrupted market with different aspirations and views.

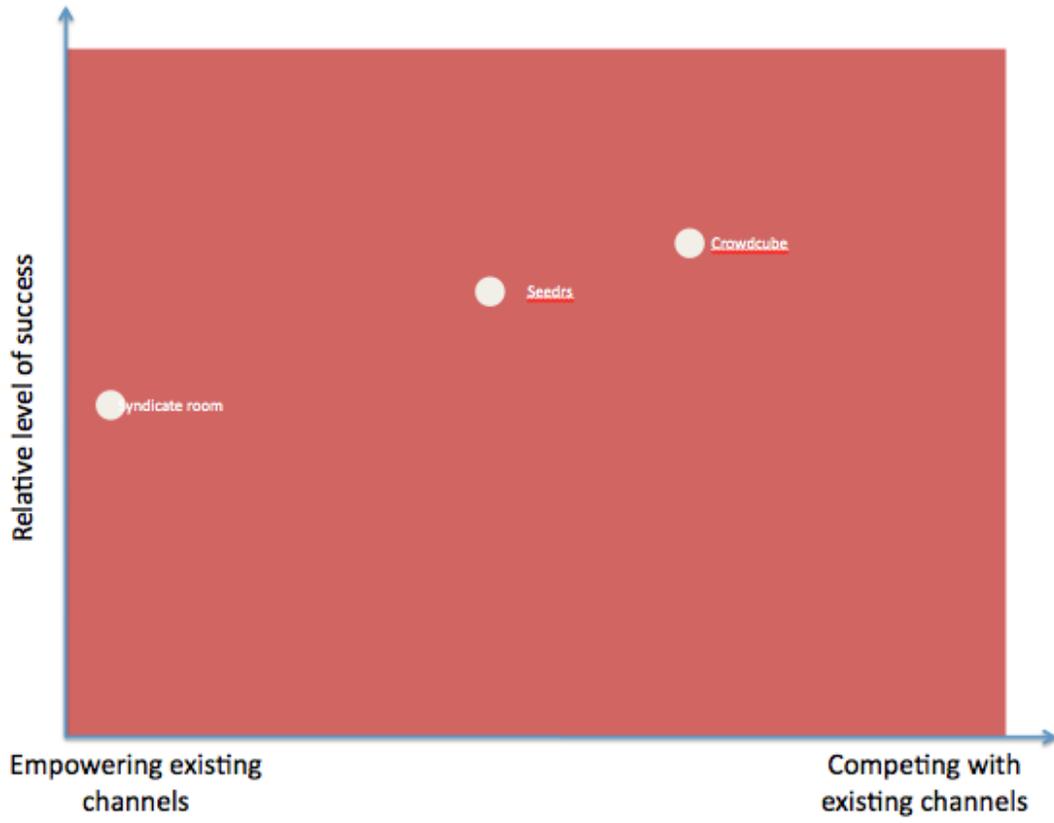
1. The established players
2. The gaps
3. Innovators

Some of the innovators are looking at the established market and saying, "We're going to take them down. We're clean, new, different." That's Crowdcube. They aspire to become the established market.

Seedrs is focused on the gap. They are all about new capital because they are focusing on seed rounds. Both of these platforms are working significantly harder to bring new money, investment and investors into their platforms.

Other innovators want to empower the incumbents to go into the new world. Syndicate room, for example, empowers angels. They believe that they will replace A-series VC, while JustInvesting empowers and administers for angels and simultaneously works with VCs.

In combination with reward-based crowdfunding, a picture is beginning to emerge of a group of disruptive challengers, whose business models in combination suggest a wholesale disruption of how capital is raised for young companies. It's a threat to the sustainability of the chokehold that venture firms currently enjoy in funding innovation companies, and in larger terms, suggests great impact on the quantity of risk capital available in total and the potential benefit that may have for economic growth.



CHAPTER 3: LENDING TO YOUNG COMPANIES

WHAT IS PEER-TO-PEER (P2P) LENDING?

Peer-to-Peer Lending echoes the principles of the peer-to-peer model that we explored in the crowdfunding chapters. The 'borrower' is an individual seeking finance for personal or business reasons from the 'lender' who is typically their peer - another individual - although as it happens, a growing amount of institutional money has been seduced by the healthy returns of the P2P platforms. Where healthy returns are offered up, the money will flow, whether from individuals or institutions. Notably as quickly as the peer-to-peer market is growing the edges of the sector are quickly growing fuzzy.

As noted by Jonathan Ross, *"The distinction between traditional finance and the peer-to-peer sector is growing fuzzy as P2P lenders tap into demand from big institutional investors and as those investors apply Wall Street techniques to the loans. e.g. Eaglewood Capital, a New York-based investment firm, bundled together \$53m worth of P2P loans into the kind of sliced-and-diced bonds that gained notoriety during the subprime crisis. There is talk of more securitisations to come, as well as exchange traded funds and secondary markets where large investors can trade the peer-to-peer loans they have already bought."*

An individual borrower or business can apply online for a loan and if the criteria are met, the loan is fulfilled by lenders on the platform who will receive interest on the loan, paid by the borrower. The P2P platforms currently offer far better returns²² on the investment than the lender would earn by leaving the money in a bank account and this is their big sell. From the borrower's perspective, they get a loan that they may or may not have been able to get from a bank (we will explore this later) at a price (interest rate) lower than they would pay from the banks. Crucially for both lender and borrower, the loan process happens with such speed and efficiency due to technology and the web-based infrastructure that it's entirely feasible for the borrower to have the money in their account within 24 hours of applying for a loan - or in some instances, in a matter of a few hours, a far cry from the protracted loan process of the major banks.

A P2P platform doesn't buy the money in the way that a bank does. Where a bank can buy money to lend - either buying from savers at a low interest rate, directly from the government at a nominal rate, or on the open market at a slightly higher rate - the P2P platforms typically don't have depositors, or access to the wholesale market. P2P platforms usually act like a matching service: Money enters the platform usually only when a loan is available to be fulfilled, so there is (in most cases) no dormant money sitting on the platform accumulating interest on behalf of the lender.

Where banks have a huge infrastructure to support the finding of people to lend to plus a substantial marketing budget to advertise its services and attract savers and borrowers, the big challenge for P2P platforms are that they have to attract lenders and they also have to attract borrowers. They have to work to find both ends of the chain: Supply and demand.

²² Though as Jonathan Ross notes, the P2P sites can be as guilty of exaggeration as their traditional counterparts, "... [the] FCA reviewed 21 peer-to-peer websites last August, it found that many "downplayed" the risks and used "misleading and potentially unfair" comparisons with bank and building society accounts. The regulator warned that some sites were emphasising a headline rate of return "that is often in double figures, without an explanation of the impact of charges, default rates and taxation". It added: "In some cases it appears the actual returns to customers can be substantially less."

“For every pound that comes through us, one pound goes out, so we can’t create money supply. Banks are a necessity. They are there as a distribution channel, they control clearing accounts. What we’re doing is facilitating either retail investors to get better returns or cash to businesses that wouldn’t normally get it. The difference between what we’re doing as a distribution of capital that may not necessarily go to banks is, as a bank, you can leverage; you’ve got fractional reserve, for every pound that comes in, upwards of £10 goes out the door in lending.”

Andrew Holgate, Assetz Capital

At RateSetter, if we want more money we need to do a huge marketing campaign to get more borrowers and lenders. We need to spend money to advertise. The banks can call up government. That barrier is a natural check on alternative finance and on its progress. The system has enormous subsidy and either alternative finance will be absorbed into that privileged system or it will challenge the idea of the system and the system will begin to unravel. I think the latter might be the case - I hope it is.

Rhydian Lewis, RateSetter

THE MAIN PLAYERS

There are two strands in peer-to-peer lending (P2P): P2P Business Lending and P2P Consumer Lending. On the consumer side, there are really only two companies in the UK that control the market: [Zopa](#) was the world’s first peer-to-peer lending site, established in 2005. It has now lent £623m. [RateSetter](#) was launched in 2010 and to-date has lent £344m.[1]

On the business side, the main player in the UK is [Funding Circle](#) with a cumulative lending to small and medium-sized businesses totalling £370m. Second and third in line to Funding Circle (in terms of market share) are [LendInvest](#) - which is P2P lending specifically for residential and commercial mortgages - and [Wellesley & Co.](#) which specialises in secured loans on property. [ThinCats](#) follows and provides secured business lending of £1m or more (cumulative total £76m) and then [Assetz Capital](#), which lends to property developers and also to businesses and stands currently at £44m in lending to-date. There are also a number of smaller platforms that are beginning to make their mark in P2P business lending, such as [FundingKnight](#).

PRODUCT AND PLATFORM OVERLAP

As with the crowd funding platforms, there are overlaps between platforms and products that are beginning to emerge. A growing number of P2P consumer loans are now being sought for business use. RateSetter and Zopa, as consumer lenders, provide unsecured loans only to individuals, although both lend to the self-employed. They are also increasingly aware that a small proportion of personal loans on their sites are being used to finance that individual’s business. In the Nesta report, 2.2% of P2P consumer borrowers said they were borrowing for their business. Essentially this means these P2P consumer platforms are doing some business lending based on an individual’s credit rating. It’s far easier to assess the individual for credit; they may have savings, a home, a credit card. The data is readily accessible to be scrutinized and with super-smart algorithms in play, the P2Ps have confidence in their credit assessment model. Some of the P2P business lenders admit that they use formal methods for looking at both the individual and the business when assessing a loan application.

And though not directly related to peer-to-peer lending, innovative young companies like Kharna and Aire.io are also using alternative means of credit scoring to cover gaps for businesses by either increasing conversion at checkout by offering post-delivery payment and assuming the accompanying credit risk or by working with individuals who have thin credit history to take control of their credit profile. At the heart of all of these companies, like the peer-to-peer lenders, is a belief that, if you change the means by which you forecast creditability you can increase the pool of people to whom you can lend money.

“The lines tend to blur; personal credit and credit scores do play a part in the decision making of lending to a business.”

Samir Desai, Funding Circle

“What we’re assuming is that what we believe is that the consumer data that we have on people is predictive. Not just facts like ‘I’ve borrowed and repaid.’ You’re trying to get into attitudes - finding people who will pay back even when they get into financial difficulties. That’s what the next level of credit model is predicting. There is a view that the kind of people we lend to - even if they start a business - will have a greater desire to repay it.”

Giles Andrews, Zopa

Like P2P business platforms, the P2P consumer platforms are a contributor to the growth of the economy, for business. They would assert that there is a type of loan that they are making that the banks won’t make but that can be made.

The value and accessibility of this data cannot be underestimated; its been the catalyst through which these platforms have erupted, supercharging the UK market whilst stifling the growth of alternative finance in other countries where the data isn’t accessible.

In the US, they are starting to understand the lifetime value of acquiring businesses early, ideally the high-growth businesses, and they do this using data on the people running those companies. From data on the individual they assess whether those companies are likely to be high growth and they’re paying 300-400% more in acquiring those customers in the belief that their lifetime value will more than compensate for the initial outlay.

But my concern for the UK market is that the consumer platforms may be naive in thinking that they can assess businesses for credit based primarily on individual credit scores. As time goes on they will begin to lend more and more to businesses – more formally, more openly – and their credit assessment models for business will need to be significantly more robust.

There will be more overlaps as the P2P platforms develop. They are currently diversifying, in the same manner that the crowd funding platforms are starting to morph and are seeking out new areas to infiltrate or traditional financial products to transform. As the P2P consumer platforms move towards business lending, will the P2P business platforms move from debt to encompass equity? Perhaps not in their current state but some of the more successful platforms are already expanding to offer a broader portfolio of debt products. This could

extend, in time, to offering a variety of financial products all available from one portal, supporting businesses at every stage of their lifecycle.

P2P BUSINESS LENDING

In November 2014, NESTA published Understanding Alternative Finance: The UK Alternative Finance industry report. It found that more than half of P2P business lenders expected to increase the amount they lent through P2P platforms in the coming year - increasing to 65% when P2P lending qualifies for the ISA scheme. NESTA found that whilst 34% of SMEs surveyed were familiar with P2P business lending, less than 5% had approached one of the platforms to seek finance and 61% thought it unlikely that they would start - often citing risk as a deterrent. But as the profile of alternative finance increases - and in the wake of recent, high profile advertising campaigns by the platforms - just how much growth could these platforms anticipate?

According to AltFi data, P2P lending platforms have now surpassed £2bn^[4]. The AltFi data includes invoice trading and crowd funding in this total but it estimates that P2P business lending alone is currently around £850m.

We talked in the introduction about the stable stock of capital available for business lending, that Barclays estimates to be around £100bn annually. But no one has offered a rival product to the banks to suggest that there may be more capital stock available. With P2P business lending at over £800m to-date, at what point do the alarm bells sound? At what level of lending do these platforms become a legitimate threat to the banks?

"If the alternative finance market got up to £2-3bn stock, that's great - but that's 2-3% of the market and that's a really bullish idea of what the size of the market will be."

Barclays

One of the most interesting areas is where P2P platforms are opening up new opportunities to people who couldn't borrow for their business before. NESTA's 2014 report found that 79% of business borrowers had attempted to get a bank loan before turning to P2P business lending but only 22% had been offered a bank loan (in contrast to consumer borrowers where 90% had been offered a bank loan.) 33% of the surveyed companies responded that without P2P business lending, it is likely or very likely that they wouldn't have received external finance. Perhaps the most important question that needs to be answered is: What type of businesses make up the 33% and for what purpose are they seeking the money? Are they businesses seeking risk capital? Or do they just not fit within the bank's credit assessment model, perhaps due to increased restrictions following the financial crash. Whatever the reason, their mere existence underscores the largest question looming over the peer-to-peer industry: How do the peer-to-peer markets successfully lend to businesses that were deemed un-lendable by the banks?

NESTA's report found that 41% of businesses seeking funds from P2P business lending platforms were looking for expansion and/or growth capital with 34% requiring working capital.²³

²³ Nesta, 2014

The number of businesses seeking risk capital suggests these P2P platforms are not merely a distribution channel for the £100bn stock but are supplying new capital - risk capital, development capital, growth capital - for new businesses. In all of alternative finance, the issue of whether the platforms are a distribution channel or bringing new capital into the market is the most difficult to fathom in this area of lending.

We have found that there is great disagreement generally around the activity of the P2P lending platforms, not least where the money is coming from and to whom it is being supplied. The reason why we need to address this question is because it informs us as to just how much of a threat the platforms could be to the mainstream financial institutions. We suggest that there are three tiers of P2P lending activity.

1. The P2P platforms provide a more efficient, better, lower cost loan to companies that could otherwise borrow from banks.
2. The P2P platforms lend to companies that have been turned down by the banks but the company has a perfectly legitimate loan request.
3. The P2P platforms lend to companies that have been turned down by the banks and the company has a high-risk loan request.

We will look at them each individually.

THE P2P PLATFORMS PROVIDE A MORE EFFICIENT, BETTER, LOWER COST LOAN TO COMPANIES THAT COULD OTHERWISE BORROW FROM BANKS.

Example: Divorce Negotiator Carol Sullivan took out a £15k business loan from Zopa to help grow her legal business by opening a franchise model of <http://www.divorcenegotiator.org.uk/> which helps couples looking to separate to cut out the high legal fees of two sets of solicitors and works to create a financial settlement that is fair to both parties. She started the business three years ago and has 120 franchisees that use her service for clients across England and Wales. When she sought cash to advertise on television, she turned to Zopa. Sullivan received £15k through Zopa, repayable over three years at 6%. The money was in her account within 24 hours of her application.

Example: Inma Goodhew, 42, Founder of The Old School Club: "I was trying to get an overdraft to cover some of the running costs and my conversations with the banks became increasingly complicated. They simply weren't able to offer me the terms I needed. I then decided to look into other options for funding. Peer-to-peer via RateSetter gave me a great opportunity to establish my business."

Example: Kaizen Furniture designs and manufactures high quality furniture from their workshop in Essex. The founders Antonius and Bill set up their business over 15 years ago and have since worked on prestigious projects across the UK, including commercial restaurants and private properties. They needed a business loan to invest in their workshop and further their marketing campaigns, and knowing the process with the banks would be too lengthy, they came to Funding Circle. Kaizen borrowed £100k from over 600 people in the UK in January 2013, allowing them to grow their workshop and take on new projects.

"60% -70% of our customers could get a bank loan but borrow from us because it is cheaper or more efficient."

Samir Desai, Funding Circle

This tier is a redistribution mechanism and it increases the efficiency of distribution of capital held within a marketplace. It doesn't increase the pool of risk capital but it provides companies that could have got a loan from a bank with cheaper, faster money. Increasing amounts of institutional money is being invested on the P2P platforms - in the US, almost a third of [Lending Club](#)'s loan book is going to institutional investors - and that's the purest example of redistribution of the same capital.

This category of lending where the P2P platforms outwit and out-process the banks could grow and grow as long as the P2P platforms offer a better, cheaper service than the banks. But how long can they maintain a cost and operational advantage?

Barclays argue that the P2P lending platforms have an artificial and temporary low cost model because they have not yet had to abide by the same regulatory framework. One of the collective fears of the P2P platforms is a new platform coming into the marketplace that could get credit risk horribly wrong - there have been some platform failures already - and pull the whole industry down like a house of cards.

With P2P success will inevitably come failures. Retaliatory regulatory reaction could mean that ultimately the returns that the P2P platforms offer will only be as much better as the efficiencies they gain, minus the regulation they acquire. Barclays argue for putting tighter regulatory systems in place now - prior to a large market failure - as preferential to retribitional regulation being applied at a later stage when it could destroy the innovation in the market.

There seems to be a broad acceptance that the current FCA regulation is appropriate; many of the P2P platforms were involved in the FCA consultation and have campaigned for regulation. But greater regulation will invariably increase the costs of loans on the platforms as they increase operational compliance. Does that remove some or all of their advantage? And is greater anticipatory regulation needed to offset the unforeseen consequences of a platform failure?

"I'm a firm believer that there should be more regulation. We operate in the US market and the UK market yet in the US, the cost of finance is structurally higher. But take Apollo - they are at \$100bn, and they are doing large regulatory loans. They are regulated as a fund. Why should we be regulated any differently to Apollo, as a fund? We don't hold the money on our account sheet, it goes directly through to end customers."

Samir Desai, Funding Circle

But in this report we aren't assessing whether the regulation that the FCA currently has in place is sufficient, or to what extent it may increase as the platforms take greater market share. I touch on regulation because the regulators may increase their requirements of these platforms to the point where the platforms are unable to compete solely on price with the banks. And if the entire difference between banks and P2P platforms is that one is regulation light and the other is regulation heavy, that suggests that Funding Circle would not be long for this world.

But customers claim that the difference is not merely one of price, though that plays a significant role. The other key differentiators are the speed of the process, the transparency of the process and the implied fairness of the outcome. Those current advantages that may or may not be sustainable. There is no doubt that the major banks will seek to redress their disadvantages in this area and some are likely to which suggests that, though the outcome for the businesses is good, the likelihood of challengers continuing to grow based on these advantages may be muted in the future.

“It [P2P lending] is unlikely to prove a stable source of capital if it retains a regulatory sword of Damocles above its head. Our regulatory environment is paternalistic in approach with regards to retail, and there is no reason to assume this market will be treated differently in the long run, especially if it achieves scale or experiences a failure.”

Barclays

From a skills perspective, the P2P platforms have teams of financial experts, often from a finance or banking background. Better data analytics should be, in theory, another relatively short-term advantage. Whoever has the most money can buy the team with the best skills for the job; can create a better system; and can buy better data.

“Since this is a skills issue, you would anticipate the incumbents buying in these skills at a certain point. A good example might be the stock market in the UK. The new MTF markets came in with faster and cheaper platforms. The result was that the LSE bought in even cheaper and faster kit, and the advantage disappeared. Interestingly driven by other reasons the MTFs have retained a sizeable market share (although no real additional funding has materialised as a result).”

Barclays

Barclays are right in that the cost advantage may well disappear entirely when regulation increases and the skills advantage is a short-term benefit but the service advantage of these P2P platforms could remain. The major banks don't yet provide a facility to apply for a loan – and receive the funds – online, and each loan product is wrapped in a number of other products, such as insurance, making the entire exercise more time consuming, confusing and expensive for borrowers.

Currently, in spite of the challenge of needing to generate both supply and demand, the P2P platforms have huge advantages in their model. They operate on a lean scale; they pivot and respond to market changes; they don't have retail premises on high streets across the country and they do the bulk of their processing online.

“A McKinsey study in 2013 looked at the operational cost advantages of platforms like Zopa and found that across the board, their cost operation was so much lower that in and of itself, it could be the solution.[6]”

Giles Andrews, Zopa

The banks are culling high street branches which are costly overheads but as the branch networks disappear, the bank's face political pressure to maintain them. Their online offering needs to improve along with their turnaround times for loan approval but these institutional machines - the great goliaths of the financial world - are unable to move fast. Further they are not merely being challenged by the alternative finance providers, the emerging challenger banks are also in some cases unencumbered by branches with structurally lower costs built in by virtue of starting from a clean page, such as Atom Bank. Thus, they face pressure from both sides: as utilities and as lenders.

Nevertheless, the P2P platforms shouldn't underestimate the sleeping giant they are poking here. Their nimbleness and speed will provoke a response from the banks but in the meantime, the P2P platforms could take advantage of nascent innovators and technology advances to stay a step ahead.

If it's the case that the P2P platforms provide a different distribution mechanism, then their small share of the market will grow until it challenges the banks to change their processes. It will improve quality and cost to the consumers of these products, but in theory, won't address the funding gap for risk capital.

THE P2P PLATFORMS LEND TO COMPANIES THAT HAVE BEEN TURNED DOWN BY THE BANKS BUT THE COMPANY HAS A PUTATIVELY LEGITIMATE LOAN REQUEST.

"There are businesses that we deal with that wouldn't get debt from a bank because of the banks' lending criteria. The fractional reserve part of the banking then creates the bar regulations, the bar regulations have tightened, especially for SME lending. It's very expensive now for a bank to lend so the borrowers come to us. That doesn't mean those businesses that don't get money are necessarily 'bad' businesses; they are just not attractive to banks because of the [regulatory] capital requirements that the banks have got. What we're doing is filling that need."

Andrew Holgate, Assetz Capital

"50% of the loans are for growth. But an average business that borrows from Funding Circle has 600k turnover, 10 employees and they've been trading for 8 years - some for hundreds of years."

Samir Desai, Funding Circle

Rhydian Lewis of RateSetter came up with this killer phrase of the 'un-bankable but lendable' and it neatly summarises the group of borrowers that we are describing in this category. The banks themselves admit they overlook certain loans and the P2P lenders are snapping up these 'overlooked' borrowers. This tier is of the most interest to Barclays as it highlights where the improvements in their model need to be made.

Let's take some examples where the banks have declined a company and the P2P platforms have deftly stepped in to provide finance. Note that we are just providing brief summaries here, to give examples of the types of business lending.

Example 1: BookSwarm founder Simon Appleby initially avoided the banks as he felt that, as a service-driven business with nothing to secure a loan against, applying for a bank loan was likely to involve jumping through a lot of hoops (business plans and cashflow forecasts) that were not applicable to BookSwarm. He looked to apply

to Funding Circle but they required that businesses have 2 consecutive years turning over £100k (this has since been dropped to £50k). Simon had three years trading history but in the second year the turnover dropped from over £100k to roughly £88k. Simon went to Zopa as part of the sole trader loans and took a £9k loan to help grow his digital publishing business. The key point with Zopa - and why Simon felt it was so much easier than the alternatives - was that technically they were lending to Simon personally and it was incumbent on Simon to pass the money on to the limited company. Zopa assessed the loan based on the business finances but no doubt his personal credit history came in to the equation too.

Example 2: Based in County Durham, Ambic borrowed £100,000 in July 2013. Ambic is a long-established UK manufacturer (founded 30 years ago) and their primary focus is making and fitting educational furniture. They supply schools, universities and offices in the North East of England. As they can only access classrooms during the summer holidays to build the furniture, they typically do all the work seasonally and wait a long time for payment. They went to four banks with evidence of their strong supply of public sector clients and they couldn't get a loan from any of the major banks. Ambic borrowed £100,000 from 1,277 investors through Funding Circle in July 2013.

This is an extreme example of a working capital problem and to my mind, if the financials made sense, the banks should have made the loan. This does appear to be a case of an overlooked loan or perhaps the inflexibility of the system. The open question about Ambic is whether the majority of their problem would have been solved through the new breed of invoice discounters, such as Platform Black or Market Invoice (see below).

“Working capital is a really interesting one for the banks at the moment. Overdraft facilities really expensive because they are on demand facilities. You’ve got to have that cash available whether for one day or 365 days. There is a move by the banks to get rid of overdrafts altogether and working capital for businesses has become a problem.”

Andrew Holgate, Assetz Capital

Example 3: Sensible Supplies was established in 2008 by Oliver Charles-Richards. He borrowed £50k from 542 people through Funding Circle to buy stock for a venture with Groupon, a website offering deals and discounts. The business has experienced huge growth over the past 3 years; Oliver started selling products from his garage and now operates out of a 10,000 sq ft warehouse in Nottinghamshire. The business needed a loan to purchase a large order of sweets to complete the deal with Groupon.

Groupon does not guarantee sales; it is merely a platform to an established audience. The risk still exists, in that the deal could go on Groupon and no-one buys the deal, leaving the business owner out of pocket with a warehouse full of stock, unable to pay back the loan. This looks like PO finance or inventory finance. But go a level deeper and ask if the business owner's existing cash-flow could support the loan. If he was able to service the loan - and this was actually the case - then the loan could and should have been made by the bank.

Example 4: A very small business that made and installed boilers got involved with the eco deal, fitting new boilers into houses. They had contracts with the big energy suppliers, and guarantee of payment. The banks weren't interested in lending because they didn't feel that the business could be scaled and it was a young company, less than a year old so had no trading record, but they were part of a government guaranteed scheme, they had the go ahead from the energy companies (once the lead had been verified) to go into houses and fit the boiler that had already been purchased by the energy companies. They went from installing, say, 5 boilers to week to installing over 250 boilers a week and they've gone from turning over less than £100,000 a year, to £5.5m of turnover. The money was lent through Assetz Capital.

In this example, the company had certainty of client – again, the banks should have lent the money.

Example 5: *Oysterworld Ltd was established in 2011 as a computer game development & publishing business. It had achieved £1m of revenues and substantial pre tax profits by its 2013 financial year. In 2014 it had negotiated and contracted potentially another £4m+ of revenue for developing a game for another publisher and over £1m of grant money from the Welsh Regional Development Agency (WRDA) because of its planned increases in staffing.*

The WRDA grant money was conditional on Oysterworld achieving matched external financing for the business. The Oysterworld founders provided the initial tranche of additional funding and then approached their bank for debt finance. Oysterworld's bank was unable to offer debt finance partly because of an existing charge over some of the company's assets even though this charge was due to expire very shortly. A £300,000 loan was successfully raised on ThinCats in May 2014.

Oysterworld was looking for a type of growth capital that is available in the US but not here. Historically banks like Silicon Valley Bank would offer loans for growth by evaluating the risk, piggy-backing on another financier (Such as the WRDA above) and asking for warrants in addition to interest. It is an interesting gap that does not appear to be solved in the market. However, organisations like ThinCats are offering a better deal than would have been offered under the SVB model.

Example 7: *The 3DD Group began in 1994 as a sales agent for international TV Licensing and it is now ranked within the top 25 of distributors and sales agents of television programmes worldwide. 3DD Productions Ltd creates programs and sells them to 3DD Entertainments Ltd, which then distributes them worldwide. 3DD Entertainment Limited approached the bank in 2013 for loan financing - working capital - for new TV projects. They applied for the Government-backed EFG scheme but the application stalled for over 9 months with little feedback. The loan was required to aid the increasing level of business being undertaken by the company.*

Until 2012 the company had an overdraft and financing facility with Coutts but switched due to a lack of business support from Coutts to the company's previous bankers Barclays, who had afforded a £250,000 loan and overdraft facility on condition that it was matched by a personal deposit of the same amount by Dominic Saville (CEO). Mr Saville provided these funds from the sale of his main residence.

The previous ThinCats loans were auctioned in early 2014 for £300,000 & £102,000 and were used to repay a Funding Circle loan of circa £48,000, bring post-production operations in house and fund new business.

In 2014 the group launched new series strands which would realise £300k in gross sales in the first 12 months alone. The group's assets (excluding intra group debts) were:

- *Programme Library: £1.4 million*
- *Trade Debtors: £2.1 million*
- *Work in Progress: £200,000*

The bank could or would not see that they had a back catalogue producing income that was very valuable, even though it had been valued by Grant Thornton for a goodly multiple of what they were being asked to lend. ThinCats lending transformed this business, from the first loan to bring post Production in house, to the financing of current & future productions.

Example 8: *Launched in 2010, Moo Free, a dairy and gluten-free chocolate manufacturer, has grown from 3 staff to 18 staff and from a warehouse of 1,600 sq ft, to 6,500 sq ft. Moo Free approached 5 different banks before coming to Funding Circle. They needed money for stock and to put down the huge deposits required when ordering new*

machinery. Moo Free borrowed £85,000 from 844 people in 2013. In the 4 years they've been running, they've won multiple awards, are stocked in Sainsburys and Waitrose and export their products internationally, with distributors in 10 countries and products available in 17 countries.

Example 9: *The Exhibition Rooms is an award-winning restaurant and bar based in Crystal Palace, winning Time Out's best local restaurant in 2009. It was started in 2008 by two friends, David Massey and Geoff Ridgeon; Geoff is an experienced restaurateur and David is the head chef, having worked alongside Anthony Worrall Thompson. In February, they took out a business loan of £36,000 through Funding Circle which was funded by 763 people and organisations across the UK, so they could develop a new restaurant site in Peckham and buy new equipment. The banks didn't want to lend money for a new restaurant.*

Example 10: *Paul Maslin and Paul Hedge have been dealing contemporary art since 1992. Originally from Deptford, they had always wanted to deal in art and help artists to make a living. They helped to launch the careers of a number of now well-known, young British artists during the '90s boom. When they found a site in Shoreditch 10 years ago, they decided to turn it into a gallery. They've now taken three loans through Funding Circle to ease working capital, borrowing over £200,000 from over 3,000 investors.*

These examples give us an idea of the types of lending that the banks could be doing and no doubt will, in due course.

This tier of lending is of most interest to Barclays as they look to their future. The banks are not capital constrained, they have more money than they are able to deploy but they cannot identify enough businesses that fit within their credit criteria. It remains very interesting that so many of the examples above obviously fall out of the banks lending criteria, as they were unable to get loans from the banks, but over time proved to have been viable loans. It suggests that there is a true gap in the market defined by the lower edge of the banks requirements and above the level of acceptable risk.

"We are intrigued by their assessment that there are safe lending opportunities which better credit assessment shows to be suitable for low risk debt investment. We would like to see data on the current and future scale of this market – I suppose a starting assumption would be that it cannot be larger than current declined lending levels, and is presumably a subset of that pool – can we assume a minority? That would seem intuitively true – that we are wrong less often than we are right, even if our wrongness is more common than we think."

Barclays

Barclays are right in that this Tier 2 is still a fringe category. It is additional lending because the P2P platforms have found a way - using a better credit assessment tool and because they are not constrained by the same capital and regulatory requirements - to identify additional, 'safe' customers that the banks can't service. But there is a limit to the scale that this area of lending can achieve. If the banks find a way to compete with the platforms on cost and efficiency and use the technological and data advantages to improve their credit model, they too will be able to assess and uncover, to a greater degree of accuracy, a wider range of safe, lendable customers.

"Markets don't exist for the benefit of intermediaries. The market is the market, it doesn't matter how many new providers there are. You might improve price and quality but not stock."

Barclays

THE P2P PLATFORMS LEND TO COMPANIES THAT HAVE BEEN TURNED DOWN BY THE BANKS AND THE COMPANY HAS A HIGH-RISK LOAN REQUEST.

"A uniform asset class is extremely difficult to diversify across."

Barclays

The success of the P2P platforms may depend on their ability to not only provide a better service but to unearth new customers through indirect channels that the banks won't touch and thus move up the risk scale.

"One of the indicators of whether or not the P2P platforms can compete with the banks is if we can find different channels or routes to market, exploiting the banks' lack of agility and lack of appetite. There is an established market price for credit in the world of moneysupermarket and moneysavingexpert but there are also all sorts of people who borrow money out of convenience, through quite fragmented channels. There is an opportunity to provide credit at a higher price, through exploiting agility and exploring channels."

Giles Andrews, Zopa

Banks in the UK are very good at pricing trading risk and not as good at pricing growth and innovation risk, by their own admission. If a company seeks to change direction, to invent a new product, to rework the business model, the banks would argue that the level of risk is too great, that the company is seeking growth capital and that should come through equity, not a loan. In the UK we tend to fund development risk with debt and Barclays would argue this isn't the appropriate structure.

RWAs are the aggregator that banks use to think about risk in capital terms. A mortgage has an RWA of 1, the banks deem property lending to be safe and almost 'risk-free' which explains why if your money is in a bank account, it will most likely be lent out as a mortgage. An SME has an RWA of 4, creeping up the risk scale. A genuine startup has an RWA of 9, which from a bank's perspective is flat-out untouchable.

The P2P platforms are an enabler for the bank's smaller business customers and those who are perhaps more risky propositions. The UK government's referral system (where details of bank customers that have been turned down for a loan are shared with the P2P platforms) is an approving nod toward that complementary relationship. The banks, under increasing pressure by the government to lend more, also see a complementary relationship.

"We're under lots of pressure to lend to companies that we don't think we can lend to, so if they are helped elsewhere in the market then that is good."

Barclays

"Banks are for low-risk saving. That's what they do and will always do. They're increasingly well capitalised and they give a measure of protection for people who want to take minimal risk with their money. As alternative finance grows, I think they will be pushed more and more to offer better rates of return. They'll also be obliged to drive through cost efficiencies and to pass the savings to their customers. As they go through this process, I think they will decide against doing certain types of business. Anything to do with working capital for half a million or less, will stop being a part of their offer. It's the same amount of work to process a £3m loan as it is to process one much smaller, so why bother with the smaller loans at all?"

Graeme Marshall, FundingKnight

But there are questions over whether the P2P platforms should service that higher level of risk. The suggestion is that if the banks have deemed those businesses un-lendable then in the majority of cases, the P2P platforms should not lend to them either.

"I invest as a bank, expecting to be repaid and observe failure. In the equity field, I expect to lose my money and observe repayment. That is the conceptual difference. One can structure the investment in different ways. You can structure and price it as equity. You can absorb the loss in whatever way. But you come back to this point - we are talking about the wrong structure of investment."

Barclays

I disagree with Barclays on this point. I do not think that there is a clear dividing line between a loan and equity. Notwithstanding the potential for convertible instruments, there appears to be a gap in lending of undetermined size; a gap that exists below equity and above a loan. It's a gap that brings new lenders and new borrowers into the market. If risk and reward are linear in relationship, then in the abstract, for every level of risk, there is a price. You can arbitrate the risk by simply raising the interest rate. If we can agree that higher risk equals higher reward, these high-risk loans can be priced and the ability to price that risk accurately becomes the paramount question.

I know of a company that provides industrial and commercial finance for mid-cap companies that are a little too risky for the banks but not too risky for this company to lend to at a higher interest rate. It's a gap that I keep seeing, where there is a lack of finance available for small businesses that have good, reliable, lendable propositions. They've got the customers, they've got a receivable coming, there's little manufacturing risk and yet they can't get a loan. Where do they go? Barclays argue that this should be structured as an equity deal but these small businesses don't want to sell a big portion of the business just to finance their operation. This is about lending money to businesses that are growing and add disproportionate value to the economy.

There is a huge tranche of businesses that are slightly too risky for banks but not too risky for individuals to invest in. The problem – and this is where Barclays is correct – is that people are going to make mistakes. Risk might not be priced correctly in some instances. The regulators don't permit the banks to lend to those people and the banks argue the regulation is *appropriate*. Retail investors should not be accessing these higher-risk

opportunities; they should remain the preserve of experienced investors, high net worth investors, and sector specialists.

But if retail investors are getting inadequate return because of the lack of competition for their money in the marketplace and somebody offers them a better return - and in fact, splits the difference by having a lower cost model - then that increases competition in the marketplace and benefits both the retail investor who gets a good return and the business that gets a better deal than from the bank. Nothing stops an intermediary (the P2P) from making at least as good a judgement as a bank - they don't have to be superior - for the retail investor to end up in the same position.

The retail market is not a single individual with poor judgement. It ranges from very sophisticated individuals to those who may be unsophisticated, but with the advent of P2P lending, are permitted to make very small bets. Since one should only ever put at risk money that one can afford to lose, P2P platforms actually lower the bar for the amount of money that you need to put at risk at all, making it more affordable for everyone to take a punt. I am not persuaded that institutions necessarily offer an advantage in this area.

If a P2P lender offers more or less the same credit risk capacity as a bank, then swapping the guarantee from the government (by banking the money) for the credit risk policies of the P2P lender, in return for disproportionately higher rates of return seem to me to be a rational bet.

It does come down to the question of whether the P2P lenders are able to make an informed judgement on behalf of the crowd (though that is mitigated by the fact that the crowd can spread their bet).

"The reason Funding Circle's rates are where they are, is because it is an intervention in the market. It launched in the bottom of the market and experienced an upturn. What will happen when you see either localised recessions in geographies in the UK or just mass failure in the market in 5 or 6 years? You should anticipate failure."

Barclays

The P2P platforms believe that they have created credit assessment models that are more accurate than the models used by the banks. What if Funding Circle with their data analysis and algorithms are just as good, just as accurate as the credit risk assessments that the banks undertake? Note that this statement below is from Zopa, a consumer-lending site, but CEO Giles Andrews makes his point well.

"We believe we are unquestionably better at credit. Not better at finding people who the banks wouldn't lend to but better at predicting and therefore lowering the cost of capital and reducing volatility by predicting the level of defaults of the people we do lend to. In the last three months, six lots of bank analysts have crawled all over our loan book and without exception they are staggered by its performance. I'll put our loan book in front of anyone in the world. We use data analytics better, we're more agile, we buy more data and more varied data."

Giles Andrews, Zopa

Barclays argue that several of the P2P models have proved faulty in the past and that their confidence in their financial modelling is currently unjustified. But as David Stephenson at AltFi points out, even if the mispricing

of risk does happen - and increasing institutional money on these platforms might bring that reality sharply into focus - we should let the market decide.

"It could be that the P2P platforms pump £10bn into the economy in which case surely the market will benefit from increased capital more than it feels the loss due to mispriced risk. The market will recover, steady itself, regulate itself. It is preferable to give to SMEs a choice for finance, in the same way that every other (typically bigger) business is permitted a choice. The P2P platforms challenge the oligopoly of the five major UK banks and perhaps we should look outside of the UK to the community and business banks that exist in a similar market ecosystem to ours, to see what the potential for business lending could be. The P2P platforms are unleveraged models that provide a multitude of answers - and put markets back in financial services."

David Stephenson, AltFi

If the investors on the P2P platforms have diversified their portfolio - and most of the platforms take great pains to educate their investor base or actively diversify on their behalf - then any losses would, one hopes, be minimal against their wider investment portfolio.

Barclays - and I expect this echoes the belief of the major banks - have concluded that they see little that's revolutionary in the P2P lending sector. They believe the advantages of the P2P platforms will be short-lived and whilst they are good for diversifying the marketplace, they will remain a distribution mechanism that offers choice to the borrower and the saver but will fail to improve risk capital supply in any significant way.

"We arrive at the position of seeing real marginal advantage to the P2P networks - either directly or through forcing improvements in the major players, they could introduce some additional lending into the UK. Although that sounds like a rather modest benefit, enhancing these marginal opportunities of course drives growth. There is no tsunami of untapped lending in the UK, but relatively modest enhancements could have disproportionate impact."

Barclays

Are the P2P platforms able to assess a company and show it as viable for investment when a bank cannot? This is the question left on the table and that will only be told over the fullness of time. If it's the case that they cannot, then they are exposing retail investors to greater risks in the shape of diminished returns. If they are correct then they are providing for businesses a greater potential for growth than the banks offer and the retail investor with a better deal, thus diminishing the role of the bank in society outside of its utility mechanisms.

Johnathan Row, talks about the notion of banks retreating, as a potential strategy, ""The battle for customer attention via new digital channels is intense. In a crowdsourcing environment, customers vote with their feet - today's winner may be consigned to the rubbish the minute a more compelling offering is launched. How should banks respond? An attempt to compete head-on with the new entrants and their vast pool of non-banking investment capital could prove costly, especially to bank shareholders.

Alternatively, intentionally deciding not to compete in the digital front line and investing heavily in their own infrastructure and platforms that are foundational to the whole sector, including payments, for example, might secure a long-term winning position.

Offering open-API, fair priced access to this ecosystem for any new entrant who wanted to chance their arm in the digital customer battlefield could potentially retain the banks' long-term sector supremacy, albeit slightly redefined. BBVA in Mexico is already on this path, and Ffrees, in the UK, is a great example of what a new entrant front-end could be – plugged into the incumbent bank ecosystem.

It sounds like a retreat – and in many respects it is. But aiming for a secure, long-term position, albeit with potentially reduced returns, might be something bank shareholders would vote for with their own feet!"²⁴

I believe these platforms don't just distribute capital more efficiently but serve a marketplace that is beyond the reach of the banks. If in fact it's correct that these platforms are lending to people who would *not* otherwise have got a loan but they are perfectly lendable to – again, un-bankable but lendable - *and* the platforms have priced the risk correctly *and* they do it more efficiently, then it is inevitable that they will disrupt the entire banking system in the process or they will get bought out by the banking system. The banking system will have to change one way or another.

DEBT FINANCE FOR YOUNG COMPANIES

Rising even further up the risk scale, start-ups have an RWA of 9, they sit far outside the bank's lending portfolio. The majority of P2P platforms that lend to businesses don't touch start-ups either. But they could.

What happens when you come across a young company that's less than two years old and that looks like a good lending proposition? Two years is an arbitrary line drawn in the sand by some of the P2P business lending platforms; they won't lend to businesses less than two years old and that's fair enough, they have to draw a line somewhere. David Stephenson at AltFi suggests there is evidence that the cost of money for risky businesses is actually coming down and platforms like [ArchOver](#) have drawn the line at 18-months, lending to slightly younger businesses. Why can't the P2P platforms price that risk and deliver a product against it?

"When we started, we had that intention - to have equity and loan mixes. We realised on day two that we needed to be regulated in a totally different way.

Kevin Caley, ThinCats

"There's less data on startups; the failure rates for businesses less than one year or two years old is much higher than others and the relationships between data starts to break down below two years."

Samir Desai, Funding Circle

²⁴ <http://business-reporter.co.uk/2014/10/26/when-retreat-can-represent-a-winning-strategy/>

"The price for credit would be a burden on those businesses. It's not sustainable; you risk the chance of the business."

Giles Andrews, Zopa

"You come back to the question around equity and debt. The attitude in the UK is that entrepreneurs want to keep it all to themselves. The markets will change as we mature as an industry - we will diversify more. But the equity side of the loan is very heavily regulated in the UK. To move into that brings in a whole new set of regulations."

Andrew Holgate, Assetz Capital

I don't completely agree with the position of the P2P lending platforms although I can see that they have more than enough opportunities to grow and grow without having to provide start-up capital. I'm working in developing countries that are developing with no infrastructure and have an acute need for risk capital. We're looking at entirely new types of products.

In Colombia, for example, we've developed a loan product which is a loan to the company at a high interest rate in the area of 30%. There's no repayment, interest just accumulates up to a point where it converts at the increased amount, to either a lower cost loan or to equity; primarily to a lower cost loan as against their lendability. It's repackaged and the price drops. This is very attractive to entrepreneurs and is still cheaper than equity (assuming success).

There is a certain point where equity and loans overlap. Let's not forget that Silicon Valley Bank made a fortune on instruments that fell between equity and loans and that was 25 years ago. Silicon Valley Bank would make a loan and top up with warrants and they made a fortune. Risk *can* be priced.

My point is that contrary to the perspective of Barclays, I see young companies that currently take finance in return for equity when I believe they should have taken debt. Where Barclays believes debt should, at an arguably quite early point on the risk/reward continuum, tip into equity, I think entrepreneurs should think about debt as a cheaper alternative to equity. Time and again I hear of entrepreneurs who sold more of the company than they should have to get money into the business, where they could have got the money more cheaply elsewhere. I think the P2P platforms are going to play an increasing role in financing small businesses at various stages of growth, *if* they can take on more of the higher-risk loan propositions and *if* they can price that risk correctly.

"If it turns out that there is a significant proportion of the market that I (Barclays) see as being closer to equity and you (P2P platforms) see as being closer to debt and you're right and I'm wrong, then it will be the most fundamental change to banking that we've seen in the past 30 years."

Barclays

There is an absolute shortage of money for young, growing companies, less than two years old and yet the appetite for capital for those businesses is insatiable. These are businesses that have been starved of capital, particularly over the last few years. I wonder to what degree the P2P platforms can, in the future, fulfil that need without a bank ever touching the money, other than to process it.

How big a footprint could the platforms grow to? Currently an entrepreneur would have look to other platforms or people for the stages of business finance: Pre-seed, seed, post-seed, angel investing. But I'm already seeing some innovative companies today jumping from one P2P stone to another P2P stone across the river without ever touching the banking system at all and getting to the point where they are so mature that the banking system is running after them.

Five years from now, will these stones in the river grow large enough to form a solid bridge? I imagine different incumbents will be affected in different ways: I've said previously that I believe the VC model is flawed; it's fractured and it's changing. The angel investment notion will be swept away and profoundly change, partly because of reward-based crowd funding and partly because of online angel platforms - they have the potential to create more capital in the world. The banks are changing and they absolutely need to irrevocably change.

"I think that is in the hands of the millennials. What we do is very internet-based and media driven. The crowd coming together is a social media thing and adopted more by young generations. Looking at who is investing, it tends to be the older generations because they have the capital. Will the younger generation get to a point of never going to a bank? Yes, that will be the case and we're setting the foundations for that to happen."

Andrew Holgate, Assetz Capital

Case study of Innpulsa Colombia

When we started Innpulsa in 2012 there were just two (barely active) angel networks and no funds at all in Colombia - there was one VC but not for early stage, only \$1m+

Our view of the whole ecosystem was to activate private investments. The priority was to test the demand for that kind of resource in early stage companies in Colombia. We connected first with entrepreneurs - giving seed grants from \$25K to \$170K. At that point we had around US\$10m as a small fund for testing. We had a huge response. We were able to allocate this money to 50 startups but around 600 applied. At least 100 of those who didn't get the funds were still qualified to do so.

At the beginning we were just asking for a minimum viable product and some demonstration of market testing, so we were really looking at startups, early stage and early growth. In the second year we decided to focus just on those with an MVP and who were selling - even just \$1 traded. We invested around US\$7m in 32 companies - that's what we have currently. We are activating a demand and evaluating how the market is

behaving. Market failure is not just about lack of information; market failure is about lack of information and wealth.

In the US and UK for investment stages, you typically have an LLP and a GP and then the companies to invest in. In Colombia, because of the regulation, you've got to have investors, general partners and something called Management Society that manage the money. The money goes into this third party and they take around 1.5% in fees each year. Added to the GP management fees, it means if you have a small fund it's too expensive. 33% of that fund will go on management fees and considerably less is left to invest and diversify your portfolio.

We have to fix the whole regulatory system in Colombia but it's going to take time! So in the meantime we have been able to activate three funds for early stage companies, which means investing \$25K - \$200K in high potential companies or 'hyper-growth' as we call it here, across all sectors. For each dollar we put in, we have activated 4 dollars. We are seeing early successes.

We need to activate more people - new investors - and encourage old investors to put more money in. We have a programme called Matching Grants where for every dollar that an investor puts into an entrepreneur, we match it as a grant for investors to invest. We co-finance the investment. We have \$4m to do this.

In Colombia, Crowd funding is not yet legal. When many investors want to take equity, it's not allowed. If you gather more than 20 investors to a platform, it's illegal. You can't have more than 20 investors in a deal.

In the US ecosystem, you often have an entrepreneur working with a serial entrepreneur who has become an angel investor or mentor. This is not the Colombian way. In Colombia we are seeing the first generation of entrepreneurs and the second generation of family offices with huge wealth - about 50 families in Colombia own more than US\$500m. It's very concentrated. They are used to classic assets as investments - real estates or traditional, institutional investments. The middle-aged executives who might invest are risk averse. It's a cultural mindset and entrepreneurs don't know how to communicate with these investors.

We help entrepreneurs with great ideas - they don't come from universities, as the universities are not hubs for entrepreneurs in Colombia. It's usually employees with great ideas that feel unable to implement their ideas within the company that they work. We call it pseudo-spin-off. The company is not involved but the employee 'spins-off' in a new direction. A mentor then joins the team and they start working together. Mentors come from enterprise support organisations like Endeavour, or from the accelerators. It's a tactical relationship with the entrepreneur. The mentor puts forward small amounts of capital - \$10K over six months - to fix cash-flow and the entrepreneur gives shares/equity in exchange.

Once they have built a more robust model, the entrepreneur and mentor go to an investor. But typically the investor wants some kind of warranty and is also risk averse. Instead of crowdfunding, at Innpulsa we are doing crowd warranties. Regular people that have an amount to invest between \$25 and \$500 and that have a credit card, can put the money in the platform as a risk back-up. They are investing in warranties. If things go well, they could earn four times the money invested. The investor will pay back the warranty that he/she asked for. If things don't go well, they won't get any money back. We want to crowd-source the warranty so the investor has enough money as a backup for their investments. We are implementing the pilot test now. If it goes well it will be the first crowd-warranty based platform in the world - and legal in Colombia!! We want to warranty 50% of the investment from the investor.

We look for hyper-growth driven by innovation - whether that's processes, new money, a new market or product. 52% of our entrepreneurial companies are digital. The remainder are highly diversified: Clean technology, biotech, biodiversity - food, cosmetics, engineering.

Innpulsa has a whole area called mentality and culture. We want to activate dialogue and bring entrepreneurial terms into everyday conversations. We have cultural barriers that don't allow us to trust entrepreneurs - a hangover from the drug trafficking in the 80s and 90s where 'entrepreneurs' were rich drug traffickers/drug-lords and they became role models to the young generation. The media perpetuated it. Society was suspicious of any successful entrepreneurs as they were deemed to be involved with the drug culture - so it was shameful to be a successful entrepreneur. We now have our own media broadcasting company that has to produce positive news about entrepreneurship every day - <http://colombia-inn.com.co/>. We have showed two films about entrepreneurship in cinemas. We want to produce a version of Dragons' Den but suited to Colombia.

We also have a programme called Financing Readiness for entrepreneurs, where they start to fix the things they need to fix to become more appealing to banks in order to get access to regular credit. That's not possible if we don't change the bank's credit scoring and mentality. So we run the programme in parallel with the banks. We want to introduce the banks to the entrepreneurs - they need to learn how to score them more smartly. Banks see entrepreneurs as a CSR policy at the moment!

We have a couple of P2P lending platforms in Colombia. The gap between rich and poor in Colombia is huge. We have pyramid-based platforms to fix cashflow problems or to fix education problems - for example, someone who wants to learn a new skill to get a freelance job can borrow money from a peer via a platform. The 'peer' who lends the money gets a proportion of the income generated as a result of the borrower acquiring the new skill. People in Colombia prefer to owe money to someone rather than have credit from the bank. It's a cultural thing. P2P is cultural.

[1] All cumulative totals are correct as of Sept 2014 and are stats from Liberum AltFi Volume Index <http://www.altfi.com/data>

[2] Nesta, *Banking On Each Other, Peer-to-Peer Lending to Business: Evidence from Funding Circle*, April 2013

[3] AltFi Volume Index <http://www.altfi.com/data>

[4] AltFi Data includes crowdfunding and invoice finance in this total, where P2P consumer lending accounts for 31.8%; P2P business lending 49.6%; invoice financing 16.1% and Crowdfunding 2.6%. Figures correct as of Sept 2014.

[5] Samir Desai, founder of Funding Circle, in conversation with Barclays, 15th Sept 2014

[6] McKinsey quoted by Giles Andrews, CEO of Zopa, in conversation with Barclays, 15th Sept 2014

CHAPTER 4: INVOICE FINANCE

WHAT IS INVOICE FINANCE?

When a company needs to get money into the business, one option is to get a loan against some income expected, for work already undertaken. Essentially a business can 'sell' their invoices – invoice trading - by getting a loan upfront for an invoice already submitted to a client. When the client pays the invoice, the company repays the loan, plus interest, to the lender.

This is a great aid to businesses that are small as the smallest companies are often the last to get paid in a pyramid of contractors. Large companies are also guilty of delaying the payment of invoices for 90 or even 120 days and if an SME is forced to agree to these payment terms (realistically there is no other option) then that delay in payment deprives that small business of the crucial cash-flow needed for it to function.

Typically where banks provide invoice trading as an option for their business customers, they take the whole debtor book – they won't 'buy' individual invoices. They also charge fees for the service: Upfront fees, annual fees, fees for not using the service, fees for extending and terminating the service. Sometimes a business has to agree to a lock-in period of several years and the bank can also take a legal charge over the business or ask for personal guarantees. The processing period and time lag for an SME to get a decision from the banks can be a number of weeks.

With alternative finance, some innovative companies have revamped the invoice finance model by providing SMEs with flexibility in the form of an 'a la carte' service meaning a business can sell just one invoice. They have removed hidden fees and yet again by being based online and using easily accessible data to create a credit check system, they are able to complete all the processing within hours, instead of weeks. These platforms can get working capital to the SME in a way that is quicker, smarter, cleaner. As with the other P2P platforms, the loans against the invoices are fulfilled by investors who receive interest on the repayment. Typically investors on these platforms are sophisticated investors and high net worth individuals.

WHO ARE THE KEY PLAYERS?

There are two platforms that dominate the UK market. [Market Invoice](#) and [Platform Black](#).

MarketInvoice launched in 2011 and has funded over £280m. As of August 2013 the UK Government began buying invoices on MarketInvoice as part of the British Business Bank initiative. An SME applies online and when approved they can upload their invoice. A member of the MarketInvoice team will schedule the invoice to sell in one of their twice daily trading sessions.

Platform Black also launched in 2011 and has funded almost £80m. An SME can apply online or through an 'introducer' (who earns commission on referrals). Once approved, the SME can upload their invoice to go into a live auction. The SME sets the maximum cost of the finance and investors bid down to the market rate in the auction. A typical 30-day trade would cost about 1.2% of the amount advanced. There is also a transaction fee which the SME can set by deciding if they want the money for 30, 60 or 90 days.

Platform Black

Investment grade companies (Tesco, Sainsbury, Carillion) are serviced well by the big banks, the JP Morgans of the world, but there remains a gap which isn't just SME funding, it's *anything* sub-investment grade.

We have no interest in competing with the banks. We have no desire to create a massive product

range. Banks will always exist. People will always need a bank account! We're here to service the companies that the banks can't service and don't want to service.

We're focusing on working capital because that's a sweet spot for us; we're staying true to that vertical and are focused on providing a future that processes and provides tens of millions a month and then, hopefully, hundreds of millions. That's the future we'd like to see. Our allies are banks, invoice finance houses, accountancy firms, brokers - and every other alternative finance provider!

The threat to the banks does not come from us; it comes from companies like Apple that process more payments in the UK than Lloyds Bank. Banks should be fearful of companies as fierce as Apple. What they do with payments is good. Google Bank is another one. Their customer relationships are key and they've nailed it.

Louise Beaumont, Platform Black

MarketInvoice

Invoice finance has a bad reputation on the back of bad practices from traditional providers. In some ways this is a benefit to us - businesses are eager for a better solution - but in others, it creates a psychological barrier because businesses think automatically that invoice finance 'isn't for them' when actually it could really help them.

We need to show that using MarketInvoice is the hallmark of an intelligent, growing business. Additionally, all too often banks have a captive relationship with their business customers. In time, the demand from businesses to access new, innovative products should drive change here, but we also have to understand how to work with banks rather than against them.

We have to grow both our market and our market share. We see no reason why we can't treble our current volumes in the next few years. The service we provide is effective and excellent value, so it's mostly about raising awareness. Since 2011 we've brought the time it takes us to fund a business down from around 20 days to just a few hours. Banks have been stuck at 3-6 weeks for about 40 years.

Anil Stocker, MarketInvoice

In the 1990s, when I was working in software, we would ask two key questions about any piece of software: 'Is that a product or a feature?' Is it really the formation of a seminal company or is it just a feature of a bigger company that's going to last long enough to get bought? I look at Platform Black and MarketInvoice as features. As with the P2P lending platforms, the invoice trading platforms have to earn every new customer, where the banks have a solid customer base of borrowers. What Platform Black and MarketInvoice offer is a feature of a product.

These platforms are classic disruptors of an established market. They've come up with a better version of a product that they are offering to a group of people who could not otherwise get access to this product before. They're going to force the incumbents to change or die. These platforms are not bringing in new risk capital to the market but they are a competing distribution system, which is good for the customer and sharpens the banks' prices. This is a much clearer situation than we found in P2P lending but it suggests to us that other unobserved areas of banking may suffer a similar fate.

The advantage that Platform Black and MarketInvoice have is not sustainable because what they are doing can be done by the banks. One cannot underestimate the sheer massive capital power of the banks. Barclays Bank opens one third of all new business bank accounts in the UK and that scale means that if they wanted to put a killer product in place for their customer base and integrate it with a financial system, they could do it. Once a big bank does it, their heft and reach will enable them to succeed.

Every bank is working on something and they'll be working on debt before equity. I am confident that what the banks are devising is an a la carte offering, directly competing with MarketInvoice and Platform Black. If I'm a bank the size of Barclays, it's much easier to build a new interface because it avoids the need to integrate another platform with existing financial systems. No bank wants another piece of technology to integrate with; the bane of all financial institutions is their financial systems.

Some of the new challenger banks are probably in a better position from an IT point of view, to code into their very infrastructure this kind of a la carte invoice trading. A bank is constrained by the fact that it has decades of code running its operations and the newer banks may be better suited to deliver these. Ultimately, banks need to start thinking more like web software companies.

The simplest thing for a big bank to do is to set up a web-based interface for small business account customers, and on any given invoice on the banking system, the customer can have the option to click on 'sell invoice.' It's an Amazon one-click system. If I'm a bank and I've got a customer that wants a loan, I'm obviously going to release the debenture for my customer and potentially not release it to an alternative finance platform. Ultimately, I doubt investors will care whether it's a bank that provides the great return or an alternative finance provider; in some ways they might prefer a bank purely from a logistical perspective. If as an investor I can pull up all my accounts and move money from this account into that one, life is simpler.

MarketInvoice and Platform Black are absolutely in peril here but I think they'll succeed. Why? Because the best banks and the worst banks will try to build their own version of the platforms but the smart second-in-line banks will try to *buy* them. These alternative finance platforms will become integrated into the core banking system. Their ending is not being big; their ending is being *bought*. The good news for those companies is that they will be made wealthy from the sale. The bad news is that the integration will inevitably fail. Large corporations cannot integrate small computer systems. The revolutionary has to own the process. If the incumbent owns the process, they'll try to preserve the incumbent. This future has repeated itself over the last 50 years in technology, in every market sector.

If the banks are smart they will buy them, keep the individual brand and pump money across. If they use the alternative finance provider as a bolt-on or an additional model, it simply won't work. Likewise if they try to build their own model, it won't work. Banks always try to own everything but they could put their money to work across platforms and take a portfolio approach, which would be far more successful.

Louise Beaumont, Platform Black

CONCLUSION

Even as we write this, it's becoming clear that people are finding more novel places to be an intermediary in ways that no one has conceived of previously. This activity lends strength to our assertion that this patchwork of point solutions could in time provide a young company a seamless journey across all seed and early stages of capitalisation that obviates the need for traditional funding.

There is evidence appearing almost daily, that alternative finance is rapidly evolving. The multiple examples that we have highlighted to make our points below, are all courtesy of our friends at AltFi:

Asset Match - www.assetmatch.com - is an innovative online exchange that allows private companies to auction off shareholdings to a network of private investors.

Yet another use of the web to take on another part of banking and takes the place of a secondary venture firm that buys the distressed portfolios of those firms that want to unload. We're seeing innovative people fill in holes everywhere.

2014's fastest growing equity crowdfunding site - SyndicateRoom - has essentially co-hosted the IPO of Mill Residential REIT, the UK's first residential Real Estate Investment Trust. Mill Group's original target was £2,100,000 however, demand was high soon the raise went into overfunding and the final total was £2,225,520. In accordance with the SyndicateRoom model, £1.6m was not committed by private investors but as seed capital from the REIT's managers. SyndicateRoom will hold all funds invested within an escrow account until the REIT lists on a UK stock exchange.

The first ever IPO for an equity crowd funded business is now complete. ReWalk Robotics completed the first ever IPO for an equity crowd funded business. ReWalk – which went through multiple funding rounds on Israeli equity-based crowdfunding platform OurCrowd – is now listed on the NASDAQ.

This is certainly more evidence that equity crowdfunding is not the younger sibling of other forms of angel or institutional investment. If someone can go from crowdfunding to IPO, that's quite an astonishing jump. That's like jumping from angel funding to IPO, and that just doesn't happen.

We also see examples where the UK Government is putting money into the equity sector:

- *Crowdcube has become the recipient of £5m of government money which has been allocated by the London Co-Investment Fund alongside private investor capital, to be used for technology, digital and science-based businesses using the Crowdcube platform.*

The efficiency of the web platforms is so great that it puts the government in a position that it has never experienced before. Governments usually try to fill in gaps in the capital cycle by creating funds - a startup fund, a seed fund, a regional fund, a growth fund. Here is evidence that instead of creating these funds, the government has found a way through alternative finance platforms to outsource the distribution of that money, without needing to rely on second tier players to distribute a fund, due to the lack of a viable business model. By putting money into these alternative finance platforms, the government has solved a new problem. The developing world - where the gaps are even greater - should take note of the UK Government's use of crowdfunding platforms.

A new report from the Royal Institution of Chartered Surveyors claims that the equity crowdfunding for property platforms could cause a liquidity shock to the housing market – resulting in increased house price volatility. The RICS has speculated that equity crowd funders could inject as much as £50 billion into housing over the next 5 years.

This goes back to our core assertion that crowd funding creates new capital. In theory, you would expect that those investors had access to property plays prior to the advent of the crowd-funding platform. In actual fact

the efficiency of the web has created a level of transactional efficiency so great that you can do things in smaller units than could be done before. It permits smaller players to be on the same playing field as larger players; people who would not have been able to make a property investment before suddenly have access to buy a small portion of a larger opportunity. The RICS predicts that this new opportunity will be picked up in such volume as to impact the price of property across the entire housing market.

Facebook has allegedly been in talks with top US P2P lending sites - Lending Club and Prosper - about working out a method for its users to get loans funded via their social media network. The conversations are said to have begun several months ago and are now escalating as Facebook gets more serious about its payment strategy.

This goes back to our discussion about whether there is an alternative way to find a credit score than the bank's traditional method and the alternative finance platform's crafty algorithms. If enough of our lives are captured online, could that information give us a predictive insight into whether and how we will repay a loan? If Facebook is reaching out to Lending Club and Prosper about getting users' loans funded by the social media network, this could mean two potential things:

1. Yet another distribution channel for lending that dis-intermediates traditional lenders because it gets right to the point of the consumer
2. The very intriguing question, could Lending Club take advantage of the knowledge they gain from interacting with Facebook, to improve the quality of their decision-making and thus get further advantage over traditional lending, beyond the advantages that they already enjoy?

The CrowdDataCenter has made allegiances with Crowdfund Capital Advisors in order to gauge the level of crowdfunding activity and its impact on job creation at a national and regional level.

Our best measure of the growth of an economy is the number of new jobs created - and in fact that is the basis of how the government distributes money for economic growth (witness the Regional Growth Fund as example). The work that is being done in the US to evidence the great impact of crowd-funding on jobs in the local area - all without use of government money - suggests that the longer-term impact of the alternative finance ecosystem is to democratise opportunity geographically, meaning that just because you live in a disadvantaged area does not mean there is not pent-up capital around you waiting to be released. There is evidence now that new people are investing, that those people like to invest locally and that this investment leads to job creation. What we'll see is a recursive benefit where local people become increasingly aware of local opportunities and more local investment leads to more jobs being created. It's exactly the kind of economic growth cycle that the government has been seeking and thus becomes a 'magic bullet' - a solution to a long existing problem.

Basware - www.basware.co.uk, the e-invoicing giant - is a new entrant to the market that will launch Basware Factoring in partnership with Arrowgrass Capital. With some 60 million invoices processed in 2013, it may take no time at all for the soon-to-launch site to gain tremendous traction.

This is a company that manages invoices between companies and has just realised the potential of their captive audience. Basware are essentially a pipes and utility business that just realised that all of the data was in their pipes! They were one button - one click - away from becoming a transformational business. By partnering with Arrowgrass Capital, they have access to all the capital they need and they can now go to their huge customer base and offer them the opportunity to sell their invoices. It demonstrates that competition to the existing alternative finance platforms will come from places we least expect.

Lending to SMEs under the FLS scheme is on the decline. Recently and for the first time, the dip in the FLS figures was more than covered up by the contributions of the alternative finance scene. Alternative finance providers have now scaled to a point where they are not only addressing the SME funding gap, they are closing it. Indeed, alternative lenders not only filled the FLS void in Q3, they in fact provided small businesses with an extra £140m after the fall off in traditional lending activity had been accounted for.

In conclusion, we find it difficult to overstate the potential impact of alternative finance (both the companies that already exist and those that we can see being created) since at every junction and in every sector, across public and private sectors, alternative finance is finding a way to make an impact in ways that traditional finance does not.

The banks will continue to exist. The banks are the utility companies; they underpin all of this change. They have huge reach and resources. Although they may be slow to respond and adapt, the inherent benefit of being the main utility underpinning all of alternative finance will mean that they continue to play a role; either a subdued but significant role or, if they are smart and aggressive, an enhanced role.

The same cannot be said of the venture capitalists who look to be profoundly disrupted over the coming decades in ways that no-one can foresee exactly but the signs suggest their future does not look good. In some ways, we could assert that the venture capitalists are funding their own failure by showing such support for the fast growing companies. It's almost the peculiar nature of venture capitalists to invest in companies that will ensure their own demise.

If we look to China, with its endless proliferation of finance platforms, 1,200 alternative finance platforms exist and yet 90% failed in 2013. China, unfettered by regulation and oversight, has churn rates at 90% and no data to give a realistic indication of the market. Conversely, in a highly regulated market, there is evidence that some of the challengers to the incumbents are overstating the opportunity already, in pursuit of unwary consumers who misunderstand the nature of what they are doing.

However optimistic we are about the alternative finance sector, it's the industry that we are predicting the success of, not one individual player. This industry is not only going to succeed but to shape or destroy a lot of the traditional financial infrastructure. There is going to be failure on the way to success. Industries are built by survivors, on the bodies of those that perished. Survivor bias says that when we look back, all we can see are those that succeeded because we can't see those that failed, they are rendered invisible. Yet the successes were built on the failures - they played a crucial part.

Today we look forward. We see a number of opportunities, we are looking with optimism to see that an industry will succeed and flourish but some of the participants will fail and be forgotten when we tell the myth about how this industry grew. In fact, their failure will become a stepping-stone to the industry's metamorphosis.

The future is always unclear; yet it is also all around us, in the form of young disrupters companies that will shake the world of entrepreneurship, and thus, the whole economy to the core.