THE GROWTH OF EQUITY CROWDFUNDING IN THE UK:
SUBSTITUTIONAL OR COMPLEMENTARY TO ESTABLISHED
BUSINESS ANGEL INVESTMENT ACTIVITY?

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I would also like to thank Emma Vartolomei of www.allstreet.org who gave up her valuable time at the start of the process during autumn 2012 to advise me on potential areas of interest within the ‘FinTech’ business sector.

Lastly, I would like to put on record my gratitude to my supervisor, Sam Kamuriwo, who has provided sage advice on the structure of the document, the research approach, and revisions to make to the text at various points along the way. I always enjoy talking to Sam, especially as we usually divert towards African politics and business at some stage!

My motivation in undertaking this work was to aid understanding and encourage further thinking and research in this topic area, in the hope that it would prove useful to various interest parties including those operating crowdfunding platforms, potential or current crowd investors, entrepreneurs, academics, regulators, etc. I hope the end result goes some way towards meeting those aims.
List of Abbreviations

BA  Business Angel
CFP  Crowdfunding Platform
DD  Due Diligence
ECFP  Equity Crowdfunding Platform
F&F  Friends & Family
GDP  Gross Domestic Product
GFC  Global Financial Crisis
HNWI  High Net-Worth Individual
OBR  Office for Budget Responsibility
P2P  Peer-to-peer
SME  Small or Medium-sized Enterprise
UK  United Kingdom of Great Britain & Northern Ireland
VC  Venture Capital
Executive Summary

The purpose of this exploratory, cross-sectional, mixed methods study is to explore whether the emergence of equity crowdfunding in the UK is complementary, or substititional, to existing ‘Business Angel’ investment practices.

Equity crowdfunding is defined as:

“the offering of shares or securities in private businesses to the public via an online platform” (Collins & Pierrakis 2012).

Business Angels are defined as:

“High net-worth individuals (‘HNWIs’) investing their own capital in unquoted companies not associated with family and friends.” (Mason & Harrison 2009).

To pursue this research question, the following associated research objectives were identified:

1. To determine whether ‘crowd money’ has the potential to offer a genuinely new supply of risk capital for small unquoted companies in the UK.

2. To explore whether Business Angels are using equity crowdfunding platforms (‘ECFPs’) to channel at least a portion of their investable capital to unquoted companies; and if so, what their motivations for doing so are.

3. To examine whether Business Angels (‘BAs’) and ‘the crowd’ co-investing alongside each other on ECFPs helps plug a larger portion of the equity gap than that addressed by traditional BA investment.

The study employs a pragmatic, mixed methods approach: although the nature of the research meant it was largely inductive, conducted using qualitative methods, it was augmented by some quantitative data, and the literature review enabled tentative theoretical positions, on deductive lines, to be posited prior to primary data collection. The research philosophy adopted employed techniques selected to best meet the needs and purpose of the work within the confines of the time and resources available to the author.
This methodology accommodated both the inherent lack of disclosure and commercial confidentiality surrounding BAs’ investment activity, and the fact that while ECFP operators were happy to be interviewed, they were reluctant to release large amounts of quantitative data surrounding equity investments they had facilitated.

The study was undertaken following a review of the existing academic and industry literature on the emergence of equity crowdfunding and BA investment practices, concentrating on the UK. Aside from a limited amount of quantitative data from two ECFPs, primary data were collected using semi-structured interviews with a range of informed and experienced interested parties in this area, including BAs, ECFP operators, academics, lobbyists for the crowdfunding industry, and others.

The study suggests that while the majority of individual investments facilitated by equity crowdfunding platforms are indeed a new source of risk capital for small unquoted companies, it also identifies that approximately 40% of the absolute quantum of investment that such platforms are facilitating in the UK are comprised of larger amounts (i.e., those above £5,000) more akin to those made by Business Angels.

This suggests that BAs are indeed using platforms for at least a portion of their investable capital, and that awareness of ECFPs is high amongst the BA community in the UK, who appear to be using platforms to:

i) diversify their investment risk across a wider range of small-scale investments, and

ii) streamline deal flow by identifying potential high-growth companies quickly

BAs can thus use platforms to identify opportunities to target offline for further transactions. They can also leverage the ‘passive capital’ of crowd investors to delay or obviate the need for VC involvement in subsequent funding rounds, thus enabling existing shareholders to crystallise more of the value created by investee businesses.

The emergent and fast-developing nature of equity crowdfunding and the paucity of relevant quantitative data means that it is probably too early to come to a definitive conclusion on whether BAs investing alongside crowd investors can help address
larger portions of the existing equity gaps for small companies, although there are indications this could indeed be the case as the two categories of investor often appear to target different portions of the risk/reward profile for unquoted company investments.

The study provides clear pointers, on the balance of evidence offered, that equity crowdfunding is indeed largely complementary to existing BA investment practices because:

a) ECFPs are drawing in a new source of funding to informal private equity,

b) Although ECFPs appear to be diverting some finite BA capital to online deals alongside crowd investors (and away from traditional syndication with other BAs or classes of investor), they simultaneously provide BAs with the potential to leverage crowd investors’ ‘passive’ capital

This conclusion must be set against the fact that ECFPs provide competition for BAs as a source of funds for some entrepreneurs. The study concludes that this competition is primarily substitutional only to those BAs who cannot provide the valuable expertise, networks and mentoring alongside their capital. However, from the overall perspective of entrepreneurial finance in the UK, this represents a positive change, decreasing the cost of the supply of capital and increasing its efficiency.

The study also suggests that the extent to which crowd investors and BAs are in competition for similar investment targets depends on a range of factors that may include the following:

- Whether the amount sought is in the typical BA (or BA syndicate) ‘sweet spot’
- Whether the industry sector is one that BAs tend to favour
- Whether the knowledge required in that industry is ‘deep and niche’, or widespread and easy to acquire
- Whether the existing shareholding structure would likely discourage BAs
Equity crowdfunding is an exciting and fast-evolving area of business finance. The UK, with its legacy of expertise in financial and professional services and its prominence in global markets and a relatively fluid current regulatory regime, is well-placed to become a leader in the field. Equity crowdfunding provides an opportunity for much-needed diversification in the comparatively narrow choice of funding sources available to UK unquoted companies, when set against that available to their peers in other ‘advanced’ economies.

Against this macro-economic backdrop, the study could lead on to many potential pieces of further academic and industry research. These include:

- The ability of ECFPs to provide meaningful additional investment into the UK’s small businesses.
- The financial returns achieved for shareholders by businesses funded by ‘open’ and ‘restrictive’ ECFPs respectively.
- The potential for the emergence of a secondary market for unquoted companies.
- The theory that equity crowdfunding platforms will drive ‘low quality’ BAs, with limited ability to add value to their investee businesses, out of the market.
- The potential dependence of the UK equity crowdfunding model on government tax incentivisation schemes such as the SEIS and EIS.

The study confirms that the emergence of equity crowdfunding is potentially a valuable source of new risk capital for UK businesses, and consequently could be of genuine if limited benefit in spurring economic growth. Those benefits exist for entrepreneurs, crowd investors and BAs alike in working together to leverage the power of the phenomenon in various ways, providing the government’s regulatory response, which will be critical in determining the progress of equity crowdfunding as an emergent business finance phenomenon, is sensible, balanced and measured.

Keywords: equity crowdfunding, business angels, angel investment, seed capital, start-up funding, early-stage business development, entrepreneurial finance, UK
1. Introduction

The objective of this research is to explore the emergence of equity crowdfunding in the UK and investigate whether it possesses the potential to ultimately become complementary, or substitional, to existing BA investment practices.

The UK is not alone in experiencing continued fallout from the GFC. However, the highly concentrated nature of the country’s banking sector and the comparative reliance of the UK’s small business sector on bank lending as the main source of finance, relative to other advanced economies, has hindered business development, and consequently economic growth, certainly since 2008 and arguably long before that (BIS 2012). Both the restructuring of banks’ balance sheets following the impact of huge losses incurred during the GFC, and the increased capital requirements resulting from the regulatory response to the crisis, have severely curtailed the supply of debt finance for the UK’s small businesses.

This is significant, as small businesses provide an important supply of new high-growth companies that in turn generate a disproportionate share of new employment opportunities and economic growth (NESTA 2009). A more diverse and competitive finance market for small and growing businesses will thus aid economic efficiency and future growth (BIS 2012).

1.1 Business Angels and Equity Crowdfunding

Set against this macro-economic backdrop, the existing investment activities of BAs are an important supply of risk capital to potentially high-growth companies in the UK, particularly in the wake of VC firms moving up the private equity ‘funding escalator’ to concentrate on larger, later-stage and lower risk investment opportunities. Indeed, there are signs that BAs, increasingly working together in ‘syndicates’, are moving in a similar direction.

Meanwhile, the emergence over approximately the last 10 years of ‘Web 2.0’ interactive digital communication via the internet, characterised by social media, has enabled the finance sector to start capitalising on the opportunities this technology provides, based on reduced data-storage and transaction costs and increased efficiency in resource-allocation, market choice and competition for entrepreneurs and investors alike.
So-called ‘FinTech’ firms, encompassing crowdfunding platforms, peer-to-peer lenders and online currency exchanges are in the vanguard of this process. The UK government is alive to the inherent potential to increase the supply of finance to small business, and the Breedon review for BIS\(^1\) (2012) highlighted this.

Within this movement, crowdfunding is a novel and transformative way of channelling investment into small businesses. Equity crowdfunding affords ordinary people the chance to invest capital in return for an equity stake in an unquoted company, providing entrepreneurs with the means to raise seed and early-stage growth capital. This helps validate their value proposition and market potential (Collins & Pierrakis 2012). The UK market for ECFPs is currently growing and diversifying, with different variations of a similar business model evolving within a comparatively fluid regulatory environment.

Equity crowdfunding and traditional BA informal private equity activity may thus be targeting very similar types of investment opportunities, and as such, may ultimately prove to be complementary to, or indeed in competition with, each other. ECFPs may thus provide either a synergetic fillip, or a substitutional threat, to BA investment practices in the UK.

This research therefore explores whether the emergence of equity crowdfunding in the UK is complementary, or substitutional, to existing ‘Business Angel’ investment practices.

\textbf{1.2 Research Objectives}

To pursue this research question, the following associated research objectives were identified:

1. To determine whether ‘crowd money’ invested through ECFPs has the potential to offer a genuinely new supply of risk capital for small unquoted companies in the UK.

\(^1\) ‘BIS’ is the UK government Department for Business, Innovation & Skills.
2. To explore whether BAs are using ECFPs to channel at least a portion of their investable capital to unquoted companies; and if so, what their motivations for doing so are.

3. To examine whether BAs and 'the crowd' co-investing alongside each other on ECFPs help plug a larger portion of the equity gap than that addressed by traditional BA investment.

1.3 Research Rationale

From an axiological perspective, the motivation for this study stemmed from a desire to study a topical, evolving area of business finance, and to explore an area of opportunity for UK businesses to access badly-needed risk capital to fund innovation, economic growth and job creation, at a time of hardship and austerity for many.

The aim is to produce useful research for those involved in using, facilitating, regulating or researching crowdfunding, sharing the results of that research as widely as possible and benefitting the maximum number of people, while respecting commercial ethics and confidentiality.

The study is informed by the Executive MBA programme I have pursued for the last two years at Cass Business School, London, and specifically on some of the ideas explored during modules focussing on Strategic Fast Track Venturing, New Venture Creation, Corporate Finance, Strategy and Marketing.

1.4 Research Structure

This paper is structured as follows:

**Literature Review**

This examines the current macro-economic context for small business finance in the UK and highlights the importance of high-growth firms for the UK economy. It then looks at BA investment practices and compares these to other players in the private equity marketplace, principally VC firms. The emergence of crowdfunding in general, and equity crowdfunding in particular, are examined. The UK government's efforts to stimulate financing for small businesses are briefly discussed, before the key
findings from the review are drawn out to help inform the design of the research undertaken.

**Project Design**

This sets out the research philosophy and methodology selected for the project, taking into account the limitations implicit in the topic choice and the time and resources available to the author.

**Data Analysis**

This discusses the key themes flowing from analysis of the data, qualitative and quantitative, collected from the participants and of key pieces of secondary data.

**Conclusions & Recommendations**

This summarises the main conclusions drawn from the research relating to the research question and associated objectives, and sets out recommendations for further areas of useful associated research.
2. Literature Review

2.1 Context for Research

This review seeks to critically summarise and synthesise existing research to aid understanding of the stated research question and associated objectives, and thus inform the subsequent project design, prior to the gathering and analysis of data.

To understand the potential of equity crowdfunding in the UK and how it interfaces with existing BA investment practices, it is first important to frame the economic context for UK entrepreneurial finance following the GFC.

The importance of high-growth firms for economic growth and development are examined, as is the nature of the ‘equity gap’ for unquoted companies.

Key characteristics of BA investment activity in the UK are summarised and analysed alongside how these may differ from those employed by larger VC firms. Trends in investment practices employed by both groups, and how these have influenced the development of ‘equity gap(s)’, are also explored.

Thereafter, a review of the emergent worldwide crowdfunding phenomenon, and of UK equity crowdfunding in particular, follows. The UK’s regulatory climate and its influence on facilitating progress in this emergent sector are examined.

Additionally, some key measures the UK government has adopted to facilitate investment in SMEs are summarised.

To conclude, characteristics of equity crowdfunding gleaned from the review are set out alongside those of BA and VC investment activity.

Material was gathered to inform this review from a variety of sources, including academic journals and working papers, industry research reports, press articles, and industry documents and presentations.

2.2 UK business funding: economic context since the GFC

While the UK remains one of the world’s most sophisticated financial centres, UK finance does not fully serve the needs of SMEs, which are heavily reliant on bank
lending. A more diverse finance market promotes competition, reduces costs and helps create a more resilient financial infrastructure (BIS 2012).

Other OECD countries, notably the US, offer SMEs a more diverse range of bank and non-bank financing options, and a more efficient marketplace. In particular, there is significant underutilisation of external equity by UK SMEs: only 3% access it, compared with 55% using credit card funding (BIS 2012).

Gross lending to the UK non-financial private sector peaked in December 2008, declining 38% to £475 billion per annum by March 2013 (BIS 2012). Bank lending declined as repayments of existing debt increased: so-called ‘deleveraging’. Commercial lending, which prior to the GFC increased in line with GDP growth has stalled since, with overall credit conditions remaining extremely tight since Q4 of 2008 (BIS 2012). SME lending has fallen almost 25% in real terms since 2009 and is still around 10% lower than in 2006, while loan rejection rates for UK SMEs in 2011 were twice those of France or Germany (BIS 2013).

Studies show that low SME demand for finance stems from weak business confidence (BIS 2012), unsurprising when UK GDP growth averaged 1.0% between 2010 and 2012, is forecast to remain below trend to 2018 (averaging only 1.8% between 2012 and 2016), with productivity currently shrinking (OBR 2013).

2 A 2010 BIS survey of UK SMEs found that 66% planned to fund expansion through organic growth alone (BIS, 2012), with a separate survey finding that only 41% reported using any external finance (smefinancemonitor.co.uk, 2012).

3 Bank of England statistical database Table C ‘Monthly amounts outstanding of UK resident monetary financial institutions’ sterling and all foreign currency net lending to non-financial corporations’ (£ millions, not seasonally adjusted).

4 Excluding lending to the commercial property and construction sectors (BIS 2012).

5 Taken from the ‘Credit Conditions Indicator’ comprising a range of data on the use of business financing including Bank of England, Office for National Statistics and other survey data; prepared by the BIS Taskforce on alternative debt markets (BIS, 2012).

6 24% of UK SMEs applying for an overdraft and 34% applying for a loan in 2011 ended the process without one (BIS 2013).
Business investment will play a crucial part in fostering gradual economic recovery (OBR 2013). Increased availability of risk capital for SMEs is recognised as having a knock-on effect for the growth of employment, productivity and GDP (Harrison et al. 2010). However, UK SMEs invest proportionally less in tangible goods than those of any other large EU economy (BIS 2013).

Increasingly risk-averse banking makes such investment harder: loan facilities have shorter average maturity periods and take longer to approve, while collateral requirements and fees have both increased. Banks have actively strengthened their balance sheets, reducing loans outstanding to meet revised capital requirements such as ‘Basel III’ (Slovik, P. & Cournéde 2011). Banks view lending to SMEs on a more conservative ‘capital gearing’ basis than private equity investors, who place as much emphasis on the entrepreneurs involved as on the business plan and proposition (Mason & Stark 2004).

The short track record of many entrepreneurs seeking start-up finance, coupled with the comparatively low margins on SME lending and the lack of upside participation enjoyed by debt holders, compared with contributors of private equity, all exacerbate the difficulty of UK start-ups sourcing bank lending (Mason & Stark 2004). Securing loans for SMEs is thus both more costly\(^7\) and more difficult than prior to the GFC (BIS 2012).

Even though SME bad debts and insolvencies have remained modest in a historical context, the retrenchment in SME finance appears particularly harsh in the UK after adjusting for risk and other factors (BIS 2012)\(^8\). Relative to other advanced economies, the UK’s highly concentrated banking sector and under-developed private bond market are further contributory factors (Posen 2012). Five UK banks

\(^7\) The spread on new SME variable rate loans over base rates has also increased (Posen 2012).

\(^8\) The BIS Taskforce on alternative debt markets commissioned research by Warwick Business School analysing Eurostat data (http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics). This concluded the UK had one of the highest loan rejection rates in Europe and that the decrease in loans to UK SMEs had been sharper than elsewhere.
hold 90% of the SME banking market; as these five institutions have retrenched, UK SMEs have fewer alternatives than many of their developed-economy counterparts (BIS 2013).

The OBR forecasts UK business will invest £127 billion between 2013 and 2016 (OBR 2013). Using previous recoveries from recession as a guide, credit supply should broadly track the recovery in GDP: SMEs will therefore require between £26 billion and £59 billion of debt and equity funding, in excess of provision through organic growth, over this period (BIS, 2012)\(^9\).

Government analysis (BIS 2013) suggests the following types of firms are particularly underserved for finance:

- SMEs of all sizes that seek finance to expand their business or to develop new products and services;
- SMEs that lack the collateral to take out a secured loan;
- SMEs at the smaller end of the size scale;
- ‘Young SMEs’, in existence for less than five years

### 2.3 The importance of high-growth firms to economic development

The importance of funding for companies whose growth stimulates innovation, employment and economic development is widely recognised (Posen 2012, Wiltbank 2009). A small proportion of innovative, high-growth companies generate a disproportionately large amount of employment and productivity for the UK economy (NESTA 2009)\(^10\).

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\(^9\) The range supplied is a factor of whether the ‘debt overhang’ of excessive lending from before the GFC is taken into consideration in calculating funding requirements

\(^10\) The 6% of firms, whether promising start-ups or existing firms undergoing transformational change, that are classed as ‘high-growth’ consistently generated around 40%-50% of all new UK jobs between 2002 and 2010 (NESTA, 2011), while the UK benefits from having a comparatively high proportion of high-growth firms amongst OECD countries: higher even than the US (NESTA, 2009).
These companies have comparatively large capital requirements and harsh credit ratings\(^{11}\) but once established, prove themselves more resilient during downturns and less prone to insolvency, evidenced by the consistent proportion of high-growth UK firms remaining in operation between 2002 and 2010 (Pierrakis & Mason 2008, NESTA 2011). Their frequent need for long-term finance to invest in intangible assets is often inappropriate for bank lending: a blend of available debt and equity financing options is therefore vital (BIS 2013).

Identifying these firms for lucrative investment opportunities is clearly difficult: NESTA data suggest that only 40% of UK firms are still in operation after 10 years, and of these only 10% (i.e., 4% of the original cohort) achieve significant growth in employment and revenues (Collins & Pierrakis 2012).

Nevertheless, while the dearth of available finance for non-financial firms is long recognised (Harrison et al, 2010)\(^{12}\), facilitating improved access to debt and equity finance for potentially high-growth firms is a vital component in stimulating the UK’s economic recovery.

### 2.4 UK entrepreneurial finance and the ‘equity gap’

The following table summarises the accepted stages of small business development:

<table>
<thead>
<tr>
<th>Business Development Stage</th>
<th>Description of finance requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed</td>
<td>To research, assess and develop an initial concept, usually before the business is formally created</td>
</tr>
<tr>
<td>Start-up</td>
<td>For product development and initial marketing activities</td>
</tr>
<tr>
<td>Early stage</td>
<td>Following completion of product development, to initiate commercial manufacturing and sales campaigns, prior to profitability</td>
</tr>
<tr>
<td>Sustained growth</td>
<td>Further growth following the achievement of profitability</td>
</tr>
</tbody>
</table>

(Source: Pierrakis & Mason, 2008)

\(^{11}\) This is generally due to their greater cashflow requirements and longer lead times to profitability (NESTA 2011).

\(^{12}\) Official recognition dates back at least as far as the 1931 MacMillan Report (Harrison et al. 2010).
Many seed projects source initial funding from family and friends (‘F&F’). Alongside ‘bootstrapping’\textsuperscript{13}, UK firms often then finance themselves to early-stage growth through bank loans and, where available, overdrafts. High-growth potential businesses, usually applying technological innovation or requiring large initial cash flows for research and development costs, often require greater funds from sources of private equity (Mason & Harrison 2004).

The UK’s private equity market is Europe’s largest, representing one third of deal value (Pierrakis & Mason 2008). The main two sources of this funding are Venture Capital (‘VC’) funds or Business Angels (‘BAs’). Many entrepreneurs benefit from the expertise and experience of VC and BA backers (Harrison et al. 2010), with BAs in both the US and Europe holding total equity estimated at around ten times the value held by ‘formal’ VC firms (Johson & Sohl 2012, Lange et al. 2003). The UK’s BA marketplace is Europe’s largest and most developed (Aernoudt & Erikson 2002), with BAs investing around 1.2\% of GDP in early-stage firms (Zu Knyphausen-Aufsess & Westphal 2008).

BAs are HNWIs investing their own capital in unquoted companies not associated with family and friends (Mason & Harrison 2009) and have long invested in commercial opportunities\textsuperscript{14}. Sitting between F&F and VC in the private equity investment marketplace, BAs usually provide start-up or early-stage finance to potentially high-growth companies through ordinary share capital (Mason & Harrison 2010)\textsuperscript{15}.

\textsuperscript{13} ‘Bootstrapping’ can be described as gaining access to the means to grow a business inventively, for example obtaining funds outside banks or external equity, or access to resources without using finance, through borrowing or sharing premises or equipment, hiring temporary staff, etc. (Jones & Jayawarna 2010).

\textsuperscript{14} For example, ‘angel-style investment’ helped fund both Alexander Graham-Bell’s invention of the telephone in 1874 and the Ford car company in the early 20\textsuperscript{th} century (Lange et al. 2003).

\textsuperscript{15} Investee businesses generally have less than 10 employees, and operate in sectors such as biotechnology, technology, medical and healthcare due to the higher growth and value creation potential in these sectors (Mason & Harrison, 2010).
While accurate estimates remain difficult given BAs’ propensity to maintain commercial confidentiality and that their activities are often invisible within wider economic data, (Wiltbank 2009, Mason & Harrison 2009/2010), the number of BAs in the UK is estimated at between 20,000 and 40,000 (Wiltbank 2009, Mason & Harrison 2002). The average UK BA is male\textsuperscript{16} with a tertiary education, over 50 years of age, and enacts at least two deals every five years, investing around 10% of their wealth this way, (Wiltbank 2009).

BAs tend to be cashed-out entrepreneurs or retired corporate executives (Wiltbank 2009, Ramadani 2009, Lange et al. 2003). As such they often take an active role in investee businesses, either as non-executive directors or even sometimes through operational involvement (Mason & Harrison 2008).

VCs usually run fixed-life investment funds sourced from banks, pension funds, other institutions, corporates or HNWIs. They pursue high financial returns for investors through successful exits from private companies (Mason & Harrison 2004)\textsuperscript{17}.

Studies show that VC investment helps businesses grow faster and sustain higher performance in the long term, particularly those in high-growth disruptive sectors (Pierrakis & Mason 2008, NESTA 2009a). VC funds can thus aid both entrepreneurs and BAs in creating value and in realising that value through exit transactions.

While the UK VC market can still be characterised as ‘thin’ compared to the US (NESTA, 2009a), VC firms in the US and Europe have recently ‘upscaled’: investing in larger and later-stage businesses. The growing quantum of investable funds and

\textsuperscript{16} Mason & Harrision (2010) conducted a comprehensive survey of UK BAs in which only 8% were women.

\textsuperscript{17} A successful exit could be a trade sale to another private holder or floatation on a public exchange via an ‘initial public offering’ (IPO). Variations on these themes could be a private sale to an existing (or incoming) management team backed by financial institutions or banks, so-called ‘management buy-outs’ (MBOs) or ‘management buy-ins’ (MBIs) respectively.
the largely fixed costs of due diligence to screen, select and monitor completed deals have driven this trend (Pierrakis & Mason 2008)\textsuperscript{18}.

Additionally, post-GFC macro-economic conditions have generated fewer attractive investment opportunities, thus reducing the exit possibilities for BAs and increasing the demands upon them from existing investees in the form of capital and time required (NESTA 2009a)\textsuperscript{19}. Alongside declining bank lending to SMEs, demand for BA investment has therefore increased relative to other funding sources (Mason & Harrison 2008 & 2010, Wiltbank 2009, Pierrakis & Mason 2008).

This has widened the existing so-called ‘equity gap’ for firms seeking seed or start-up funding in excess of that which F&F funding or bank lending currently offer, but which are not developed enough to attract VC funds for accelerated and sustained growth\textsuperscript{20}. Alongside BAs, the crowdfunding sector is emerging as an alternative funding source.

BAs have partly risen to the challenge, growing in relative importance to other capital sources\textsuperscript{21} and displacing ‘bootstrapping’ or F&F funding to become the main source of seed and early-stage funding below £2 million in both the UK and US private equity marketplaces (Johnson & Sole 2012).

\textsuperscript{18} The high risks of early-stage investment in nascent concepts and inexperienced management teams accentuate this trend, leading VCs to often conclude the less volatile risk-reward profiles of later-stage investments are preferable. Additionally, the trend towards MBOs & MBIs, with the relatively large average size of private funds involved, is another driving force towards larger and later stage investments in general (Pierrakis & Mason, 2008).

\textsuperscript{19} Most importantly, by increasing the need for ‘follow-on’ funding of additional equity injections into existing investee businesses.

\textsuperscript{20} UK government reports suggest the equity gap is most pronounced for investments between £250k and £5m due to fixed DD costs (BIS 2013).

\textsuperscript{21} One estimate puts BAs as contributing around 12% of the total investment into SMEs (Mason & Harrison, 2008).
Figure 1: The private equity ‘funding escalator’

This has mainly been achieved through constructing larger syndicates (Mason & Harrison 2010), frequently participating in multiple rounds and leveraging each other’s capital (NESTA 2009a, Mason & Harrison 2010). Indeed, this trend may in turn be creating a ‘second equity gap’ at the foot of the funding ladder for investments up to £50,000 (Harrison et al. 2010).

While BA co-investment alongside public-sector VC funds has partially helped address the equity gap (Mason & Harrison 2009), with BAs now investing an estimated £1 billion per annum in the UK (Wiltbank 2009), the quantum of BA money available is insufficient (Harrison et al. 2010) and a marked equity gap remains for growth-oriented firms seeking more than £250,000 (NESTA 2009a).

2.5 Business Angel investment characteristics
The risk of failure for BA investments is significant, with many factors in a firm’s ‘success mix’ 22 often remaining unproven. 56% of exits in a recent study of UK BA investments failed to return capital (Wiltbank 2009).

22 For example pricing strategies, talent recruitment and the building and maintenance of customer relationships (Wiltbank 2009).
The following table characterises different categories of Angel investor by activity, together with the diversity of their motivations for investing:

### Table 2: Angel investor categories

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘Lotto Angels’</td>
<td>Limited managerial/entrepreneurial experience, less demanding on returns, use the media a lot for information, not often operationally involved, usually invest alone.</td>
</tr>
<tr>
<td>‘Trader Angels’</td>
<td>Very active, (3-4 investments every 5 years), limited managerial/entrepreneurial experience, very demanding on returns, not operationally involved and have an investment horizon &lt;3 years.</td>
</tr>
<tr>
<td>‘Analyst Angels’</td>
<td>Low level of activity, considerable managerial/entrepreneurial experience, use friends and colleague networks a lot, invest regionally, and have an investment horizon &lt;3 years.</td>
</tr>
<tr>
<td>‘Real’ Business Angels</td>
<td>Very high investment activity (averaging 7 investments in 3 years), extensive managerial/entrepreneurial experience, invest alongside other informal investors, function as leaders. Personal/Business networks very useful, longer investment horizon, active involvement in companies.</td>
</tr>
</tbody>
</table>

**Investment Motivations (descending order of importance)**
- Personal satisfaction from involvement in an entrepreneurial business
- Growth potential of capital investment
- Having fun
- Tax incentives
- Supporting the new generation of entrepreneurs
- Supporting the production of goods and services useful for society
- Helping friends to set up businesses
- Building a good impression and reputation in the community
- Other non-financial motives

Source: Ramadani (2009)

While the UK market is under-developed relative to the US (where BA investment per capita is 3.5 times greater), BA involvement in early-stage UK private equity deals increased in number from 16% in 2000 to 41% in 2007 (Pierrakis & Mason 2008), with around half of BAs’ investments in pre-revenue businesses (Wiltbank 2009).23

The average return from a UK BA investment is 2.2 times money over 3.6 years (Wiltbank 2009)24, lower than in the US where the corresponding figures are 2.6

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23 This 50% is split between 15% as seed (or ‘concept’) stage businesses, and 35% as start-up stage firms.

24 This is equivalent to a ‘gross IRR’ (i.e. gross of the costs of sourcing and monitoring investments) of 22% (Wiltbank 2009).
times money over 3.5 years (Wiltbank & Boeker 2007)\textsuperscript{25}. Successful UK exits also take longer to realise, with returns of 10 times money averaging 8 years to realise (Wiltbank 2009).

Returns are not normally distributed: a small minority of investment exits produce the vast majority of cash returned in the UK\textsuperscript{26}. The probability that the average UK BA portfolio is ‘in the black’ is around 60%, while over half of investments yield a loss, often an entire loss (Wiltbank 2009).

The median amount invested in total by a UK BA is around £240,000 across 5 or 6 investments (Wiltbank 2009). Most deals involving BAs provide between £50,000 and £2 million of funding, although BAs typically would only provide between 25% and 50% of this alongside other classes of investor such as VC funds (Mason & Harrison 2010)\textsuperscript{27}.

While luck plays its part, investing in one’s own area of expertise, conducting proper due diligence, interacting meaningfully with investee businesses and pursuing follow-on investments on a measured basis\textsuperscript{28} are all connected to enhanced BA investment returns (Wiltbank 2009)\textsuperscript{29}.

\textsuperscript{25} In 2007, it is estimated there were around 250,000 BAs in the US investing around $25 billion annually in over 50,000 new or growing ventures.

\textsuperscript{26} 9\% of exits produced 80\% of the cash returned at multiples of over 10 times money, while 35\% of investments made solid returns of between 1 and 5 times money (Wiltbank 2009).

\textsuperscript{27} In a 2009 survey of UK BAs, 83\% of investments were made with co-investors, with two thirds of these being other BAs (Wiltbank, 2009).

\textsuperscript{28} Follow-on funding refers to participation in rounds of investment subsequent to the ‘series A’ or initial external investment in private business, often sourced from Business Angels.

\textsuperscript{29} The UK BAs who had founded the most businesses themselves, who had some relevant industry experience to their investments, who did more than 20 hours of due diligence and who contributed board involvement yielded superior returns (Wiltbank, 2009).
2.6 Business Angel networks and syndication

The visible BA marketplace is dominated by Business Angel Networks (‘BANs’), who provide a range of services, including introductions between entrepreneurs and investors, advising businesses on being ‘investment-ready’, and facilitating formal and informal syndicates of BAs who invest together (Mason & Harrison 2011). BANs are by necessity more visible than ‘lone Angels’. They can source opportunities more effectively, reduce transaction costs, spread risk and facilitate more effective investment management (Paul & Whittam 2010). BANs are highly selective, with around 8% of business plans received being presented to members and only 2.5% actually receiving funding (Mason & Harrison 2010).

While BANs vary in the quality of the investments they source and the value they add for entrepreneurs and investors alike (Lange et al. 2003), the power of networks in facilitating such business connections is widely acknowledged (Steiner & Greenwood 2000).

Typically, BANs source income through a mixture of fees from entrepreneurs and investors, sponsorship and some grant funding (Mason & Harrison 2010). Some BANs also take a success fee of around 5% of funds raised, and thus track deal flow more assiduously, although this model of income generation is waning now, arguably partly due to the rise of ECFPs in the UK who can showcase a much wider range of potential investments.

Since the 1990s there has been considerable consolidation in the UK BAN marketplace (Mason & Harrison 2009/2010). Co-investment activity between private and public sector equity funds increased during the early 21st century, with

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30 The number of BAs operating through Business Angel Networks (‘BANs’) is estimated at between 4,000 and 6,000 (Mason & Harrison, 2011).

31 The Scottish marketplace especially is dominated by one player, LINC Scotland, a super-network that has co-invested widely alongside the public sector Scottish Co-Investment Fund (Mason & Harrison 2009/2010).
BANs and syndicates participating in this trend alongside VC funds (Pierrakis & Mason 2008)\textsuperscript{32}.

\textbf{2.7 Relationship between VC firms and BAs in the UK}

The relationship between BAs and VCs is complex and can be complementary or substitutable (Chahine et al. 2007).

VC investment in ‘follow-on’ funding rounds has traditionally provided BA-supported firms with additional investment, and thus BAs with both a potential exit route and a source of liquidity, freeing up capital for re-investment. BAs and VCs are also a mutual source of deal referral (Mason & Harrison 2008), with suggestions that the level of entrepreneurial activity in a particular economy is linked to the extent of their complementary activity (Burke et al. 2010).

Co-investment between VCs and BAs remains relatively common in the UK. However, the growing quantum of VC investments and the increasingly onerous terms and conditions often associated with them have created increasing friction between the two groups, which often target differing timescales to exit (Mason & Harrison 2008). VCs place more emphasis on earning healthy portfolio management fees, raising future portfolio funds and the potential to take investees public, while BAs’ interests are arguably more closely aligned with management than other pre-IPO shareholders (Johnson & Sohl 2012).

Both BAs and VCs place great emphasis on the perceived qualities of entrepreneurs seeking finance (Clark 2008), although there is some evidence that VCs emphasise market risk around value proposition more than BAs, who focus more on agency risk around the entrepreneurs in question (Mason & Stark 2004, Chahine et al. 2007). The costs of sourcing and screening deals and the high risk such investments entail mean that both investor categories require high returns to justify their time and capital. As a result, only potentially high-growth companies are regarded as serious targets by either group (Collins & Pierrakis 2012).

\textsuperscript{32} The Angel Co-Fund is the latest and most high-profile attempt at public-private co-investment working specifically with Business Angels: \url{http://www.angelcofund.co.uk/}
Studies suggest that BAs are often as motivated by the satisfaction of contributing to investee businesses through strategic advice, mentoring and aiding resource acquisition (Macht 2011) as they are by securing good financial returns, compared to VCs who are highly motivated to generate good financial returns for their own investors (Mason & Stark 2004).

BAs lack the resources of VC funds to undertake exhaustive due diligence and typically invest through comparatively simple contractual arrangements, relying instead on post-investment involvement to influence business conduct and strategy (Harrison et al. 2010). Whilst both BAs and VCs have a catalytic effect on business creation and growth, the key differences between BAs and VCs are summarised in the table below:\(^{33}\):

\(^{33}\) The summary table concentrates, where relevant, on the UK market.
**Table 3: Comparison of BA and VC investment characteristics**

<table>
<thead>
<tr>
<th>Differentiation Factor</th>
<th>Venture Capital Firms</th>
<th>Business Angel Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Source of capital</strong></td>
<td>External capital supplied by institutions and high net-worth individuals to VC fund managers on the strength of their reputation and access to opportunities</td>
<td>Their own capital, often accumulated as a result of their own cashed-out entrepreneurial activities, or earned wealth through corporate life</td>
</tr>
<tr>
<td><strong>Asset Managers</strong></td>
<td>VC fund managers</td>
<td>The BA him/herself, often working very closely with the entrepreneur or management team concerned</td>
</tr>
<tr>
<td><strong>Remuneration</strong></td>
<td>Annual management fee (percentage of fund) averaging c. 2% and bonus fees (percentage of fund surplus)</td>
<td>Capital gain on successful exit from the investment (i.e. through trade disposal of company, or floatation on quoted exchange: Initial Public Offering, or IPO)</td>
</tr>
<tr>
<td><strong>Investment motivation(s)</strong></td>
<td>Overwhelmingly purely financial</td>
<td>More mixed: incorporating financial returns with non-financial motivations</td>
</tr>
<tr>
<td><strong>Due Diligence Practice</strong></td>
<td>Greater resources afford weeks of intensive due diligence work from VC firm managers, staff and advisors</td>
<td>Time and cost constraints limit this to days per investment, usually below 100 hours (Wiltbank, 2009)</td>
</tr>
<tr>
<td><strong>Investment Size</strong></td>
<td>VC funds typically these days invest a minimum of around £2 million</td>
<td>£42,000 average for UK individual investors, median total invested £220,000 per investor.</td>
</tr>
<tr>
<td><strong>Usual opportunity referral sources</strong></td>
<td>Businesses self-referring, Business Angels, personal networks</td>
<td>Businesses self-referring, Business Angels, Venture Capitalists, personal networks</td>
</tr>
<tr>
<td><strong>Co-investment Trend</strong></td>
<td>Can invest alongside Business Angels (usually in follow-on funding rounds)</td>
<td>Often investing £500k-£1m + through BA syndicates (Wiltbank, 2009), or alongside public sector funds. VC firms often invest in the same firms at a later date, if successful.</td>
</tr>
<tr>
<td><strong>Business Development Stage</strong></td>
<td>Early-stage or early-growth</td>
<td>Start-up or early-stage</td>
</tr>
<tr>
<td><strong>Corporate Investment Structure</strong></td>
<td>Usually through a fixed term investment fund in the form of a formal Limited Partnership (LP)</td>
<td>Usually under the BA’s own corporate investment vehicle, or from personal funds</td>
</tr>
<tr>
<td><strong>Statutory/Regulatory Reporting Requirements</strong></td>
<td>Formal reporting requirements under FSA and Government legislation and regulation</td>
<td>No formal reporting requirements outside of investee firms accounting and audit requirements</td>
</tr>
<tr>
<td><strong>Holding Period</strong></td>
<td>Usually target a 10 year fund life with holding periods for business within this fund of between 3 and 5 years on average (NESTA 2009a, Lange et al., 2003).</td>
<td>Average around 4 years (Wiltbank, 2009)</td>
</tr>
<tr>
<td><strong>Follow-on investment patterns</strong></td>
<td>Capacity for follow-on funding considerable if required and viewed as appropriate</td>
<td>Capacity for follow-on funding limited, although growing with larger syndication</td>
</tr>
<tr>
<td><strong>Average Returns</strong></td>
<td>VC funds between 1998 and 2005 returned 1.0 times money equating to negative (1.21%) net IRR (after management costs and charges) (Lerner et al. 2011)</td>
<td>2.2 times money over 3.6 years, approximating to 22% gross IRR (before deduction for management time and associated costs).</td>
</tr>
<tr>
<td><strong>Geographic Diversification</strong></td>
<td>VC funds tend to invest predominantly close to their headquarters, which in turn tend to be in centres of high entrepreneurial and technological density (e.g. San Francisco, Boston, London, Texas etc.)</td>
<td>Predominantly within 100 miles of home, but BAs are based all over the UK, although proliferate more in richer areas, e.g. London &amp; South East. Tend to invest locally but are more geographically spread than VC funds (Harrison, Mason &amp; Robson 2010).</td>
</tr>
<tr>
<td><strong>Tax Incentivisation for Investment (see Appendix D)</strong></td>
<td>Venture Capital Trusts are the most relevant tax incentivisation scheme for VC style investments.</td>
<td>Very often make use of Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS).</td>
</tr>
<tr>
<td><strong>Underpricing Trend in Subsequent IPOs</strong></td>
<td>VC backed firms tend to underprice more aggressively in IPOs due to the heightened motivation to earn quick returns and the greater information to VC asymmetry that results (Johnson &amp; Sohl, 2012, Chahine at al, 2007).</td>
<td>While underpricing exists, the motivation to IPO early is less strong in general, and thus the market knows more about the firm in question at offer. BAs tend to sell more of their shares on IPO</td>
</tr>
</tbody>
</table>
2.8 The worldwide emergence of crowdfunding

Since around 2008 crowdfunding has emerged as a viable conduit through which individuals can invest debt or equity in companies, or donate or contribute to charities or social enterprises, through the confluence of technological progress and the diminishing availability of bank finance (Collins & Pierrakis 2012).

Crowdfunding is a variety of ‘crowdsourcing’, whereby the internet (in its incarnation of ‘Web 2.0’) facilitates interaction such as social media, often via user-generated content, and is used to source ideas, feedback or solutions (in this case finance) from a vastly wider range of providers or customers than was previously possible. It is a classic example of how the internet dramatically reduces transaction costs for information, communication or commerce (Ashta et al. 2010).

This reduction partly stems from removing or reducing fees for intermediaries and professional advisors. Thus the burden of due diligence (‘DD’) and investment risk shifts towards the direct investor, particularly as crowdfunded businesses, as unquoted companies, are generally not obliged to adhere to the strict accounting and disclosure standards required of public companies. However, ordinary investors can therefore access the kind of opportunities, albeit on a smaller scale, previously only available to the privileged elite (Baeck et al. 2012).

Consequently, when compared to private equity investors such as BAs and VCs, information asymmetry between entrepreneurs and potential crowdfunders is greater (Colllins & Pierrakis 2012)

Most CFPs generate the majority of their revenue through charging a flat commission on funds raised of around 5% for successful transactions, but incur varying costs on DD and administration-related processes, according to their particular business model (Baeck et al. 2012).
The following table outlines the typical stages of a crowdfunding campaign and the key challenges of the model for investors and entrepreneurs:

**Table 4: Crowdfunding campaign stages / business model challenges**

<table>
<thead>
<tr>
<th>Stages of typical crowdfunding campaign</th>
<th>Challenges of the crowdfunding model</th>
</tr>
</thead>
<tbody>
<tr>
<td>A firm submits an application to a crowdfunding platform, which is vetted</td>
<td>Managing co-investment from groups with differing motivations – an emerging field</td>
</tr>
<tr>
<td>Funds are raised via an online pitch, business plan, marketing and online interaction (often through social media), with a fundraising target and a deadline</td>
<td>Information asymmetry: limitations on the ability of investors to extract information from and about the founders/entrepreneurs to target funds at the best ventures, limit fraud, value fairly and help manage shareholders</td>
</tr>
<tr>
<td>Fundraising closes, usually an ‘all or nothing’ result prevails (i.e. the target is reached and funds are released to the business after further vetting, or it is not and funds are returned to the would-be investors)</td>
<td>Attracting more experienced investors and businesses to improve the quality on both sides</td>
</tr>
<tr>
<td>Post-investment, investors can often maintain contact and often become advocates for the business, in some cases receiving voting rights attached to their equity</td>
<td>Providing a clear system of legislation and regulation in this area, with a system for platform authorisation</td>
</tr>
</tbody>
</table>

(Source: Collins & Pierrakis 2012)

The majority of CFPs operate an ‘all-or-nothing’ model, whereby only firms reaching a pre-determined funding target receive finance. Crowdfunding thus helps measure demand in ‘real-time’, providing validation for innovative products and services that large corporates often find difficult to establish (Baeck et al. 2012).

While traditional bank lending to SMEs relies on the availability of security, the quality of the business plan, the credit history both of the firm and its directors and on personal relationships; success in raising finance through CFPs depends as much on the credibility of both the firm’s and its directors’ online presence and their ability to communicate through social media, leveraging the quality and quantity of networks (Collins & Pierrakis 2012).

Four main models of crowdfunding have emerged. The form of both contribution and return differs between models, according to the funder’s motivation and the recipient’s business. These are summarised below, with some recent supporting statistics:

34 A further diagrammatic representation of a crowdfunding campaign is provided in Appendix B.
Table 5: Variants of crowdfunding with key operating data

<table>
<thead>
<tr>
<th>Form of Crowdfunding:</th>
<th>Donation</th>
<th>Reward</th>
<th>Lending</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form of contribution</td>
<td>Donation</td>
<td>Donation or pre-purchase</td>
<td>Loan</td>
<td>Investment</td>
</tr>
<tr>
<td>Form of return</td>
<td>Intangible benefit</td>
<td>Reward combined with intangible benefit</td>
<td>Repayment with interest. Some socially-motivated lending is interest free</td>
<td>Return on investment in time if business performs. Rewards also sometimes offered. Intangible benefits may motivate some investors</td>
</tr>
<tr>
<td>Motivation of funder</td>
<td>Intrinsic and social motivation</td>
<td>Combination of Intrinsic and social motivation and desire for reward</td>
<td>Combination of Intrinsic, social and financial motivation</td>
<td>Combination of Intrinsic, social and financial motivation</td>
</tr>
<tr>
<td>2011 Market Composition by category</td>
<td>27%</td>
<td>47%</td>
<td>11%</td>
<td>15%</td>
</tr>
<tr>
<td>2011 Worldwide Share of Funds raised</td>
<td>49%</td>
<td>11%</td>
<td>22%</td>
<td>18%</td>
</tr>
<tr>
<td>2011 Worldwide Growth of Funds raised</td>
<td>47%</td>
<td>291%</td>
<td>74%</td>
<td>83%</td>
</tr>
<tr>
<td>2011 Pledged-to-paid-out ratio</td>
<td>79%</td>
<td>50%</td>
<td>88%</td>
<td>75%</td>
</tr>
<tr>
<td>2011 Average campaign size</td>
<td>$664</td>
<td>$4,076</td>
<td>$5,587</td>
<td>$84,597</td>
</tr>
<tr>
<td>2011 Average campaign length (weeks: launch to completion)</td>
<td>10.2</td>
<td>10.0</td>
<td>4.8</td>
<td>8.2</td>
</tr>
</tbody>
</table>

Source: NESTA (2012), crowdsourcing.org (2012)

Crowdfunding facilitates risk capital provision for some businesses that would not otherwise successfully raise finance, offering a wider variety of destinations for donations, savings or investments than was previously possible. The lack of security required by banks is no barrier to receiving debt finance for businesses that appeal to the crowd. For many investors, the perceived ‘social value’ of the business is important, with many businesses accessing funds on favourable terms because of...
altruistic motivations or by appealing to funders’ sense of local loyalty or passion for

Similarly, sector or investment size restrictions imposed by formal private equity
investors do not apply (Baeck et al. 2012). However, the crowd needs attention:
CFPs that actively curate, inform and nurture their investor base can create
competitive advantage in a fast-expanding sector (Baeck et al. 2012).

CFPs raised an estimated £1.8 billion ($2.7 billion) in 2012 for a huge range of
projects, businesses and charities, with global crowdfunding activity increasing by
81% in 2012 (up from 64% growth in 2011). The global market is forecast to facilitate
£3.4 billion ($5.1 billion) of funding during 2013 (crowdsourcing.org 2013), increasing
to £15 billion by 2015, providing augmentation to (and potentially a partial substitute
for) the £115 billion financial services industry (Baeck et al. 2012).

The US, by far the largest market for CFPs worldwide with 42% of the total number
in 2011, is dominated for regulatory reasons by reward and donation-based models.
The UK is second at 10% and was expected to double in size to £240 million p.a.
during 2012, ahead of the Netherlands (6%), France (6%), Brazil (5%), Germany
(4%) and Spain (4%) (crowdsourcing.org 2012).

Equity[^35] and lending-based models for financial return have to date proved most
effective for digital goods (e.g. software, film and music), whilst donation and reward-
based models are more effective for cause-based campaigns that appeal to funders’
personal beliefs and passions (crowdsourcing.org 2012).

Equity-based campaigns have by far the highest average campaign size ($84,597 in
2011, compared to between $664 for donation-based and $5,587 for lending-based
campaigns), due to the nature of the investment being enacted (crowdsourcing.org
2012).

[^35]: That is, the offering of shares or securities in private businesses to the public via an online
platform. Investors in equity crowdfunding obtain a pro-rata share of equity in a business
correspondent with the proportion of target funding they offer in return (Collins & Pierrakis,
2012).
More summary global data on crowdfunding activity from 2011 is supplied in Appendix C.

2.9 The development of UK equity crowdfunding

Equity crowdfunding offers potential for genuinely expanding the pool of risk capital for entrepreneurs, and could help plug the equity gap(s) that exist for small firms between BA and VC investment levels, and also increasingly between those of F&Fs and BAs (Collins & Pierrakis 2012). While VCs and BAs focus on high-risk, high-return investment opportunities, equity crowdfunding could help to fill a gap in the risk/reward trade-off, as demonstrated below:

Figure 2: Equity crowdfunding plotted in the traditional risk/reward profile

Equity crowdfunding has the potential to partly decentralise capital formation and investment, stimulating innovation, encouraging economic growth and allowing those outside the main financial centres to access investment opportunities (Best et al. 2012). The long-term success of ECFPs will be judged on financial returns available to investors and the benefits supplied to businesses, compared with the alternatives available from existing channels of investment and involvement from third parties (Collins & Pierrakis 2012).

Equity crowdfunding worldwide grew by 30% to £77 million ($116 million) during 2012 (crowdsourcing.org 2013). In early 2012, ECFPs constituted 15% of all CFPs.

\[^{36}\text{And also, in some cases, non-financial.}\]
and 18% of all funds raised\textsuperscript{37}. ECFPs also grew at the fastest rate between 2007 and 2011, particularly in Europe where regulatory regimes mean they are more prominent, at 22% of all CFPs, compared to 6% in the US (crowdsourcing.org 2012)\textsuperscript{38}.

The UK’s comparatively fluid regulatory system has facilitated the evolution of its ECFP marketplace. The regulatory challenge lies in achieving an appropriate balance between regulating sufficiently for a high-risk marketplace and reassuring potential investors of consistently applied standards, but not so much as to stifle growth in a sector that could provide vital funds to help plug the ‘equity gap’ faced by many SMEs, some of which will go on to provide much needed employment, investment and taxation revenue for the UK economy. See Appendix E for a fuller description of the emergent UK regulatory response to crowdfunding.

Many investee businesses’ concerns revolve around releasing commercial information into the public domain and how to handle large numbers of shareholders for the first time (Collins & Pierrakis 2012). Other key challenges equity crowdfunding faces as a fast-developing and innovative sector are summarised in the table below:

\textsuperscript{37} Donation-based and lending-based CFPs formed the largest segments of the crowdfunding market, aT 38% and 36% of CFPs by number, respectively.

\textsuperscript{38} The prominence of ECFPs in the US is expected to increase once regulatory changes, permitted under sections of the April 2012 ‘JOBS Act’, are enacted in detailed legislation. These open up mainstream equity crowdfunding to the majority of American citizens. The Jumpstart Our Business Startups (‘JOBS’) Act permits SMEs with gross revenues below $1 million to access equity crowdfunding via official SEC portals for unquoted companies. The SEC has to date been slow to implement the required detailed legislation due to concerns over investor protection:

### Table 6: Key challenges for equity crowdfunding

<table>
<thead>
<tr>
<th>Challenging Areas for Equity Crowdfunding</th>
<th>Specific challenges</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation</td>
<td>How to protect less sophisticated investors from businesses with fraudulent intentions or little chance of success?</td>
<td>UK regulators are moving to create a framework where ECFPs receive their authorisation following a procedural audit. Seedrs, CrowdCube and CrowdBnk have already received this.</td>
</tr>
<tr>
<td>Setting Valuations</td>
<td>While crucial to securing a fair value for the vendor and fair return for investor, valuation is also very difficult with unquoted companies due to information asymmetry. Additionally, assets are often IP and valuations make assumptions about market size, competition and other variables hard to verify.</td>
<td>Most ECFPs encourage businesses to value themselves, potentially very dangerous if too high or too low. Thus some also allow flexibility in the % of equity offered as the fundraising progresses online. BanktotheFuture in the UK offers training to entrepreneurs, including valuing their own firms.</td>
</tr>
<tr>
<td>The ‘wisdom of the crowd’, business selection and fraud detection</td>
<td>The danger of fraud is often cited by sceptics.</td>
<td>ECFPs differ in the amount of vetting/DD undertaken: this is expensive but will become a differentiating factor as the market matures. The ‘all-or-nothing’ funding model helps to some extent but relies on investors performing some checks rather than succumbing to the ‘herding’ or ‘bandwagon’ effect. The internet and social media assist greatly in researching opportunities, particularly as a crowd pools different expertise in the process.</td>
</tr>
<tr>
<td>Investor types and visibility</td>
<td>Viewing information on other investors is important to assess an endorsement by a fellow investor. Those connected with the entrepreneur or with specific passions related to the business will have differing motivations from those purely motivated by financial return.</td>
<td>BAs or other HNWIs offer valuable validation for an investment if their identity is known. Some BAs may find their desire for privacy and the fees charged by ECFPs are deterrents. Others will appreciate the streamlined deal-flow that ECFPs provide. Post-investment support by BAs or VCs is important to business success – this is something ECFPs should consider in future derivations of the model.</td>
</tr>
</tbody>
</table>

Source: Collins & Pierrakis 2012

Various derivations of the equity crowdfunding model have begun to emerge since 2011. Some ECFPs adopted slightly restrictive investment practices, limiting platform access to both entrepreneurs and investors on the basis of business plan quality,
expertise or quantum of investable capital (Collins & Pierrakis 2012)\(^{39}\). The legal structure for managing investors’ equity interests differs between ECFPs and between legislation in place in various jurisdictions\(^ {40}\).

At least 36 UK ECFPs are in operation at the time of writing, building on the UKs legacy of a strong financial services sector to pioneer this disruptive business model. The following table summarises key information on the most prominent of these:

\(^{39}\) For example, Northern Ireland-based Seedups, US-based CircleUp or Angellist or UK-based Syndicate Room.

\(^{40}\) Seedrs and FundtheGap employ a nominee structure, whereby nominees elected by the ECFPs represent the crowd’s interests. Conversely, CrowdCube and Syndicate Room are among the ECFPs to allocate shares directly to crowdfunders. CrowdCube only allocates full ‘A’ shares (with normal voting and pre-emption rights) to investors injecting over a certain funding threshold determined by the entrepreneur, but usually around £25,000. Syndicate Room will rely on the ‘lead’ Angel investors within its model of representing the interests of all shareholders as the interests of the lead and other shareholders adjudged to be perfectly aligned.
### Table 7: Summary of the key UK ECFPs as at summer 2013

<table>
<thead>
<tr>
<th>Platform Name</th>
<th>Operational Inception</th>
<th>Specialism</th>
<th>Fee Model</th>
<th>Funding Terms</th>
<th>Minimum investment</th>
<th>Due diligence undertaken by CFP</th>
<th>Decision on how much equity to offer</th>
<th>Shareholding structure</th>
<th>Funding Raised</th>
<th>Post investment practices</th>
<th>Further Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crowdcube</td>
<td>February 2011</td>
<td>Start-up funding</td>
<td>5% of funds raised + £1,750 towards legal costs, if successful</td>
<td>All or nothing</td>
<td>£10</td>
<td>Vetting done by platform before pitch goes live on site</td>
<td>Entrepreneur decides but can increase it during funding window</td>
<td>Direct by funder</td>
<td>c. £10m</td>
<td>Entrepreneur decides what threshold entitles investor to voting ‘A’ shares with pre-emption rights etc.</td>
<td>Became FSA authorised after trading started</td>
</tr>
<tr>
<td>Seedrs</td>
<td>April 2012</td>
<td>Start-up funding</td>
<td>From business; 7.5% of funds raised if successful, From investors: 7.5% of ultimate profit</td>
<td>All or nothing</td>
<td>£10</td>
<td>Approve disclosures as financial promotions beforehand and legal due diligence conducted once target is funded</td>
<td>Entrepreneur sets amount which cannot be subsequently altered</td>
<td>Nominee basis</td>
<td>c. £1m</td>
<td>Seedrs hold shares on behalf of investors on nominee basis</td>
<td>Became FSA authorised before trading started</td>
</tr>
<tr>
<td>Seedups (UK plus US, Ireland)</td>
<td>2011</td>
<td>Start-up funding</td>
<td>5% of funds raised</td>
<td>All or nothing</td>
<td>US $1,000</td>
<td>Vetting done by platform before pitch goes live on site. ‘Collective DD’ using the wisdom of the crowd is the basis of the model however</td>
<td>This is set by the internal marketplace and finalised when the deal window closes</td>
<td>Direct by funder</td>
<td>Unknown</td>
<td>Platform’s reporting software helps keep investors informed of progress</td>
<td>Investors value start-ups in an internal market for price and % of equity offered</td>
</tr>
<tr>
<td>CrowdBnk</td>
<td>May 2013</td>
<td>Start-up funding</td>
<td>5% + £1,000 flat fee + 3% transaction fee</td>
<td>All or nothing</td>
<td>£10</td>
<td>Vetting done by platform before pitch goes live on site</td>
<td>Entrepreneur sets amount which cannot be subsequently altered</td>
<td>Direct by funder</td>
<td>Unknown</td>
<td>Help facilitate communication between investors and entrepreneurs</td>
<td>Equity or reward-based models offered. FCA authorised as representative of an existing authorised firm</td>
</tr>
<tr>
<td>Platform Name</td>
<td>Operational Inception</td>
<td>Specialism</td>
<td>Fee Model</td>
<td>Funding Terms</td>
<td>Minimum investment</td>
<td>Due diligence undertaken by CFP</td>
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<td>Post investment practices</td>
<td>Further Notes</td>
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</tr>
<tr>
<td>Fund the Gap</td>
<td>February 2013</td>
<td>Start-up funding</td>
<td>Unspecified</td>
<td>Unspecified</td>
<td>£500</td>
<td>FTG differentiates itself by the amount of in-house DD undertaken by the team, checking all facts in business plans</td>
<td>Entrepreneur sets amount which cannot be subsequently altered</td>
<td>FTG hold shares on behalf of investors on nominee basis</td>
<td>Unknown – c. 10 deals completed to June 2013</td>
<td>Operates an ‘investment dashboard’ that enables investors to track progress of companies and communicate with them</td>
<td>FTG is not directly FCA authorised yet, but is an appointed representative of an FCA authorised company, Sapia Partners LLP</td>
</tr>
<tr>
<td>Syndicate Room</td>
<td>March 2013</td>
<td>Angel Investments</td>
<td>5% - 7.5%</td>
<td>Angel Deals with crowd money</td>
<td>£1,000</td>
<td>Reliance is placed on the DD conducted by the lead Angel investor who has already invested a considerable sum</td>
<td>Set by the entrepreneur and lead Angel investor</td>
<td>Direct by funder</td>
<td>Unknown – platform due to go live to crowd investors August 2013</td>
<td>Reliance is placed on lead Angel investors representing the interests of crowdfunders as there is very close alignment</td>
<td>The only UK platform to leverage the credibility and experience of professional Angel investors</td>
</tr>
<tr>
<td>BanktotheFuture</td>
<td>2012</td>
<td>Multiple finance provisions</td>
<td>5% of funds raised when target reached + £1,750 for equity</td>
<td>All or nothing</td>
<td>£10</td>
<td>Vetting done by platform before pitch goes live on site</td>
<td>Entrepreneur sets amount which can be increased but not decreased</td>
<td>Entrepreneur can set minimum threshold to qualify for voting and pre-emption rights attached to shares</td>
<td>Unknown</td>
<td>Investors are collected into private group for updates</td>
<td>Offers blend of debt, reward and equity-based models, and training programmes to assist entrepreneurs in being ‘investment ready’</td>
</tr>
</tbody>
</table>

Source: [http://www.crowdsurfer.co/platforms/](http://www.crowdsurfer.co/platforms/), Collins & Pierrakis (2012), individual ECFP websites
There are indications that any scepticism BAs harboured about the emergence of crowdfunding is dissipating, and that smaller angel-style investments are being made through some of the more established UK ECFPs\textsuperscript{41}. Meanwhile Envestors, a formal BAN, participated alongside Crowdcube to each facilitate investment of £250,000 into the London Distillery Company, in something of a landmark deal (UKBAA 2013).

While government is aware of equity crowdfunding, one of the notable recommendations that the 2012 BIS taskforce on alternative debt markets put to the UK government to address these issues (see Appendix A) was commercially attractive government investments in P2P lending platforms (BIS 2012)\textsuperscript{42}.

\textbf{2.10 UK government support for lending to and Investment in SMEs}

Like many other countries, the UK has put in place a wide array of supply-side incentives to encourage investment in and lending to businesses, particularly SMEs; being mindful of the importance of encouraging economic growth. Those currently most prominent are summarised in Appendix D.

\textsuperscript{41} Founders of both Seedrs and Crowdcube report larger investments being made that indicate angel-style activity on their ECFPs: 2\% of all investments on Seedrs exceed £5,000 and represent around one third of all funds invested to date, while on Crowdcube, 37 people have invested between £20,000 and £50,000, 7 people have invested £50,000-£100,000 and 3 have invested over £100,000 since its 2011 inception. Both Seedrs and Crowdcube, along with newly formed CrowdBnk, have become members of the UKBAA since having become authorised by the FCA (UKBAA 2013).

\textsuperscript{42} The 2012 BIS taskforce’s remit only addressed alternative sources of debt finance for SMEs, and did not cover equity markets for private, unquoted companies. P2P lending is essentially the debt equivalent of equity crowdfunding, where again the combination of the UK’s strong tradition in financial services and relatively light-touch regulatory environment has encouraged strong market development. These match money from lenders with borrowers through a competitive bidding process to arrive at a market interest rate. The UK’s permissive regulatory environment has fostered a thriving market, with Zopa and Ratesetter having secured around 2\% of the UK personal loan market, and Funding Circle forecasting the facilitation of £40 million of commercial lending in its first year of operation to August 2012, growing to £200 million in year two and £1 billion within 5 years (BIS, 2012).
The key programme aimed at increasing lending to the real economy, ‘Funding for Lending’, launched in 2012, has so far failed to significantly increase SME lending, although it has had some effect on mortgage lending rates. This failure appears primarily related to the pressures on banks to continue deleveraging their balance sheets (FT 2013).

Tax incentivisation schemes such as EIS and SEIS are aimed at encouraging investment in unquoted companies and are used widely by BAs (Mason & Harrison 2010), whilst also featuring prominently in the value proposition of many, if not all, UK ECFPs (Collins & Pierrakis 2012).

While supply-side measures are common in the UK and elsewhere, including the development of public-private ‘hybrid’ VC funds that combine public funding and tax incentivisation to foster investment, numerous studies have pointed to the importance of improving business’ investment readiness, training entrepreneurs on the advantages of receiving external private investment and how to pitch and present the business plans effectively (Mason & Harrison 2001, 2004), all skills highly pertinent to a successful equity crowdfunding campaign.

2.11 Findings from the Literature

This critical review of current research informs the design of the primary research stage of the project to address the stated question: whether equity crowdfunding in the UK has the potential to be ultimately complementary, or substitutional, to the existing investment practices of Business Angels.

43 Funding for Lending works through participating institutions borrowing government debt in exchange for collateral.

44 The EIS was cited as being utilised in 57% of investments per one 2009 survey of UK BAs. 53% of investors in the same survey said without tax incentives they may have made fewer investments, and 24% of investments may not have been made without incentives. Follow-on funding rounds may often exceed the EIS eligibility thresholds, while VC involvement may necessitate the use of preference shares or other non-eligible financial instruments (Mason & Harrison 2010).
Framing the context for the design stage, the review has identified the following key related themes:

- **While banks in many ‘advanced’ economies are lending less, managing risk and accommodating revised regulatory requirements through deleveraged balance sheets, UK SMEs face a particularly harsh financing climate following the GFC due to the UK’s highly concentrated banking sector and comparatively strong reliance on bank lending to finance small business growth.**

- **Demand for SME financing in the UK over the coming years will comfortably outstrip supply.** Aware that addressing this problem will be an important contributory factor to facilitating genuine and sustainable economic recovery, the UK government has developed a variety of mainly supply-side measures to stimulate debt and equity investment to small businesses. The indications are that while welcome, they will not satisfy demand.

- **Small businesses with high growth potential, disproportionately important for economic development and job creation, are clear targets for private equity investment from investors such as BAs and VCs.** The risks of investing in such businesses are high as the probability of strong growth and lucrative investment profits, via successful exits, are low.

- **BAs are professional individual investors who often work together in the UK to help meet the demands on their capital from small unquoted companies with high-growth potential.** They often invest alongside, or divest business investments to, VCs. However, the relationship between the two groups is complex and not without friction, due to misalignment in objectives and timescales.

- **As VC investment has recently upscaled, focussing on larger and later-stage businesses, BAs have become an increasingly important source of SME finance in the UK,** forming larger syndicates to fund larger deals in the funding space left behind by VCs. However, demands on their capital exceed supply.

- **Social interaction and crowdsourcing through ‘Web 2.0’ has enabled crowdfunding to emerge as a conduit for ordinary people to donate, lend to or invest in businesses or projects.** Transaction costs have been lowered compared to similar offline activities, as all or most of the intermediaries and
third parties in the process are removed and the burden of risk and due diligence consequently shifts towards the ‘crowdfunder’.

- Crowdfunding facilitates risk finance for viable businesses that would otherwise struggle to obtain it, either due to the lack of collateral possessed by early stage firms to secure against bank loans, or the high returns required by private equity investors such as VCs or BAs to compensate for high inherent portfolio risk.

- Equity crowdfunding thus has the potential to expand the pool of risk capital available to entrepreneurs and to help plug the equity gap(s) that exist for small firms. While existing private equity investors focus on high-risk, high-return opportunities, equity crowdfunding may help to fill a gap slightly lower down the risk/reward trade-off.

- Europe, and at present particularly the UK, is at the vanguard of equity crowdfunding development. By leveraging its financial services expertise and getting the regulatory balance right between the interests of investor and entrepreneur, the UK has the opportunity to become a centre of innovation, excellence and deal-flow for equity crowdfunding.

- This would contribute, albeit marginally, to decentralising capital formation and investment away from the UK’s concentrated banking sector, stimulating innovation and encouraging economic growth, while providing those outside the main financial centres with access to investment opportunities.

- The UK ECFP marketplace shows clear signs of differentiation between operators in the amount of pre-screening and due diligence platforms perform on behalf of would-be investors, and their target investor markets and the minimum investment thresholds in place.

Using these insights and the comparative evaluation format of Table 3 above, we can now compare the equity crowdfunding investment model against the criteria used for VCs and BAs:
**Table 8: ECFPs incorporated into comparison of BA/VC investment characteristics**

<table>
<thead>
<tr>
<th>Differentiation Factor</th>
<th>Venture Capital Firms</th>
<th>Business Angel Investors</th>
<th>Equity Crowdfunding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source of capital</td>
<td>External capital supplied by institutions and high net-worth individuals to VC fund managers on the strength of their reputation and access to opportunities</td>
<td>Their own capital, often accumulated as a result of their own cashed-out entrepreneurial activities, or earned wealth through corporate life.</td>
<td>'Crowd capital', which may include a significant minority of total funds in 'angel' style amounts of £5,000 - £10,000 (UKBAA 2013).</td>
</tr>
<tr>
<td>Asset Managers</td>
<td>VC fund managers.</td>
<td>The BA him/herself, often working very closely with the entrepreneur or management team concerned.</td>
<td>The entrepreneur of the investee business.</td>
</tr>
<tr>
<td>Remuneration</td>
<td>Annual management fee (percentage of fund) averaging c. 2% and bonus fees (percentage of fund surplus).</td>
<td>Capital gain on successful exit from the investment (i.e. through trade disposal of company, or floatation on quoted exchange: 'Initial Public Offering, or IPO).</td>
<td>ECFPs typically take 5%-8% of funds raised, with some also taking a proportion of profit on subsequent disposal of equity interests.</td>
</tr>
<tr>
<td>Investment motivation(s)</td>
<td>Overwhelmingly purely financial.</td>
<td>More mixed: incorporating financial returns with non-financial motivations.</td>
<td>Mixed: dependent on the crowd investors' motivations but blending financial gain with passion for a particular sector, locality, entrepreneur etc.</td>
</tr>
<tr>
<td>Due Diligence Practice</td>
<td>Greater resources afford weeks of intensive due diligence work from VC firm managers, staff and advisors.</td>
<td>Time and cost constraints limit this to days per investment, usually below 100 hours (Wiltbank, 2009).</td>
<td>Time and cost constraints limit this to days per investment, usually below 100 hours (Wiltbank, 2009).</td>
</tr>
<tr>
<td>Investment Size</td>
<td>VC funds typically these days invest a minimum of around £2 million.</td>
<td>£42,000 average for UK individual investors, median total invested £220,000 per investor.</td>
<td>Unknown on an industry scale, although the vast majority of investments by number and around 60-70% by financial quantum are below £5,000 (UKBAA 2013).</td>
</tr>
<tr>
<td>Co-investment Trend</td>
<td>Can invest alongside Business Angels (usually in follow-on funding rounds).</td>
<td>Often investing £500k-£1m + through BA syndicates (Wiltbank, 2009), or alongside public sector funds. VC firms often invest in the same firms at a later date, if successful.</td>
<td>Practice is evolving rapidly here but while crowd investors are often the only external shareholders, investing alongside BAs and BA syndicates appears to be more common.</td>
</tr>
<tr>
<td>Business Development Stage</td>
<td>Early-stage or early-growth.</td>
<td>Start-up or early-stage.</td>
<td>Seed or start-up stage.</td>
</tr>
<tr>
<td>Corporate Investment Structure</td>
<td>Usually through a fixed term investment fund in the form of a formal Limited Partnership (LP).</td>
<td>Usually under the BA’s own corporate investment vehicle, or from personal funds.</td>
<td>Usually ordinary share capital in the investee business, often (but not always) with voting and pre-emption rights attached, depending on the ECFP business model.</td>
</tr>
<tr>
<td>Statutory/Regulatory Reporting Requirements</td>
<td>Formal reporting requirements under FSA and Government legislation and regulation.</td>
<td>No formal reporting requirements outside of investee firms accounting and audit requirements.</td>
<td>No formal reporting requirements outside of investee firms accounting and audit requirements.</td>
</tr>
<tr>
<td>Holding Period</td>
<td>Usually target a 10 year fund life with holding periods for business within this fund of between 3 and 5 years on average (NESTA 2009a, Lange et al., 2003).</td>
<td>Average around 4 years (Wiltbank, 2009).</td>
<td>Unknown at present due to the emergent nature of the sector. The need for liquidity may prove a key factor in the success of the model.</td>
</tr>
<tr>
<td>Differentiation Factor</td>
<td>Venture Capital Firms</td>
<td>Business Angel Investors</td>
<td>Equity Crowdfunding</td>
</tr>
<tr>
<td>----------------------------</td>
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</tr>
<tr>
<td>Follow-on investment patterns</td>
<td>Capacity for follow-on funding considerable if required and viewed as appropriate.</td>
<td>Capacity for follow-on funding limited, although growing with larger syndication.</td>
<td>Capacity for follow-on funding is unknown due to the emergent nature of the sector, although likely to be limited given the nature of the crowd investor community.</td>
</tr>
<tr>
<td>Average Returns</td>
<td>VC funds between 1998 and 2005 returned 1.0 times money equating to negative (1.21%) net IRR (after management costs and charges) (Lerner et al. 2011).</td>
<td>2.2 times money over 3.6 years, approximating to 22% gross IRR (before deduction for management time and associated costs).</td>
<td>Unknown at present due to the emergent nature of the sector.</td>
</tr>
<tr>
<td>Geographic Diversification</td>
<td>VC funds tend to invest predominantly close to their headquarters, which in turn tend to be in centres of high entrepreneurial and technological density (e.g. San Francisco, Boston, London, Texas etc.).</td>
<td>Predominantly within 100 miles of home, but BAs are based all over the UK, although proliferate more in richer areas, e.g. London &amp; South East. Tend to invest locally but are more geographically spread than VC funds (Harrison, Mason &amp; Robson 2010).</td>
<td>Theoretically crowd investors can be situated anywhere, as long as a good internet connection exists to access the ECFPs, read business plans, watch video pitches, correspond with fellow investors and entrepreneurs, etc.</td>
</tr>
<tr>
<td>Tax Incentivisation for Investment (see Appendix D).</td>
<td>Venture Capital Trusts are the most relevant tax incentivisation scheme for VC style investments.</td>
<td>Very often make use of Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS).</td>
<td>Most ECFPs market themselves heavily on the strength of the EIS and SEIS tax incentivisation schemes.</td>
</tr>
<tr>
<td>Underpricing Trend in Subsequent IPOs</td>
<td>VC backed firms tend to underprice more aggressively in IPOs due to the heightened motivation to earn quick returns and the greater information asymmetry that results (Johnson &amp; Sohl, 2012, Chahine at al. 2007).</td>
<td>While underpricing exists, the motivation to IPO early is less strong in general, and thus the market knows more about the firm in question at offer. BAs tend to sell more of their shares on IPO.</td>
<td>Unknown at present, due to the emergent nature of the sector.</td>
</tr>
</tbody>
</table>

This comparative framework invites a re-examination of the main research question and associated research objectives following the literature review:

1.) To determine whether 'crowd money' has the potential to offer a genuinely new supply of risk capital for small unquoted companies in the UK.

As Baeck et al. (2012) and Collins & Pierrakis (2012) emphasise, the emergence of equity crowdfunding for unquoted small businesses, often at seed or start-up stage, is potentially an alternative source of capital. While the literature review indicates that ECFPs source money from a blend of small amounts from new investors in unquoted companies and 'angel-style' investments of £5,000 and over, this area is relatively under-researched. This study therefore aims to further explore whether ‘passive’ crowd investments via ECFPs are genuinely a new source of capital for such businesses.
2.) To explore whether BAs are using ECFPs to channel at least a portion of their investable capital through to unquoted companies, and if so, what their motivations for doing so are.

Mason & Harrison, amongst others, show that BAs have traditionally used formal or semi-formal networks and syndicates offline to help screen investment opportunities and structure deals. Some networks source commission-based fees from successfully completed deals. ECFPs operate a similar business model online, albeit with a much larger potential investor base injecting a much smaller average quantum of equity into a much wider range of potential targets. Such BANs could therefore face challenges from ECFPs for BA capital, providing improved deal flow as the phenomenon grows in popularity, although Collins & Pierrakis (2012) point out that this is at the expense of increased information asymmetry, less control over equity valuation and less knowledge about their fellow investors, relative to offline BA practices.

Again, the literature on this area has not yet developed, although there is evidence of some ‘angel-style’ quantum of investments on UK ECFPs (UKBAA 2013). This research thus seeks to confirm that BAs are actively using ECFPs, and if so, what their motivations for doing so are. This could indicate that ECFPs are substitutional to existing networks to the extent that they divert existing capital online, away from traditional BANs. However, this could also signal complementary activity if only a proportion of their investable capital is used in this way, with the balance invested through existing networks. Exploring how actively ECFPs are marketing themselves to BAs is a useful additional point of enquiry in addressing research objective two.

3.) To examine whether BAs and the crowd co-investing alongside each other on ECFPs help to plug a larger portion of the equity gap than that traditionally addressed by BA investment models.

Collins & Pierrakis (2012) speculate that this may indeed be the case when they discuss the potential for equity crowdfunding to help fill the evolving equity gaps created by VC and BA investments upscaling to larger and later-stage opportunities, illustrated by the following graphic from their paper:
Collins & Pierrakis (2012) also suggest that ECFPs can address an overlapping but distinct element on the risk/reward profile of private equity investment in small businesses. While they posit that ECFPs can therefore at least partly address a previously unfilled part of the equity gap, further research on this point is again needed as the phenomenon is in its infancy and as a result, existing research offers no firm conclusions.

While Funders Club is a US-based EFCP that connects ‘accredited investors’ (with over $1 million net worth) to highly-screened start-up investment opportunities, the nascent UK platform ‘Syndicate Room’ leverages the lighter-touch regulatory environment by specifically attracting ‘passive’ crowd money to augment BA funding for investment opportunities the ‘lead’ Angel investor has already conducted due diligence on, and committed their own capital to. As such, this platform is worthy of specific research in addressing this research objective.
3. Project Design

3.1 Research philosophy and approach

While there have been industry reports on equity crowdfunding in the UK, none to date have sought to explore the potential for it to be substitutional or complementary to established BA investment practices, although Collins & Pierrakis (2012) do suggest that:

“The co-investment model between professional and amateur investors (or crowdfunders) is one that is worth exploring further.”

Saunders et al. (2009) emphasise the importance of understanding one’s philosophy towards a piece of primary research and how this understanding can influence the strategy and methodology for that research. They break the analysis of such philosophies down under the headings of ontology (the study of the nature of reality), epistemology (what constitutes acceptable knowledge in a particular field) and axiology (the study of value judgements).

Ontologically, the research question appears to lend itself to an objectivist approach: exploring whether or not ‘crowd’ money is a new source of risk capital for business; whether or not BAs are using ECFPs for at least a portion of their investable capital; and whether or not the joint deployment of crowd and angel capital plugs a larger part of existing equity gaps each appear to be binary questions.

However, consideration remains due to the role that subjectivity plays for research participants, who are helping to produce evidence towards the research objectives. Entrepreneurs, BA investors and ECFP operators will each perceive reality around those objectives in different ways. Awareness of this subjectivity does not however change the objective or positivist way in which those decisions are ultimately seen to affect the emergence of crowdfunding and its impact on the UK’s entrepreneurial finance landscape.

A similarly nuanced awareness is required surrounding epistemological issues. While a positivist approach seeks to establish ‘facts’ around online investment
behaviour, and ‘direct realism’ in results⁴⁵, participants’ differing perception of reality, depending on their background and commercial position, will therefore require a somewhat interpretivist research stance; recognising the differences in participants’ perspectives and applying empathy to help interpret responses and feed these into subsequent interviews.

Axiological concerns are also crucial when considering research philosophy and design. My own values, instrumental in choosing to conduct this research, are summarised in the following statement:

“\[I \text{ am fascinated by the emergence of crowdfunding, and equity crowdfunding in particular, as a topical area of evolving business finance with the potential to provide additional risk capital to UK small businesses, many of whom have seen their access to capital negatively affected in the aftermath of the GFC.}\]

\[\text{In this relatively new and rapidly developing area, I aim to produce research that is useful to those involved in using, facilitating, regulating or researching crowdfunding, sharing the results of that research as widely as possible to benefit the maximum number of people. While doing so, I pledge to respect commercial confidentiality.}\]

\[\text{An additional motivation is the opportunity to network with established players in the field of equity crowdfunding and BA investment as a way of developing business connections and my future career.}\]"

I am aware that this axiological position could lead me towards a ‘critical theory perspective’ in undertaking and analysing my research, perceiving equity crowdfunding as a means of empowering entrepreneurs and investors to transcend

⁴⁵ Direct realism suggests that “\text{what you see is what you get: what we experience through our senses portrays the world accurately}” (Saunders et al. 2009) p. 114
constraints placed on them by their socio-economic position, in particular relative to BAs or other private equity investors.\footnote{Cresswell (2009) states that “critical theory perspectives are concerned with empowering human beings to transcend the constraints placed on them by race, class and gender”.

However, whilst acknowledging that claiming objectivity in the postmodern age is naive, I will strive to maintain balance and authenticity in the design and interpretation of my research (Patton 2002) to ensure the resultant analysis and conclusions remain useful to the maximum number of interested parties.

Given the emergent and rapidly developing nature of equity crowdfunding, the level of commercial confidentiality that many BAs and ECFP operators require, and the lack of developed primary research relating to the main research question and associated objectives, a pragmatic philosophy is required to obtain relevant primary data within the context of the intended purpose, available resources, procedures followed and results obtained for the stated audience, as Patton states:

”...being pragmatic allows one to eschew methodological orthodoxy in favour of methodological appropriateness as the primary criterion for judging methodological quality, recognising that different methods are appropriate for different situations.” (Patton 2002, p. 72)

This pragmatic approach has influenced my research approach and design, which is to some extent emergent, adapting the enquiry as understanding deepens, and which is influenced by what Patton (2002) terms ‘truth and reality-oriented correspondence theory’, aimed at understanding what is going on in the real world of online investment, insofar as I can access that ‘truth’, so that my findings correspond as closely as possible to practical reality. Building upon the post-positivist perspective that knowledge is conjectural and we can’t be positive about our claims (Cresswell 2009), Patton describes this theory as follows:

“Realising that absolute objectivity of the pure positivist variety is impossible to attain, you are prepared to admit and deal with imperfections in a phenomenologically messy and methodologically imperfect world, but you still believe that objectivity is worth striving for.” (Patton 2002, p.93)
3.2 Primary Data Collection

This pragmatic approach implies techniques and procedures are chosen to best meet their needs and purpose (Cresswell 2009). Whilst a mixed-methods methodology combining both quantitative and qualitative data and mixing open and closed-ended questions would appear ideal, it is necessary to consider the impact of potential issues around commercial confidentiality and consequent lack of access to plentiful quantitative data. The nature of the research area and the means of enquiry dictate the approach will be largely inductive. This is because:

a) The research area is extremely fluid and emergent at present, with the number of ECFPs in the marketplace growing all the time and the nature of the regulatory regime still evolving.

b) The literature around the topic is therefore relatively limited, primarily comprising industry reports and press articles rather than academic research papers and texts.

c) Most primary data are qualitative, based on interviews eliciting experiences and activity. This does not lend itself to the detailed testing of previously stated hypotheses through large sample sizes of quantitative data and a structured methodology designed to establish proven causal relationships, as a purely deductive approach implies.

This is a cross-sectional study on the interface between equity crowdfunding and the BA investment community in the UK, conducted during the summer of 2013. The mainly qualitative methodology employed is based on conducting one-to-one semi-structured interviews with representatives from the BA and ECFP communities in the UK and other relevant selected parties\(^{47}\), between May and July 2013. In this way, findings can be corroborated, or ‘triangulated’, between independent sources of information and insight concerned with the research question (Saunders et al. 2009).

Cresswell (2009) sets out the design logic for such an inductive approach to qualitative research as follows:

\(^{47}\) For example trade representatives, academics, lobbyists, sector specialists etc.
However, this pragmatic, mixed-methods approach means that elements of a deductive approach are also relevant, linking the first and last stage of Figure 4 above (see purple linking box).

### 3.3 Tentative Deductive Theories

The key themes and findings emerging from the literature review not only guide the structure of the interview process, but also enable the author to posit some tentative deductive theoretical positions in relation to the research objectives surrounding the manifestations of and motivations for online investment behaviour relating to BAs in the UK:

1. *To determine whether ‘crowd money’ has the potential to offer a genuinely new supply of risk capital for small unquoted companies in the UK.*

The majority of ‘crowd money’ does appear to be a new source of risk capital, albeit a significant minority of funds raised may be in the form of ‘angel-style’ amounts of £5,000 and over.
2. To explore whether BAs are using ECFPs to channel at least a portion of their investable capital to unquoted companies; and if so, what their motivations for doing so are.

The indications are that, increasingly, BAs could well be using ECFPs for at least a portion of their investable capital.

3. To examine whether BAs and ‘the crowd’ co-investing alongside each other on ECFPs helps plug a larger portion of the equity gap than that addressed by traditional BA investment.

Industry reports indicate that crowd investors may be targeting investments with a different risk/reward profile than that traditionally sought by BAs, while emergent ECFPs such as Syndicate Room actively encourage the blending of ‘active’ BA and ‘passive’ crowd money alongside each other in unquoted equity investments. Both these trends point to a larger portion of the equity gap therefore being addressed.

These deductive theoretical positions require testing through the subsequent collection and analysis of relevant primary data (Saunders 2009), in this case largely qualitative data from semi-structured interviews augmented with limited quantitative data from ECFPs. In turn, those primary data are themselves analysed to refine those theoretical positions around the research question and objectives in an inductive manner, suggesting directions further research might take to explore certain aspects more comprehensively. The study thus takes the form of a genuinely pragmatic, mixed-methods and semi-grounded exercise.

3.4 Sampling selection

The participant samples from each target group (BAs, ECFP operators, other interested parties) for a largely qualitative study in this emergent area of finance were arrived at through using personal networks to build purposive samples. For

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48 Since October 2012 the author has attended meetings of the ‘London New Finance’ networking group which specialises in linking professionals interested in innovative and disruptive digital finance technologies. Through this group I met sector specialists and made
ECFP operators and other interested parties this approach is appropriate for selecting particularly informative participants from a small potential sample size (Neumann 2005).

This yielded interviews with founders or senior management of four UK ECFPs: Crowdcube, Seedrs, Fund the Gap and Syndicate Room, and six further interviews with other interested parties, including sector specialists in disruptive finance technologies, academics researching crowdfunding, lobbyists for the crowdfunding industry and the CEO of the major trade association for BAs in the UK.

Despite their reputation for anonymity and commercial confidentiality, the same method enabled me to interview three self-professed BAs: two based in Cambridge, both specialising in life sciences, and one larger-scale private equity investor with a broad range of private equity investment experience.

This total of thirteen interviews across the three selected target audiences was considered sufficient for the purposes of a study of this nature.

3.5 Research ethics
While many participants were happy to be named, some wished to remain anonymous and the decision was made to keep participants’ identities confidential in the main body of the report, although professional biographies are listed against participant numbers in Appendix F.

3.6 Interview methodology
Interviews were conducted between 30th May and 14th July 2013, either over the phone or face-to-face, depending on the geographical location of participants and time constraints. The interviews averaged between 30 and 90 minutes in duration, with the line of questioning and discourse tailored to the background of the interviewee (i.e. BA, ECFP operator or other interested party). Interviews were recorded digitally and were usually written up within 48 hours.

contacts that led the way to further participants. In addition, I used contacts at the Cass Entrepreneurship Fund and existing personal networks to access further participants.
3.7 Secondary data collection

Secondary data from desk-based research including press articles was used to enhance primary data gathered through the interview process. The author also continued to network at relevant industry events to gain further insight into the arenas of equity crowdfunding and BA investment activity. This included attendance at the Westminster Crowdfunding Forum, a parliamentary-based group chaired by Barry Sheerman MP aimed at influencing the awareness of the political executive about all forms of crowdfunding in the UK, particularly with reference to the emergent regulatory regime.

3.8 Quantitative data collection

In order to corroborate some of the key findings flowing from the analysis of qualitative data gathered from the semi-structured interview process and from secondary data, primary quantitative data was obtained from two prominent ECFPs surrounding the incidence of ‘angel style’ individual investments being made through those platforms.

3.9 Limitations

There are a number of risks, weaknesses and limitations associated with the chosen research methodology.

Firstly, purposive sampling methodologies can mean that only the most interested or opinionated parties from each grouping agree to participate, meaning that the sample of views represented through data analysis is skewed towards their specific perspectives. This is recognised as an inherent risk weakness in many such studies.

Secondly and flowing from this, while the number of participants is regarded as sufficient for a study of this nature, having more time and resources to include a

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49 The Westminster Crowdfunding Forum adopted the following mission statement at the meeting the author attended on 3rd July 2013: “The Westminster Crowdfunding Forum exists to debate, support and increase the power that crowdfunding has to stimulate the economy, democratise our financial systems, generate opportunities for entrepreneurs, create jobs and strengthen civil society by combating poverty and helping local communities”.

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greater cross-section of each participant group would have enriched both the blend of views represented and thus the resultant findings.

While participants naturally possess subjective views on relevant topics depending on their professional context within the field of study, the use of diverse groups representing entrepreneurial, investor, academic and industry perspectives acts to some extent as a natural counterweight to the risks highlighted above, alongside the author’s awareness of the somewhat interpretivist stance required when analysing data.

Thirdly, as a cross-sectional study conducted during mid-2013 at a very fast-moving time for the ECFP marketplace in the UK, the findings are limited in relevance in relation to time and place.

Fourthly, it is recognised that the commercial confidentiality required by many participants, particularly BAs and ECFP operators, means that the amount of quantitative data available to corroborate and triangulate qualitative data is extremely limited, thus the mixed-methods approach adopted is skewed towards the qualitative.

As a result of the pragmatic, mixed-methods, semi-grounded approach adopted to address the research area within the context of the time and resources available for this study, the risk of not producing firm conclusions was recognised before research commenced. This is acknowledged as a function of the emergent, fluid, fast-developing nature of the equity crowdfunding area. Counterbalancing this was the knowledge that should this be the case, the research would at least be able to highlight useful areas for further research to advance the knowledge-base on the topics studied.
4. Data Analysis

4.1 Analytical Approach

Qualitative responses from interviews, with meaning expressed through words, were condensed down by identifying and summarising the key themes and meaning arising from the interviews using ‘fragmentation’, or synopsis, during the write-up of digital recordings, which are provided in Appendix G.

This deviates from the strict phenomenological approach, espoused by Moustakas (1994), which requires full verbatim transcripts on the basis that the ways in which interviewees express themselves through subjective interpretation, and by relating these to constructions of the social world in which they live, is crucial to the interpretation of that data. The fragmentation method was selected as meaning from the data is structured less in narrative, and more through content and opinion (Sanders et al. 2009), consistent with the pragmatic research approach.

The key conceptual categories emerging from this process were then used to group together themes, facilitating more meaningful analysis and inductively develop a conceptual framework (Saunders et al. 2009).

Key findings from the qualitative analysis were then compared both against the tentative deductive theoretical positions derived from the literature review and the limited amount of quantitative data collected from two ECFPs, ensuring a semi-grounded, mixed methods approach was partly possible. This enhances the integrity of the findings and the credibility of the conclusions and recommendations that follow.

4.2 Data Quality

The sources of data for the 13 semi-structured interviews were considered robust enough for a study of this nature. Further details on the participants interviewed are included at Appendix F.

The three BAs interviewed had accumulated over 40 years of investment experience between them after successful business careers in other fields.
The sample of four ECFP operators includes some high-profile individuals in this nascent UK industry and is considered relatively robust, including co-founders or senior management from two of the most high-profile ECFPs in the UK currently, ‘Seedrs’ (based in London) and ‘Crowdcube’ (based in Exeter), which are both ‘open access’ to crowd investors and only require a minimum investment of £10.

The two other ECFP operators interviewed are founders of more recently established platforms, ‘Fund the Gap’ and ‘Syndicate Room’, both of which are more restrictive in access to entrepreneurs and investors alike. Syndicate Room is the only UK ECFP to build its business model around encouraging the ‘crowd’ (investing a minimum of £1,000) to participate in opportunities alongside Business Angels who have sourced and part-funded a deal.\textsuperscript{50}

The six other participants interviewed have various interests in the equity crowdfunding arena as follows:

- The CEO of the UKBAA,\textsuperscript{51} the country’s leading Business Angel representative organisation
- A serial entrepreneur who is launching a private online platform during Q3 2013, enabling HNWIs and corporate clients to access private equity investment opportunities marketed by professional accredited advisors
- Two co-founders of a leading London networking group, connecting people in the rapidly growing ‘FinTech’ strategic space and well-versed in the dynamics of crowdfunding and peer-to-peer lending, amongst other emergent models
- A doctoral researcher studying crowdfunding from the perspective of economic geography and global capital mobility

\textsuperscript{50} ‘Funders Club’ in the US and ‘My MicroInvest’ in Belgium operate similar, although not identical business models in those jurisdictions: the former is a type of online VC club restricted to ‘accredited investors’ to comply with US law, while the latter allows professional investors to access opportunities upon which a group of experienced investors has already performed DD. ‘Syndicate Room’ is thus arguably the least restrictive ECFP in this industry niche.

\textsuperscript{51} The United Kingdom Business Angels Association
• A serial entrepreneur who has established a Scottish-based reward-based crowdfunding platform, also a lobbyist for the informed regulation of the crowdfunding phenomenon in the UK
• Another serial entrepreneur who is also lobbying for informed regulation of crowdfunding, having established the ‘Westminster Crowdfunding Forum’\textsuperscript{52}

Many researchers have acknowledged the problem of self-selection when investigating the investment practices of BAs (Mason & Harrison 2009 & 2010, Wiltbank 2009), as such investors often cherish their commercial confidentiality. In addition, two of the BAs interviewed had a similar background in the life sciences and pharmaceuticals, thus their shared perspective may have skewed the findings derived from the interviews somewhat.

However, the inclusion of a more ‘generalist’ private equity investor in the sample, together with the CEO of the leading representative body for BAs in the UK goes some way towards mitigating that effect, as does the inclusion of a range of other entrepreneurial and academic perspectives on the research question and objectives.

The data itself provides a rich variety of informed opinion and experience from the participants, which goes some way towards addressing the research question and objectives and also helps to indicate future worthwhile areas of research and analysis to focus upon as the equity crowdfunding field in the UK continues to develop rapidly over the next few years.

4.3 Key Findings
The following section summarises key themes emerging from the process of analysis, synthesis and synopsis of qualitative data collected from interviews conducted for research. The figures in brackets supplied after statements relate to their assigned participant numbers set out in Appendix F.

General views on equity crowdfunding as a phenomenon
• Unsurprisingly, ECFP operators were very positive about the potential for equity crowdfunding to grow rapidly and radically change the private equity space in the UK for small companies. One highlighted the disruptive nature of

\textsuperscript{52} See section 3.7 above for more information on the Westminster Crowdfunding Forum
the technology and business model (4), while two others emphasised the opportunity the UK has to grow market leading platforms in the field due to the flexible current regulatory regime (5,7).

- Another participant suggested ‘open’ ECFPs were basically a mainstream retail offer with doubtful potential for good financial returns in contrast to more restrictive platforms that matched established investors with high quality opportunities, conceding that the market would ultimately decide (8).

- The fact that crowdfunding in general is an excellent way of proving a market concept to entrepreneurs and potential investors alike was raised repeatedly (1,9,12).

- One participant expressed concerns about the equity-based model’s ability to cope with the inevitably high failure rates that were bound to affect crowd investors over the coming years, and worried about the potential regulatory backlash following such an occurrence (9).

- Participants with entrepreneurial perspectives were predictably more upbeat, suggesting that equity crowdfunding will expand the pool of risk capital available to entrepreneurs and achieve this more economically than in the past, with enhanced entrepreneurial control over equity valuation and post-investment management (11a, 12).

- One participant emphasised that theoretically, one could create a business with forward orders and no debt without ceding meaningful control, through the sale of equity with limited voting rights attached (12).

- Another reinforced the revolutionary potential of equity crowdfunding compared to existing BA investment practices, particularly the potential to streamline deal flow and facilitate easier diversification of investment risk. He did however highlight that to date, ECFPs had been slower to grow than lending-based models, in his view due to both the lack of the mentoring provided to investees via ECFPs compared with that often provided by professional investors, and to the potentially complex capitalisation tables that crowdfunded businesses present to subsequent BA or VC investors. He raised the prospect of this new source of funding increasing entrepreneurial risk appetites in the pursuit of success (13).
The idea of ECFPs purveying a new asset class, as a result of their “democratising the funding escalator”, was raised by one participant (11a), although conversely, another suggested that crowdfunding harked back to the ‘joint stock’ companies of the 19th century raising finance from large numbers of investors for infrastructure projects (11b), contrasting this with the high transaction costs of raising equity on recognised exchanges through IPOs. Another participant emphasised the newness of ECFP’s ability to facilitate bonds of communication and trust between strangers in the investment and entrepreneurial finance communities, a positive trait of social media (12).

Motivations of ECFP Operators

- All expressed excitement at providing entrepreneurs and investors with new opportunities to source and invest capital and the ‘democratising’ potential of the private equity investment space that equity crowdfunding helps facilitate, e.g. the founder of ‘Syndicate Room’ quoted motivation from providing access to high-calibre investment opportunities, usually accessible only to wealthy investors, to the ‘intelligent crowd’ (7).
- Two expressed their frustration at the capital-raising process for their own past entrepreneurial ventures as a source of motivation for entering the field (4,9).
- One explicitly quoted the economic opportunity that recent reforms to the financial advice industry in the UK have in his view created, with wealthier investors therefore more aware of advisors’ fees and commissions and in turn becoming more open to alternative investment solutions (6)53.

53 Participant 6 stated that the Retail Distribution Review, conducted by the Financial Services Authority (‘FSA’, now Financial Conduct Authority, ‘FCA’) and designed to make the fees payable for advice more transparent to UK investors, had in his opinion created heightened opportunities for his ECFP business and he was capitalising on this in marketing material and promotions.
Motivations of Business Angels

- The BAs interviewed quoted mixed motivations for their investment behaviour, echoing those highlighted by Ramadani (2009) in the literature review.
- One emphasised supporting growth in fields characterising “the right kind of capitalism”, helping people develop economically and socially, stating that making money, while not his primary concern, was a welcome by-product (1).
- Another BA stated a desire to support socially useful technological innovations: while not wanting to lose money, he said he was not explicitly chasing large financial returns (2).
- The third characterised his motivations as “having fun, making money, doing good”, although as his age and wealth increased, confessed that doing good was assuming a higher priority in that motivational triumvirate (3).

BAs’ awareness and acceptance of equity crowdfunding

- All three BAs were highly aware of equity crowdfunding’s potential not just to help diversify their own investment portfolios but to benefit entrepreneurs and ‘ordinary’ investors (1,2,3). They highlighted the potential that crowd investment in unquoted companies could provide: helping businesses to develop through the provision of a genuinely new source of risk capital - potentially all the way to a successful exit (e.g. via a private trade sale or IPO) without utilising VC funding, thus ultimately strengthening the position of the existing shareholders in subsequent equity transactions (1,2,3).
- While one BA highlighted the increased efficiency created by removing some intermediaries or advisors from investment facilitation (2), another was sceptical that more ‘open’ platforms could really change the investment landscape without the involvement of ‘lead’ investors (as utilised in the Syndicate Room model), an understandable if predictable viewpoint from a BA mindset (1).
- All three BAs expressed greater concern than ECFP operators on the challenges for small companies maintaining good investor relations with large numbers of shareholders (1,2,3), with two also expressing concerns about the quality of investments on the more open platforms and how this would affect subsequent potential for successful exits and healthy returns (1,2).
All ECFP operators emphasised they either regarded BAs as very important current and future investors (4,5,6), or as absolutely crucial to the success of their platform (7). While only Syndicate Room targets BAs explicitly through its business model and specifically markets to them, the other ECFPs also view BAs as an important target market and direct marketing material towards them (4,5).

The UKBAA CEO stated that BAs’ general acceptance of ECFPs had increased substantially during the past 18 months, confirming that many BAs were indeed using ECFPs to streamline deal flow and diversify risk by investing a small proportion (e.g. c. 5-15%) of their investable capital across numerous small businesses. She referenced examples of BA syndicates enacting some deals through ECFPs, emphasising that experienced BAs were among Seedrs own financial backers (10). This accords with the secondary data alluded to in the literature review54.

The qualitative data obtained helps corroborate this purported use of ECFPs by UK BAs: two ECFP operators supplied data around the quantum of individual investments going through their platform (CrowdCube and Seedrs, the country’s two longest-established ‘open’ platforms). While only 1.4% of individual investments that Seedrs has facilitated through successfully funded campaigns exceeded £5,000 since trading commenced in April 2012, with 4.3% being the corresponding figure for Crowdcube (since February 2011)55, the total absolute investment inherent in these figures represents over 40% of the total funding involved56. The largest single commitment received by Seedrs was over £65,000 (Appendix H contains summary charts summarising the key points of this quantitative data).

54 See section 2.9: ‘The development of UK equity crowdfunding’
55 Source: primary data supplied by Seedrs and Crowdcube in August 2013.
56 The 40% quoted applies only to Seedrs: corresponding data was not supplied by CrowdCube.
BAs investing online as ‘crowd’ investors

- All three BAs stated categorically they would not become ‘crowd investors’, citing a lack of direct need and high inherent investment risks, stemming primarily from perceived information asymmetry and a lack of control over due diligence, valuation, timing and terms. This was not unexpected, as BAs are accustomed to dictating these factors in ‘traditional’ offline deals.
- Conversely, all expressed potential interest in becoming a ‘lead investors’ in online deals as promoted by Syndicate Room, seeing the potential to augment their capital with ‘passive’ capital from crowd investors as a useful way of expanding the quantum of risk capital at their (and by implication, at entrepreneurs’) disposal (1,2,3).

Education of Crowd Investors

- The level of knowledge and financial education of crowd investors was a key theme emerging from the interviews. All the BAs doubted that many investors would be aware that to maintain their pro-rata share in a company during follow-on rounds entails investing potentially significant further sums, with the alternative being dilution of existing equity stakes: just as this is fact of life for BAs now, it will become so for crowd investors in businesses attracting further investment rounds (1,2,3).
- One participant characterised crowd investors as ‘early adopters’, helping to pioneer a new investment model, and emphasised the need for their education on the risks and rewards implicit in equity crowdfunding investments (13).

Pre-screening, due diligence and ‘investment readiness’ work undertaken by ECFPs

- This area is becoming a differentiating factor between UK ECFPs with attitudes differing about how to approach it (12), a fact echoed by another ECFP operator (of a more restrictive platform), who stated his belief that BAs find enhanced pre-screening and DD procedures by platforms an indicator of higher potential deal quality (6).
• One platform operator stated that they only performed basic identity checks to comply with money laundering legislation, but did require a detailed business plan to be submitted (which only 20% of initial applicants did), suggesting the onus was on crowd investors to question entrepreneurs and that the attitude was ‘caveat emptor’\textsuperscript{(5)} (4).

• Another ECFP operator stated they undertake additional fact verification on business plans submitted (5).

• Another (the founder of ‘Syndicate Room’) suggested that reliance was placed on the DD performed by the lead angel investor in any one deal who had already committed a large amount of their own capital in any event (7)\textsuperscript{(6)}.

• Another ECFP employs people with private equity backgrounds to perform more rigorous legal and financial DD on investees’ business plans and submissions, believing this approach would yield a lower volume but higher quality of investment opportunities, and thus generate a lower company failure rate, with ultimately higher fee income attached as they become known as industry leaders in this regard (6).

• Other participants disagreed with this view entirely, stating that the ‘wisdom of the crowd’ pooling their shared knowledge could perform more effective overall DD on potential investments (9).

• Another stated that simple legal and financial DD was an expensive hygiene factor and was not meaningful without some common industry ‘kitemark’ scheme (not yet in existence for unquoted small companies below audit thresholds) that facilitated meaningful comparison, and that the real value lay in ‘market DD’, evaluating the fit between market opportunity and value proposition which crowds were well-placed to undertake, adding that “picking winners is not easy” (11a).

\textsuperscript{57} This is Latin for “buyer beware”.

\textsuperscript{58} However, this platform did require entrepreneurs to sign off on warranties connected to their business plans and pitches to both the lead ‘angel’ and crowd investors in their businesses.
Unsurprisingly, the CEO of the UKBAA suggested that BAs believe high standards of DD are vital to protect reputations, potential investors and ultimately, the entrepreneurs themselves (10).

Another participant agreed that undertaking in-house DD is expensive for ECFPs and questioned the sustainability of that approach, suggesting more basic checks complemented by crowds pooling knowledge is more effective. He believed that no amount of DD could materially affect company failure rates, and that ECFPs need to be very transparent about the risks involved in this area (13).

In summary, the more ‘open’ ECFPs saw themselves as more democratic, whereas more restrictive platforms tended to see themselves as offering higher quality and lower risk at the expense of what must ultimately be higher fees for crowd investors and/or entrepreneurs to cover costs. Ultimately there may be market capacity for both approaches, as they appear to be targeting different classes of investor, but only time will tell.

**Forms of share capital, shareholder rights and representation offered by ECFPs**

- One ECFP operator stressed that crowd investors should not require in-depth corporate legal knowledge to ensure their rights are protected, but that they should be confident their interests are being properly represented and protected (7).

- The ECFPs operators interviewed offer slightly differing forms of share capital and associated shareholders’ rights, and also differ in the ways in which crowd investors are represented on companies’ management boards:
  - Some ECFPs (e.g. Fund the Gap, Seedrs, Syndicate Room) offer full voting and pre-emption rights to all shareholders, irrespective of the amount invested. Others (e.g. Crowdcube) allow entrepreneurs to dictate an investment threshold above which ‘A’ shares with such rights attached are offered, and below which ‘B’ shares with no voting rights are the offered instead.
  - Some ECFPs (e.g. Seedrs, Fund the Gap) ensure the interests of crowd investors are represented on company boards via a nominee structure in
which there is only one legal shareholder representing all such investors. Others (e.g. Crowdcube, Syndicate Room) have no such arrangements, implying that potentially numerous individual shareholders co-ordinate their actions to communicate with and influence management; the Syndicate Room model in this instance being predicated on the belief that the ‘lead’ BA investor(s) (often possessing a controlling or substantial minority interest under company law) represents crowd investors’ interests efficiently as a result of the alignment of interests between the two groups.

- One ECFP operator believed that all investors, no matter what their investment size, should possess equal rights per share (7), citing the risks that:
  i) a subsequent incoming investor may not acquire crowd investors’ non-voting ‘B’ shares as there is little incentive to do so, and
  ii) without pre-emption rights, a crowd investor’s stake in a successful investee business could be hugely diluted by the issuance of new equity just before an IPO transaction is enacted

- Characterising themselves as ‘good stewards’, the two ECFPs operating a nominee structure stated that they protect crowd investors’ interests by maintaining nominees’ right of veto over such management decisions as awarding unreasonable bonuses (5, 6), citing the resultant ‘clean’ capitalisation table of relatively few legal shareholders as attractive to subsequent investors such as BAs or VCs who might find a complex listing of small shareholders a potentially unattractive prospect (5, 6). Another participant affirmed this as a wise approach (13).

- One of these ECFPs appears to go slightly further than the others in investor relations, actively offering support and assistance in this area (6).

- The form of share capital offered and the way crowd investors’ interests are represented in investee’s governance structures appears to be a further differentiating factor between ECFPs in the UK at present. One BA participant indeed identified that in time, the form and structure of equity offered could be a defining difference between platforms (1).
Differing ECFP business models to address the ‘equity gap’ for small companies

- All BAs interviewed believed that the model of explicitly combining professional and crowd investors is a good one in addressing the equity gap facing small businesses (1,2,3).
- ‘Syndicate Room’ is predicated on this partnership, with the founder stating that the supposedly superior quality of investment opportunities will address a higher value portion of the equity gap more effectively by providing an ‘informed crowd’ with the confidence to invest alongside a professional (7). However, the other ECFP operators interviewed believed that their sites were also fulfilling this investment partnership role (4,5,6).
- One participant believed that the equity gap was most acute for those businesses right at the bottom of the funding escalator and that her reward-based platform addressed this well, expressing repeated doubts about the long-term viability of the equity model due to her predictions of high future company failure rates disappointing crowd investors and eliciting a draconian regulatory response (9).
- Another participant stated that slightly different ECFP business models may end up addressing different stages of business development and therefore different parts of the existing equity gap(s) (12). Another ECFP operator agreed, stating that more ‘open’ models tend to attract lower average investment by size but are genuinely opening up a new retail-oriented asset class, while she argued the more restrictive sites are arguably “just making angel investing more efficient” (5).
- Another participant suggested that any ECFP model just matched potential investors with businesses, but remained sceptical about their potential to materially affect the status quo of the private equity market (8).
- Another summarised by stating it was at present simply too early to conclude whether BAs investing alongside the crowd online will help plug a larger part of the equity gap than either group investing separately online, or indeed BAs investing alone offline (13).
Regulation

- Participants unanimously agreed on the crucial importance of the emergent regulatory framework for the continued development of equity crowdfunding in the UK\textsuperscript{59}.

- Several stated that this response could define whether the UK became a world leader in the area or not (3, 7, 10), with one remarking on the contrast with the prescriptive approach and slow implementation from the Securities & Exchange Commission (‘SEC’) in the US in the wake of the JOBS Act passed in April 2012 (10).

- Another was concerned that this response might be heavy handed in the wake of what she saw were inevitably high failure rates of investee businesses over the coming years (9).

- Yet another observed that a contrast exists between the increasingly international or global nature of money flows using crowdfunding and the persistence of existing regulatory approaches based on national jurisdictions, which remain very important in economic and financial governance (13).

- Of the 4 ECFP participants, two had already secured FCA authorisation in the UK (Seedrs and CrowdCube), one was authorised via an agent that it uses (Fund the Gap) and the other (Syndicate Room) declared that they would seek authorisation in due course.

Suitability of sectors for equity crowdfunding

- Several participants highlighted the suitability of ‘tech’, ‘cleantech’, ‘greentech’ and healthcare sectors for equity crowdfunding due to the high profile of these sectors in the public consciousness and the relatively small sums often required to prove concepts and test the market in these areas (1,13,7).

- One of these suggested that consumer-facing gadgets were easier for crowd investors to relate to rather than ‘B2B’ products (13), a fact reinforced by one ECFP operator’s contention that retail products are popular with the crowd but not with BAs due to the high level of risk involved (7).

\textsuperscript{59} A summary of the UK’s developing regulatory response to the equity crowdfunding phenomenon is provided in Appendix E.
- The CEO of the UKBAA agreed with this, suggesting that for riskier business models crowdfunding provides a potentially useful source of quick investment if the pitch is constructed intelligently (10).
- One BA highlighted charitable causes and local infrastructure and amenities as sectors using crowdfunding to reduce fundraising transaction costs and increase their popular appeal, albeit mainly via donation and reward-based models rather than equity crowdfunding (2).
- The two BA participants with a background in the sector were at pains to point out that the very large sums and long developing periods required by biotechnological innovations, and the traits of equity crowdfunding campaigns, were not well suited for each other, at least in their current guises (1,2).
- ECFP respondents were more sector-agnostic, emphasising that any business with high-growth potential was welcome on their platforms (4,5,6,7).
- Another participant suggested the sectors where equity injections would have a proportionately greater positive effect were most suited to equity crowdfunding, but that these were not necessarily the sectors that would benefit from the phenomenon, due to the preferences crowd investors might have for sectors that are ‘en vogue’ or that appeal to their particular value sets or ethical perspective (11a).
- Another respondent reiterated the truism that to date, the creative and project-based industries (e.g. film-making, music, art, theatre etc.) had benefitted from the reward model (12).

**Business Development stages targeted by ECFPs**

- There were differences in the size of crowdfunding campaigns the ECFP operators interviewed traditionally target, although the platforms varied in the amount of funding they had supplied to businesses, therefore it may be too early to draw conclusions here.
- CrowdCube, the most mature platform having supplied £10.2 million to investee businesses to date, averages around £170,000 per successful pitch (4).
- Seedrs is younger, having supplied around £1 million to date at an average of around £40,000 per successful pitch and with another £1.2 million in pending
campaigns at the time of writing\textsuperscript{60}, but states its aim is to provide seed capital up to £150,000 (5).

- Fund the Gap is younger still but states that it will happily target larger campaigns and is mulling over teaming up with established finance houses to help facilitated later stage deals (6).
- Syndicate Room was just about to launch to crowd investors at the time of research but the founder stated his target funding round would typically be between £150,000 and £500,000 with at least 25% of that amount coming from the lead angel investor(s), although in practice early discussions for his first deals had seen lead investors contributing up to 75% of a funding round (7).

**Secondary Market**

- Many participants also highlighted the increased potential value for unquoted company shares (including those obtained through equity crowdfunding), should a functioning secondary market for those shares emerge. The increased liquidity such a market would provide could draw much more capital into such businesses and ECFPs are alive to the business opportunities that would exist in helping to facilitate transactions (4,5).
- Indeed, one participant highlighted that ‘SecondMarket’ was an emergent exchange in the US that had partnered with an ECFP to be its in-house provider of secondary trades\textsuperscript{61}, while both CrowdCube and Seedrs mentioned that they had already considered this idea themselves (4,5).
- However, one ECFP operator and another participant separately were both sceptical about the prospects for the emergence of a functioning secondary market, believing this would fundamentally change the risk/reward profile of investing in ‘unquoted’ shares and that the basic pricing problem rooted in the large information asymmetries for such equity could not be easily surmounted; indeed even on exchanges such as the AIM exchange in London there had been pricing problems and a lack of liquidity on occasion (6,13).

\textsuperscript{60} Per primary data obtained from Seedrs itself on 8\textsuperscript{th} August 2013.

\textsuperscript{61} The ECFP in question was ‘Circle Up’ and SecondMarket has contracted to be its intra-platform (as opposed to inter-platform) provider of secondary trading.
• The founder of Syndicate Room agreed, suggesting the only way around these issues was to offer the pre-money valuation to all existing shareholders when a third party transaction for some equity occurs, providing a negotiated arms-length price, while acknowledging the risks of such a system being open to abuse and collusion (7).

• Another participant observed the lack of liquidity was a real issue for many private equity investors and BAs at present, with many investors being locked into follow-on funding rounds in the hope of eventually securing a successful exit (9), echoing Wiltbank (2009) and Mason & Harrison (2002).

• However, the CEO of the UKBAA did point out that a US entrepreneur was trying to launch just such a secondary market in the UK during the summer of 2013, and that it would be very interesting to see how this developed over the next months ahead (10).

Is equity crowdfunding destined to be substitutional or complementary to existing angel investment practices?

• BA participants stated it would be generally complementary, suggesting that ECFPs will in the main be used by small-scale investors who will have no control over valuation, the level of equity on offer or indeed the identity of their fellow investors, and in addition target a very different type of business compared to the typical BA, or professional investor (3,8).

• They all also concluded that if BAs were using ECFPs for a portion of their investable capital (which it appears they increasingly are from the qualitative and quantitative data available to this study) that this was both complementary and to an extent substitutional: it allowed BAs to diversify investment risk and ‘place more bets’ using smaller individual investments,

62 The business in question is ‘Liquity’ [http://www.liquity.co.uk/] and is being launched by Barry Shrier, a successful US entrepreneur and inventor. It has recently launched £150,000 in its own initial funding round and is beginning to market itself to unquoted companies and existing and potential shareholders in such companies to trade equity in a secure online environment.
but also diverted a finite quantity of BA capital online from the traditional offline deals (1,2,3).

- Another participant suggested that from the entrepreneur’s perspective, the growth of ECFPs would challenge BAs to genuinely add value to their investee businesses. The theory was that BAs do not always possess the personal networks, business experience and mentoring skills that they claim during negotiations with entrepreneurs, and that as a result, this supply of capital becomes inefficient and hugely expensive. The implication of this is that ECFPs will therefore separate UK BAs into ‘good’ angels and ‘bad’ angels, with ECFPs only being genuinely substitutional to ‘bad’ angels (11a).

- Two participants raised the prospect of a break from existing BA investment practices and expectations, and a change to the balance of power between entrepreneur and investor (11a, 12).

- The fact that equity crowdfunding could indeed supply capital that enabled BAs to go without intrusive VC funding and its associated conditions for longer was raised as a highly complementary factor by one BA (1), a fact not lost on the founder of Syndicate Room who suggests this is a key selling point of his model for angel investors (7).

- Another BA reiterated the attractiveness of ECFPs providing valuable deal flow for angels who could later approach investees offline for larger stage deals after concepts had been proven (3).

- Similar views emerged from ECFP operators. One suggested ECFPs were indeed both complementary and substitutional to traditional BA practices, but suggested it depended on the wealth of the BA: it was very complementary for richer BAs investing more, whereas more competitive for smaller BAs with less capital (5).

- Other ECFP operators were more keen to stress the complementary nature of the model, suggesting ECFPs took the pain out of pre-screening business plans for BAs and that they attracted new money into unquoted businesses that BAs could leverage (6,7).

- Two participants also suggested the more ‘open’ sites attract money towards earlier-stage businesses with greater popular appeal (and higher average
risk) than those favoured by BAs, emphasising that ECFPs were complementary from the entrepreneurial perspective too (7,8).

- The CEO of the UKBAA agreed on the complementary nature of the two phenomenon on the whole, suggesting that the added-value of mentoring provided by experienced angels would be very hard for ECFPs to replicate and that equity crowdfunding is really competition for other sources of seed and early-stage finance such as friends and family, bootstrapping or bank debt, adding that BAs can and will approach investee businesses offline for more significant deals once ECFPs have helped them prove their concepts and demonstrate high-growth potential (10).

- Participants viewing the question from a more entrepreneurial perspective did argue that equity crowdfunding could become substitutional as it provided real alternatives for entrepreneurs who could spurn ‘expensive’ BA capital, ironically in much the same way that ECFPs could help BAs spurn VC capital (9,12).

- One participant suggested the answer to this question really depended on a range of factors: whether the amount required was in the typical BA syndicate ‘sweet spot’, whether the industry sector was one that BAs tended to favour, whether the knowledge required in that industry was ‘deep and niche’ or widespread, whether the existing shareholding structure would likely discourage BAs, to quote some examples of criteria. He added that there was strong evidence that BAs were using ECFPs to curate deal-flow and that more empirical work was required to examine this more fully (13).

**Challenges for the equity crowdfunding sector**

There were many challenges that the UK equity crowdfunding sector faces over the coming years highlighted by participants. The most common included the following:

- Public education surrounding financial risk in private equity, particularly with regard to the facts around:
  - failure rates of businesses (4,5,10)
  - the kind of equity that they hold and the rights attached to it (5)
  - the frequent need for follow-on funding to secure an eventual return (3).
- Supporting investors and entrepreneurs with investor relations, particularly with large numbers of shareholders in a small company (1,3).
- Helping to represent the interests of smaller shareholders (1), whether via a nominee structure or a lead investor with more experience (10).
- Undertaking enough pre-screening and DD to mitigate some investor risk and help prevent a large-scale fraud (6,7), but without incurring unsustainable overheads and having to raise fees as a result (2,9).
- Lobbying to avoid a backlash from ‘big finance’ (i.e. banks and financial institutions) that may eventually perceive crowdfunding as a threat and lobby government to ‘protect the consumer’ when their objective is to remove a threat (2).
- Working to create trust between the parties involved by helping to recommend investments based on investor preferences and track record (8).
- Using technology and digital communications to help recreate the mentoring and support that professional investors can provide to their investees, via ECFPs (13).

**Future Trends within the industry**

- Similarly, several predictions were forthcoming from participants about trends that could emerge in the UK equity crowdfunding sector over the coming years, including:
  - The continuation of the current specialisation and differentiation in the sector targeting different investor groups and different stages of business development, etc, followed by consolidation as the more successful models win out and either acquire opponents or steal their market share (7,8,5).
  - Larger deals put together by BA syndicates providing more opportunity for ECFPs to work with them and help structure deals involving passive capital (7).
  - The evolution of ‘local crowdfunding’ to support infrastructure or services in one’s own local area (8).
5. Conclusions & Recommendations

This research has involved an exploratory, cross-sectional, semi-grounded mixed-methods study surrounding the emergence of equity crowdfunding in the UK and whether it is complementary, or substitional, to existing ‘Business Angel’ investment practices.

While press coverage and industry reports have tracked the heightened profile of the crowdfunding phenomenon, there has been very little academic research into the interface between existing BA activity and equity crowdfunding platforms.

While a study of this nature, with limited time and resources, can only point to potential conclusions to draw from the data and recommend further areas for useful and relevant research, this is an opportune time to be investigating this emergent area of entrepreneurial finance. The economic crisis, ongoing since 2008, has curtailed the supply of bank finance to many small firms in the UK and has heightened the importance of other funding sources to them.

Meanwhile, persistently low interest rates have meant many investors, wealthy or otherwise, have been searching for potentially high-yielding investments, which inherently require a higher risk appetite than that applicable to cash or quoted equities, for example. Investing in unquoted companies can indeed provide good returns, but is a high-risk activity, as demonstrated in the literature review.

The objectives of the research are:

1. To determine whether 'crowd money' has the potential to offer a genuinely new supply of risk capital for small unquoted companies in the UK.

2. To explore whether BAs are using ECFPs to channel at least a portion of their investable capital through to unquoted companies, and if so, what their motivations for doing so are.

3. To examine whether BAs and the crowd co-investing alongside each other on ECFPs helps to plug a larger portion of the equity gap than that traditionally addressed by BA investment models.
5.1 Conclusions

1. On the basis of the research conducted, the consensus view of the participants interviewed is that the majority of investments facilitated by equity crowdfunding platforms are indeed a new source of risk capital for small unquoted companies. This is reinforced by the quantitative data indicating that the vast majority of individual investments in successful campaigns (between 96% and 98%, depending on the ECFP concerned) are below £5,000, with between 82% and 92% being under £1,000 (depending on the ECFP concerned).

This assumes those making small investments via ECFPs were not investing in seed and early-stage unquoted companies previously. The nature and scope of this study means it is not possible to come to a definitive conclusion on this point, as this would require a large sample size for a quantitative study of current crowd investors. However, given the findings of this exploratory research, it appears reasonable to assume that this is not the case, and that the majority of crowd investors are indeed supply a new source of risk capital to unquoted companies.

2. However, larger amounts more akin to BA levels of investment make up a significant minority of total absolute funds (as opposed to the number of individual investments) going through both Seedrs and CrowdCube (c. 40% for both ECFPs). This accords with the view of the CEO of the UK BAA and of the ECFP operators interviewed, who were clear that some BAs were indeed using platforms for at least a portion of their investable capital.

Again, the limitations of the scope and resources available to the author make it impossible to verify in this study whether these larger investments are indeed being made by established BAs or those who would already consider such informal private equity activity. However, given the qualitative and quantitative findings of this study, it appears reasonable to surmise that to some extent at least, this is indeed the case. While awareness of equity crowdfunding within the general population is growing at present, largely as a
result of press coverage, it appears to be high amongst the BA community in the UK.

The motivations provided by participants in the study driving BAs to engage with and use ECFPs for a portion of their investable capital were consistent:

- Using ECFPs to help diversify investment risk across a wider range of small-scale investments, thereby ‘placing more bets’ for the future
- Helping to streamline deal flow with a view to their crowdfunding investments producing an acceptable proportion of high-growth companies to approach offline as part of a traditional deal (either inside or outside a syndicate), or to invest more via ECFPs, leveraging more passive capital from crowd investors later on
- Potentially thus delaying or removing the need for VC involvement in subsequent funding rounds, enabling existing shareholders to crystallise more of the value creation generated by investee businesses

Indeed, the emergence of ‘Syndicate Room’ onto the UK’s ECFP market during the summer of 2013, when this study was conducted, is a strong indicator of perceived demand from BAs to participate in equity crowdfunding campaigns. Time will tell on the size of this demand and indeed on the longevity of the equity crowdfunding business model as a whole.

3. With regard to the question of whether BAs investing alongside crowd investors can help address larger portions of the existing equity gaps for small companies, the paucity of empirical data means that it is probably too early to come to a definitive conclusion.

However, Collins & Pierrakis (2012) do suggest that this indeed may be the case as equity crowdfunding may address a set of businesses in a different portion of the risk/reward matrix than that traditionally associated with BAs.

To answer this question in a more robust way would require a longitudinal study comparing failure rates and shareholder returns for a sample of
investee businesses funded only by BAs with other samples funded by only crowd investors, and also of the two groups investing alongside each other. Indeed, the study could be extended to include investment returns achieved by those using ‘open’ and ‘restrictive’ ECFPs too.

As a result of these conclusions relating to the research objectives, this study provides clear pointers for addressing the initial research question of whether the emergence of equity crowdfunding in the UK is complementary, or substitutional, to existing ‘Business Angel’ investment practices:

To the extent that ECFPs are drawing in a new source of funding to informal private equity, ECFPs are clearly complementary to BA investment practices and can provide passive capital which established BAs can use to help leverage deals, a model explicitly employed by ‘Syndicate Room’

Although ECFPs appear to be diverting some finite BA capital to online deals alongside crowd investors, away from traditional syndication with other BAs or classes of investor and are thus substitutional to established BA investment practices, this ignores the ‘leverage effect’ that the crowd investors’ passive capital provides

To the extent that ECFPs provide a competitive source of funds for entrepreneurs, particularly when set against ‘expensive’ BA capital where valuable expertise, networks and mentoring are not forthcoming, ECFPs are clearly substitutional. However, from the perspective of entrepreneurial finance in the UK (rather from that of ‘bad angels’) this is a positive change, decreasing the cost of the supply of capital and increasing its efficiency.

To the extent that crowd investors and BAs are in competition for similar investment targets, this does indeed depend on a range of factors that would again required further quantitative research based on larger samples of equity crowdfunded businesses focusing on the following:
• Whether the amount sought was in the typical BA syndicate ‘sweet spot’
• Whether the industry sector was one that BAs tended to favour
• Whether the knowledge required in that industry was ‘deep and niche’ or widespread
• Whether the existing shareholding structure would likely discourage BAs, to quote some examples of criteria

In summary however, on the balance of evidence offered by this study, it would appear that equity crowdfunding is indeed largely complementary to existing BA investment practices.

5.2 Recommendations & Further Research
The study highlights the need for many pieces of further research, particularly given the fast-developing and emergent nature of equity crowdfunding in the UK and the fact that the regulatory regime is adapting all the time to the way the industry is evolving. However, the following recommendations and suggested further research areas appear relevant to the author:

i) The UK Government should use the emergence of equity crowdfunding as the source of a pilot study on encouraging additional investment into the country’s small businesses. Potential elements of such a study could include:

• Incremental changes to the FCA’s regulatory regime to study their effects on investment activity (including an increased focus on public education around the risks and rewards involved, rather than by taking the prescriptive and prohibitive approach adopted by the SEC in the US)
• Investing ‘Angel Co-Fund’ monies in deals involving equity crowdfunding

ii) Academic and industry research should focus on the financial returns achieved for shareholders by businesses funded by ‘open’ and ‘restrictive’ ECFPs respectively. This would best be achieved by a longitudinal study of two carefully selected samples of investee businesses.
iii) Further research into the potential for the emergence of a secondary market for currently unquoted companies would be an interesting and potentially valuable piece of work to undertake. The emergence of ‘Liquity’ and other platforms in the UK and overseas, and the way that pricing and trust is established (or not) between counterparties could provide valuable insights into increasing the liquidity of equity in such companies, and thus the confidence of investors and in turn the value of this equity in future.

iv) Further work on the effect of emergent ECFPs on BAs over the coming years would be useful, particularly with reference to the interesting theory that platforms will drive BAs with limited ability to add value to their investee businesses out of the market.

v) A study on the potential dependence of the UK equity crowdfunding model on the tax incentivisation schemes such as the SEIS and EIS.

In conclusion, it is clear to the author the emergence of equity crowdfunding is potentially a valuable source of new risk capital for UK businesses, and consequently could be of real benefit in spurring economic growth. There are benefits for entrepreneurs, crowd investors and indeed for BAs in working together to leverage the power of the phenomenon in various ways, providing the regulatory response is sensible and measured.
Appendices
Appendix A: Summary of the recommendations made by the Breedon independent industry taskforce into alternative debt markets to boost financing options for business, and the UK government’s official response

<table>
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<th>Recommendation</th>
<th>UK Government Official Response</th>
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| **Introduce a UK business finance advice scheme to help guide business through the complexities of sourcing bank and non-bank finance, and where appropriate, the relevant government support schemes.**  
The main accountancy bodies have agreed to work together under a ‘kitemark’ scheme to help deliver such a programme on a consistent basis. | The government welcomes this industry-led development. The government’s online Business Finance Finder tool is also available to help seek out information and advice, but a further response will be forthcoming during 2013 on how to improve access and understanding to SME-directed government schemes. |
| **Improve communication of government support programmes through the creation of a single for its interventions.**  
Many businesses are confused by the plethora of government support programmes available (see Appendix D) for a summary of the most important. Frequent changes to the branding and terms of these schemes mean it is difficult to navigate your way through them as a potential borrower/investee. | The Government will consider how best to improve both awareness and understanding of SME schemes. This will include consideration of existing schemes and the use of a unifying umbrella brand to provide more clarity to SMEs. |
| **Responsibility for delivery of Government Access to Finance programmes should be consolidated into a single delivery agency.**  
Government provides a range of business support activities through a number of different organisations such as HM Treasury, BIS, UK Export Finance, the Carbon Trust, and businesslink. Businesses do not know where to turn if they are turned down for a loan from their bank. Often, they then decide not to proceed with their investment plan due to the time required and the uncertainty in attempting to secure alternative finance. A single entity could provide better delivery of the full range of existing Government programmes through the creation of a ‘one-stop shop’. Such an agency could also ensure the objectives of each intervention lead to coherent outcomes as a whole and expand current capabilities within businesses through training and management support, particularly in the area of finance expertise. | The Government also welcomes the suggestion of a single delivery agency for Government support schemes. This provides a welcome contribution to the debate on the role of Government finance interventions in tackling market failures. The comparison with state-supported agencies in other countries shows the different models available. The Government will examine the options and will need to consider the evidence and rationale carefully, balancing any proposals for change with the need to ensure continuity for existing schemes that work well. |
<p>| <strong>Launch a feasibility study, led by Association of Financial Markets in Europe (AFME), to explore the creation of an aggregation agency to lend directly to SMEs and/or to pool SME loans to facilitate SME access to the public corporate bond markets.</strong> | The Government will support the feasibility study into how such aggregation models could be developed, involving participants from across the finance community and co-ordinated by the Association for Financial Markets in Europe. The Government recognises it may have a role to play in supporting the initial development of these markets. If such support is appropriate, the Business Finance Partnership (BFP) could be a potential source. However, BFP investments must be commercially sustainable, requiring private investors to share in the risks that taxpayers would potentially be exposed to. Separately, the UK financial authorities will publish a paper later this year on improvements to UK securitisation markets, which are another potential tool for directing institutional investment to SMEs. |</p>
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<th>Increase the number of UK-based Private Placement investors through an industry initiative led by the Association of Corporate Treasurers.</th>
<th>For mid-sized businesses, the Government welcomes industry ambitions to expand the UK private placements market. We are grateful to the Association of Corporate Treasurers (ACT), which has agreed to drive and co-ordinate this through the establishment of a UK Private Placements organisation to standardise documentation and develop common processes for credit appraisal.</th>
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<td>(Whilst UK issuers account for nearly 21% of the global private placement market, the vast majority of these issues are placed with US based investors)</td>
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<td>Increase the UK retail investor appetite for corporate bonds through:</td>
<td>The Government welcomes the growth in retail bond markets and supports proportionate regulation of these markets, balancing protection of investors against the regulatory burden on issuers and the markets themselves.</td>
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<td>a.) Launching electronic retail-dedicated gilt products available through registered stock exchanges; and</td>
<td>The taskforce suggest that one way of improving retail investors’ familiarity with bonds could be through launching retail-dedicated gilt products on registered exchanges. Currently, retail investment in Government borrowing is delivered primarily through National Savings and Investments, whilst gilt products are issued by the Debt Management Office (DMO) and mainly focused on the wholesale market.</td>
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<td>b.) Introducing additional tax incentives for investing in SMEs.</td>
<td>Both these institutions have a mandate to finance Government borrowing at the lowest possible cost to the taxpayer, subject to risk. The DMO keeps its issuance channels under review and would consider using emerging retail bond platforms if they were to provide a cost-effective proposition. Retail investors can already invest in gilts by applying directly at one of the DMO’s public auctions, and can also invest in the secondary market through its Approved Group and Purchase and Sale Services, through a bank, a stockbroker of their choice, or the DMO’s approved market makers.</td>
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<td>Government should:</td>
<td>The Government believes that all firms should be able to manage their supply chains in a way that suits them, but that larger firms should not benefit by squeezing terms offered to smaller suppliers.</td>
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<td>a.) Require that benefits to large companies of its prompt payments are passed on to their suppliers; favourable payment terms should be withdrawn if those agreements are not met.</td>
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<td>b.) Explore practical ways to encourage faster payments by larger companies.</td>
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<td>c.) Work with industry associations to promote invoicing best practices to enable more effective enforcement of the existing legislation on late payment.</td>
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<td>Government should:</td>
<td>The Government already acts as an exemplar on prompt payment, with a target to pay 80% of undisputed invoices within 5 days and requires its prime contractors to pay Tier 2 suppliers within 30 days. The Crown Representatives team, who coordinate the Government’s approach to the management of key suppliers across all departments, strongly encourage prime contractors to pay more quickly than 30 days. Departments monitor the performance of their suppliers in meeting the 30 day commitment and are expected to follow up instances of consistent poor performance as part of their contract management processes. In addition, suppliers can use the Cabinet Office’s ‘Mystery Shopper’ service2 to report to Government instances where payment is slipping, as well as other instances of poor procurement practice. The results of Mystery Shopper</td>
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cases are published quarterly.

Beyond prompt payment, the taskforce recommend that larger companies use their credit strength to help suppliers access additional sources of credit and improve liquidity levels. The Government is keen to examine the role of innovative solutions, such as supply chain finance, which aim to speed up payments within supply chains, and will seek out opportunities to bring businesses together to explain and promote its potential as a credible financing option.

The Government is also exploring

i) how to speed up payments to SMEs in its own supply chains, having recently announced plans to extend the use of Project Bank Accounts (PBAs) beyond the Construction Sector across government procurement, commencing with Facilities Management and Defence. PBAs have been successfully piloted by the Highways Agency and have had significant success in reducing the duration that tier 2 suppliers have to wait in order to get paid. In addition, the Government is also considering the role of supply chain finance as a means to reduce the working capital costs for the SMEs in its supply chains;

ii) whether Government can use its purchasing power to encourage greater use of supply chain finance for businesses;

iii) the role for supply chain credit support to enable faster payments within supply chains more generally; and

iv) whether Government guarantees can be used to support supply chains, including the scope for UK Export Finance, businesses and banks to work together.

Government should explore the potential for the Business Finance Partnership to make commercially attractive investments in the following:

a) Online Receivables Exchanges;

b) Mezzanine Loan funds; and

c) 2P lending platforms.

The taskforce highlights the potential growth in emerging financial products, including asset-based finance, mezzanine finance, and peer-to-peer lending as alternatives to traditional bank finance. It calls on Government to stimulate further development of these products by inviting bids to the Business Finance Partnership (BFP). The BFP has initially focused on investment in loan funds that can lend directly to mid-sized businesses. The Government requested proposals for investment in January 2012, and 24 were received. Budget 2012 announced that the Government intends to invest up to £700m with some or all of seven shortlisted fund managers, subject to due diligence and private sector fund-raising. The Government also allocated an additional £200m to the BFP. The Government has also considered other channels through which the BFP could invest, and supports the aim to use the Business Finance Partnership to stimulate innovative and sustainable forms of finance that can reach smaller businesses. The Government welcomes the development of new and innovative forms of finance such as peer-to-peer lending and recognises the potential of these models to have a positive impact on the SME lending market. The Government has allocated £100m of the BFP to invest through non-traditional channels that can reach smaller businesses, which could include peer-to-peer
lending as well as mezzanine loans and asset-based finance. The Government will request proposals for investment in May. The Government also welcomes moves by peer-to-peer lending platforms to develop an industry body, which could help raise awareness among SMEs and investors and establish industry standards to protect investors and borrowers.

The Government recognises the important role played by Community Development Finance Institutions (CDFIs) in providing loans to smaller businesses. These constitute an important part of the business finance landscape and can present a genuine alternative to mainstream lenders. The Government supports investment into CDFIs through the Community Investment Tax Relief (CITR).

| UK authorities and business representative bodies should provide an evidence-based perspective of the impact of international regulatory measures on the provision of bank and non-bank finance to UK SMEs and to update their evidence on an annual basis. | The Government believes the current balance of regulation is appropriate and will strengthen the resilience of the UK financial sector, thereby supporting the wider economy. |

- Analysis by the Basel Committee on Banking Supervision and the European Commission suggests that there will be large net benefits to the UK economy of the Basel III agreement, with SMEs as key beneficiaries of enhanced macroeconomic and financial stability.

- While the macroeconomic benefits of these regulations are clear, the Government is committed to ensure that any unintended consequences that disadvantage businesses are considered. The UK financial authorities are supporting an evidence-based approach at the European level to help ensure consistency across European rules.

- Another relevant issue the taskforce raise is the treatment of trade finance under Basel III. The Government welcomes the ongoing efforts of the BBA's Business Finance Taskforce in analysing this matter and encourages them to develop further evidence. On Solvency II, the Government remains committed to working with the industry to ensure a sensible package to protect insurers' role as investors in the economy, for example on long-term guarantee products.

- The Government recognises the importance of continuing engagement in the European debate on financial regulation and already works closely with the Bank of England and the Financial Services Authority to gather evidence on these issues. The Government would welcome ongoing engagement from industry to ensure that international regulation is proportionate and balanced in its impact on SMEs.

The BBA should explore greater credit data sharing with non-bank providers, and this should be considered by the FCA; and

Government should consider whether further data could be made available to support the development of new finance products and markets to benefit businesses.

Beyond specific products or institutions, the taskforce also pointed to the potential for greater sharing of information to facilitate more lending via non-bank channels.

This issue has frequently been raised as a potential barrier to the development of alternative sources of debt finance. The Government agrees that this warrants further exploration and would welcome a commitment, through the British Bankers' Association (BBA) working with non-banks and credit reference agencies.
agencies, to improve the sharing arrangements for credit information in order to facilitate greater accuracy in the assessment of risk.

The Government has already committed to opening up public data in the interests of greater transparency and will explore whether the release of further specific types or categories of data, be it publically or for individual use, would be of benefit to third party assessors of risk thereby facilitating the provision of finance - whether formal such as a loan or informal such as suppliers offering extended credit.

An industry-led Taskforce should be launched to make specific proposals on how to remove barriers on bank lending to support SME trade finance.

The Government welcomes the ongoing efforts of the BBA’s Business Finance Taskforce in analysing this matter and encourages them to develop further evidence.

The European Parliament has been discussing the treatment of trade finance under the Capital Requirements Directive.
Appendix B: Diagrammatic representation of a crowdfunding campaign

(Source: Baeck, et. al 2012)
Appendix C: Summary statistics on global crowdfunding

2011 growth in worldwide funding volume ($ million)

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<tbody>
<tr>
<td>Donation-based</td>
<td>530</td>
<td>854</td>
<td>1,470</td>
<td>1,063</td>
</tr>
<tr>
<td>Reward-based</td>
<td>1,013</td>
<td>256</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lending-based</td>
<td>472</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity-based</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Growth: 61% 72% 91%

Source: Massolution 2012 (research-based estimate)
Growth in the number of CFPs by category

Source: Massolution 2012

2011 percentage breakdown of CFPs by region and category

Source: Massolution 2012
Funds paid out per equity-based project

Source: Massolutions 2012 (based on a sample of 10 CFPs)
**Appendix D: UK Government current supply-side stimulus packages for SME growth**

<table>
<thead>
<tr>
<th>Scheme Name</th>
<th>Scheme Type</th>
<th>Operating Since</th>
<th>Quantum Available to Date (approx.)</th>
<th>Operational Notes/Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Enterprises Investment Scheme</strong> ('EIS')</td>
<td>Tax incentive for investment</td>
<td>1993/94</td>
<td>£100 million</td>
<td>Tax reliefs offered to investors purchasing a maximum of 30% of the ordinary share capital in private companies. Income tax relief is available at 30% of amount invested up to a maximum of £300,000 relief. Total Capital Gains Tax ('CGT') relief is available on the subsequent disposal of shares qualifying on acquisition for this income tax relief, or where other taxable gains are invested in EIS eligible shares. Losses on disposal of eligible shares can be set against other taxable gains. Specific reference to Business Angel eligibility for relief even if a company director, providing that they receive no remuneration. <a href="http://www.hmrc.gov.uk/eis/">http://www hmrc gov uk/eis/</a></td>
</tr>
<tr>
<td><strong>Seed Enterprises Investment Scheme</strong> ('SEIS')</td>
<td>Tax incentive for investment</td>
<td>2012/13</td>
<td>£8.6 billion</td>
<td>Complement to EIS but specifically for seed and start-up stage companies and thus offering more generous reliefs to reflect investment risk. Tax relief is available at 50% of the cost of eligible shares in a company less than 2 years old and with a maximum of 25 employees and £200,000 of gross assets, if they are held for at least 3 years, up to a maximum of £50,000 annual relief. Taxable gains for CGT purposes can be offset against SEIS-eligible relief. Maximum of 30% of ordinary share capital allowed, as per EIS. <a href="http://www.hmrc.gov.uk/seedes/index.htm">http://www hmrc gov uk/seedes/index.htm</a></td>
</tr>
<tr>
<td><strong>Venture Capital Trusts</strong> ('VCTs')</td>
<td>Tax incentive for investment</td>
<td>1995</td>
<td>£4.6 billion</td>
<td>VCTs are publicly traded closed-end funds which themselves invest in private equity unquoted investments. As such they help to spread investment risk across a range of investments. For new shares issued by VCTs, income tax relief is available at 30% of the amount invested up to £60,000 of relief, provided the shares are held for at least 5 years. For second-hand shares (i.e. those shares in VCTs bought on a recognised exchange) dividends are exempt from income tax and CGT taxable gains are exempt. VCT fund managers have 3 years to make their qualifying investments, using up at least 70% of VCT assets. These can be loans to companies as well as shares or securities. Investments in a qualifying company can reach £1m but must not exceed 15% of the VCT's assets. <a href="http://www.hmrc.gov.uk/guidance/vct.htm">http://www hmrc gov uk/guidance/vct.htm</a></td>
</tr>
<tr>
<td><strong>Business Angel Co-Investment Fund</strong></td>
<td>Co-investment Fund</td>
<td>2011</td>
<td>£50 million (expansion to £100m announced March 2013)</td>
<td>The CoFund is a consortium established by private and public bodies with BA investment experience, including the Regional Growth Fund and the nascent Business Bank (see below). The fund aims to support Business Angel ('BA') investment into high-growth potential early-stage SMEs in deprived areas of the UK to support long-term, high-quality employment in growth businesses. The CoFund can invest between £100,000 and £1 million alongside BA syndicates who must put forward investment proposals, up to a maximum of 49% of any investment round. The CoFund’s independent investment committee makes investment decisions. <a href="http://www.angelcofund.co.uk/">http://www angelcofund co uk/</a></td>
</tr>
<tr>
<td>Scheme Name</td>
<td>Scheme Type</td>
<td>Operating Since</td>
<td>Quantum Available to Date (approx.)</td>
<td>Operational Notes/Comments</td>
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<td>---------------------------------------------------------------------------</td>
<td>---------------------------------------</td>
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<tr>
<td>Enterprise Capital Fund (&quot;ECF&quot;) Programme</td>
<td>Co-investment Fund</td>
<td>2006</td>
<td>£240 million of government commitments to date</td>
<td>Designed to help bridge the ‘equity gap’ for young innovative firms while being cost-neutral for government. ECFs are funds managed by commercial fund managers, with the governmental contribution limited to £2 million or two-thirds of fund size or £25 million. Twelve such funds have been launched to date, with total investment commitments of £400 million. <a href="http://www.capitalforenterprise.gov.uk/ecfp">http://www.capitalforenterprise.gov.uk/ecfp</a></td>
</tr>
<tr>
<td>UK Innovation Investment Fund (&quot;UKIIF&quot;)</td>
<td>Venture Capital Fund of Funds</td>
<td>2009</td>
<td>£150 million government funding to date</td>
<td>The UKIIF is aimed at driving economic growth and creating highly skilled jobs through investment in innovative businesses where significant growth opportunities exist. The underlying funds invest in technology-based firms in sectors strategically important to the UK including digital technologies, life sciences, clean technology and advanced manufacturing. UK government funds are invested alongside private sector funds into selected specialist VC funds in the UK and Europe. Two funds with a value of £330 million, including £150 million UK government funding, have been established so far under private sector management. <a href="http://www.capitalforenterprise.gov.uk/uiif">http://www.capitalforenterprise.gov.uk/uiif</a></td>
</tr>
<tr>
<td>Schemes facilitating lending</td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Enterprise Finance Guarantee Scheme</td>
<td>Government Loan Guarantee Scheme</td>
<td>2009</td>
<td>£1.9 billion</td>
<td>Designed to replace the Small Firms Loan Guarantee Scheme and attract lending to firms refused traditional bank finance due to lack of securitisable assets. Lenders must be happy the debt is repayable and have full delegated authority for decision-making. Business must operate in the UK with a turnover of less than £41 million and be seeking finance of between £1,000 and £1 million, with repayment between 3 months and 10 years. Government guarantee of up to 75% of principal. Recipients must pay up to 2% annual fee to cover cost of the guarantee. Personal guarantees for loans advanced are still permitted. Lenders cannot claim back more than 13% of funds advanced. <a href="https://www.gov.uk/understanding-the-enterprise-finance-guarantee">https://www.gov.uk/understanding-the-enterprise-finance-guarantee</a></td>
</tr>
<tr>
<td>National Loan Guarantee Scheme (&quot;NLGS&quot;)</td>
<td>Government Loan Guarantee Scheme</td>
<td>2012</td>
<td>c.£2.5 billion of a total £20 billion set aside in total</td>
<td>The NLGS is a further scheme designed to reduce the cost of bank loans to business by up to 100 basis points, using government guarantees for unsecured bank borrowing to enable cheaper lending. Borrowing companies must have turnover of less than £250 million p.a., be UK based and not in financial difficulty. Market conditions since the scheme launched mean that Funding for Lending is the more realistic option for banks.</td>
</tr>
<tr>
<td>Funding for Lending Scheme (&quot;FLS&quot;)</td>
<td>Government Lending Incentivisation Scheme</td>
<td>2012</td>
<td>£16.5 billion drawn down under the scheme, but commercial loan books of participating banks have contracted since introduction</td>
<td>The FLS is designed to incentivise banks and building societies to increase lending to the real economy, by providing funding to those institutions for an extended period, with the price and quantum of that funding linked to lending performance. Participating institutions can borrow UK Treasury bills in exchange for collateral. <a href="http://www.bankofengland.co.uk/markets/Pages/FLS/default.aspx">http://www.bankofengland.co.uk/markets/Pages/FLS/default.aspx</a></td>
</tr>
<tr>
<td>Scheme Name</td>
<td>Scheme Type</td>
<td>Operating Since</td>
<td>Quantum Available to Date (approx.)</td>
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<tr>
<td>Business Finance Partners hip ('BFP')</td>
<td>Support for non-bank lending to business and diversity capital sources</td>
<td>2012</td>
<td>£1.2 billion.</td>
<td>The BFP plans to invest through non-bank institutions acting as ‘fund managers’, to whom bids from business with turnover up to £500 million p.a. should be addressed to request funds to be matched by private sector sources. Decision-making will be made within HM Treasury. Two rounds accounting for £900 million have already closed, the final tranche of £300 million will be available later in 2013. <a href="https://www.gov.uk/government/policies/making-it-easier-to-set-up-and-grow-a-business--6/supporting-pages/encouraging-private-sector-investment">https://www.gov.uk/government/policies/making-it-easier-to-set-up-and-grow-a-business--6/supporting-pages/encouraging-private-sector-investment</a></td>
</tr>
<tr>
<td>BFP (Small Business Tranche)</td>
<td>Support for non-bank lending to business and diversity capital sources</td>
<td>2012</td>
<td>£100 million</td>
<td>A specific tranche of BFP funding aimed at smaller businesses, channelled through mezzanine finance funds, supply chain finance schemes and peer-to-peer lenders (including Zopa, Funding Circle and Market Invoice), who will make lending decisions. Again funds must be at least matched by private sector sources. Businesses with a turnover of up to £75 million are eligible.</td>
</tr>
<tr>
<td>Business Bank</td>
<td>Public-sector commercial lending body</td>
<td>2014 onwards</td>
<td>n/a (£1 billion will be available alongside £2.9 billion of existing government commitment)</td>
<td>The bank will take on responsibility for many of the government sponsored or administered programmes mentioned above and will work through the private-sector wholesale market (i.e. not lending directly to business). Funding will specifically be aimed at SMEs. <a href="https://www.gov.uk/government/publications/building-the-business-bank-strategy-update">https://www.gov.uk/government/publications/building-the-business-bank-strategy-update</a></td>
</tr>
</tbody>
</table>

Other financial support programmes

| Regional Growth Fund ('RGF')        | Economic Support Fund                           | 2011            | £2.6 billion                       | The RGF aims to lever private sector investment to create economic growth and sustainable employment. The first 3 rounds allocated £2.4 billion and leveraged £13 billion of private sector investment to create or safeguard 500,000 jobs. The fund helped established the Angel Co-investment Fund (see above). https://www.gov.uk/regional-growth-fund-a-guide-for-small-and-medium-enterprises-smes |

Private sector but government-supported investment programmes

| Business Growth Fund ('BGF')        | Private-sector backed investment fund           | 2011            | £2.5 billion                       | Established and owned by UK banks including Barclays, HSBC, Lloyds, RBS and Standard Chartered, the BGF invests between £2 million and £10 million in businesses turning over £5 million - £100 million p.a., in return for a minority equity stake and a seat on the board, usually for a period of between five and seven years. The fund is targeted at addressing the equity gap and can invest money through a variety of capital structures to suit the circumstances. http://www.businessgrowthfund.co.uk/ |
Appendix E: The UK Regulatory Framework for Equity Crowdfunding

UK regulation, akin to much in place in advanced economies, has until recently stated that companies cannot promote share offerings on a public basis for investment activity unless:

a) The company produce a prospectus approved by an FCA-approved ‘authorised person’ (i.e. an accredited financial advisor), or

b) Shares are only offered to an exempt person (e.g. a HNWI, sophisticated investor, BA or VC).

Prospectuses are not required for equity raisings in the EU below the equivalent of €5 million, but still need to be approved by an FCA authorised person (per UK Financial Services & Markets Act 2000, c8, part II, 21), thus the transaction costs associated with such an issuance, commonly estimated at between £20,000 and £100,000 per transaction, are much the same.

A further exemption applies if people have a ‘private concern’ in receiving shares, i.e. they have some relationship with the business already. Authorisation for a promotion can come from either the FCA or An FCA-authorised firm, and the promotion must be ‘clear, fair and not misleading’. Seeking authorisation requires the regulated firm to comply with the FCA’s conduct of business obligations, and is lengthy and time-consuming.

Brewdog, an independent and innovative Scottish brewer was involved in a rare case of crowdfunding before the CFPs grew in prominence, raising £750,000 and £2.2 million in 2009 and 2011 respectively, but incurring £150,000 in transaction costs for auditing, the legal verification of prospectuses, the FCA authorised person process and other matters.

Crowdfunding has the potential to reduce these transaction costs considerably. Thus many platforms across Europe, including the UK, have been using a combination of exemptions and exclusions to conduct their business in compliance with FCA regulations. ‘Collective investment schemes’ necessitate stricter regulation so platforms generally ensure that this is not the case.

To gain exemption, platforms have traditionally either created an SPV that funders buy shares in first and that becomes the parent company of the fund-seeking company (this was the model that Crowdcube operated until it became FCA authorised in 2012), or the platform assesses the sophistication of would-be investors so that they self-certify their sophistication (this is the route that Seedrs pioneered on the way to gaining the first FCA authorisation for an ECFP).

In the UK, a new regulatory regime specifically designed for equity crowdfunding is required, as the existing regulations for corporate finance businesses and investment funds both cater for professional investors only. In the UK and Germany regulators
have adapted by starting to take a step by step approach, dealing with each crowdfunding platform on a case by case basis while advising caution in general.

The FCA and UK Government are thus developing a more consistent regulatory strategy in time, creating a framework where funding can be facilitated under their supervision.

Seedrs and now CrowdBnk have launched as ECFPs with FCA oversight after a long authorisation process, while Crowdcube gained FCA authorisation retrospectively in 2012. Italy has passed the first national crowdfunding law and Spain also has a very active market.

As a result, the UK’s FCA has recently issued various pronouncements on the emerging regulatory framework for crowdfunding and peer-to-peer lending, with updated guidance due to be released for equity crowdfunding in September 2013, and peer-to-peer lending coming under a formal regulatory regime from April 2014.

The most recent pronouncement on equity crowdfunding states that:

“i) We believe most crowdfunding should be targeted at sophisticated investors who know how to value a startup business, understand the risks involved and that investors could lose all of their money.

ii) We want it to be clear that investors in a crowdfund have little or no protection if the business or project fails, and that they will probably lose all their investment if it does.

iii) We are also concerned that some firms involved in crowdfunding may be handling client money without our permission or authorisation, and therefore may not have adequate protection in place for investors.”

The regulation of the equity and debt-based models are thus in a state of flux and development. Donation and reward-based lending fall out of the scope of UK financial services regulation as they don’t involve financial investment or return.

In contrast, the US JOBS Act, passed by Congress after long deliberation in April 2012, will enable individuals with over $100,000 annual income or net worth to invest the greater of $10,000 or 10% of that sum (whichever is the greater), or $2,000 or 5% for those with less than $100,000 of annual income/net worth (whichever is the greater) into private businesses.

However, the legislation stipulates that they must do so through a ‘funding portal’ which is subject to SEC supervision and authorisation. The publication and enactment of the necessary regulation and procedural guidance by the SEC has so far taken over six months longer than the originally envisaged timeframe of December 2012. As a result, the development of the equity crowdfunding industry in the US has been temporarily hampered.
Sources:

FCA guidance note:  

European Crowdfunding Network, ‘Regulation of Crowdfunding in Germany, the UK, Spain and Italy and the impact of the single European market’, June 2013:  
http://www.europecrowdfunding.org/european_crowdfunding_framework

http://www.nesta.org.uk/publications/assets/features/the_venture_crowd
<table>
<thead>
<tr>
<th>Participant Number</th>
<th>Participant Category</th>
<th>Professional Biography/Background</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.)</td>
<td>Business Angel</td>
<td>This Professor started his career in the life sciences as a healthcare scientist with a background in pathology and haematology, and went on to spend almost 30 years in senior executive positions in technology based industries and has become one of Cambridge's most articulate promoters of entrepreneurship. He is Entrepreneur in Residence at the University's Centre for Entrepreneurial Learning, and a Visiting Professor at the University of Bedfordshire School of Graduate Business Studies, Xiamen University and the Shanghai College of Science and Technology. More recently, he was appointed as International Research Fellow at Laurea University of Applied Science, Entrepreneur in Residence at McMaster University and Guest Professor at Tohoku Fukushi University. He currently chairs the East of England NHS Strategic Innovations Council, Health Enterprise East Limited and the Senior Advisory Board of the National Consortium of University Entrepreneurs (NACUE), which has recruited more than 40,000 members since its formation less than a year ago. He has also pursued advisory and practical roles in charitable organisations, primarily with a healthcare and education. He is a member of the investor groups Cambridge Angels and Sophia Business Angels and has previously chaired the Cambridge Enterprise Conference and works closely with a number of Science Parks and Innovation Centres in Cambridge, elsewhere in the UK and overseas. He received The Queen's Award in 2006 for Enterprise Promotion and was conferred the Honour of Knight First Class, Order of the White Rose of Finland in February 2011. He has recently co-authored a book, ‘Show me the money’ about how to source funding for small businesses. He spent 6 years in an executive position within a Cambridge-based Venture Capital firm, during which time he became a Business Angel involved in two Angel networks in Cambridge and one in France, Sophia Business Angels. He has about 10-12 years of investment history and is currently on the board of 5 early stage companies.</td>
</tr>
<tr>
<td>2.)</td>
<td>Business Angel</td>
<td>This Doctor of life sciences started his career working for a large pharmaceutical company which went on to become what is now Astra Zeneca. He went on to manage up to 2,000 people as Head of Research at Roche, and became Chief Executive of a biotechnology company in the early 2000s, and now remains fully involved in starting biotechnology companies. He sits on the board of several biotech companies as a non-executive director and is the Chair of a technology park in Cambridge which currently houses 42 start-ups. As a result, he is very aware of the difficulties that SMEs have in attracting capital, although he approaches this topic very much from the perspective of the biotech sector. He has invested his own money in biotechnology start-ups for around 10 years, in part alongside the Schroders Life Science Fund. Acting as a ‘lone angel’ he only invests money in companies that he has acted as an advisor for.</td>
</tr>
<tr>
<td>3.)</td>
<td>Business Angel</td>
<td>This investor considers himself a serial entrepreneurial investor in unquoted companies. His original training was in farm management but he left the agricultural sector soon after graduation from college to join a quoted leisure company. The company was disposing of a chain of American bars which he bought through means of a loan note, so begun his entrepreneurial investment career. He disposed of this investment at the age of 31 and was joined by his brother in further investment activity. He lost half of his accumulated wealth investigating opportunities in Cuba with a view to capitalising on the imminent demise of Fidel Castro, which of course did not happen! He then invested in a start-up technology/consumer goods deal, aimed at growing a business selling cotton-based toilet paper. While promising,</td>
</tr>
</tbody>
</table>
this venture suffered from some aggressive tactics employed by some of the biggest multinational FMCG companies whose existing interests were threatened by this emergent technology.

He has gone onto These are early examples of course, but I've always invested in opportunities from an entrepreneurial perspective.

<table>
<thead>
<tr>
<th>4.) ECFP Operator</th>
<th>This co-founder of Exeter-based CrowdCube has a background in marketing, working in both SME and large corporate environments, and has also helped to set up several small businesses.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>His co-founder, who also had a track-record of business start-ups and possesses an IT background, had the original idea for CrowdCube in 2009 when both were working in a corporate environment, and they began working together on the business full time in 2010.</td>
</tr>
<tr>
<td></td>
<td>CrowdCube was launched in January 2011 as the first equity crowdfunding platform in the world that allowed non-accredited investors and non-angel investors (i.e. ‘ordinary people’) to invest in unquoted companies. The first business was funded in July 2011 and was regarded by many as a milestone, proving a lot of doubters wrong and validating the model.</td>
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<td></td>
<td>More fundings quickly followed and included quite quickly the Rushmore Group (owner of members’ clubs and bars in London) raised £1 million, which raised the bar in many people’s minds as to what was achievable via this model for a good business, although many investors in this deal were existing members of the clubs concerned and had been made aware of this deal ‘offline’.</td>
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<tr>
<td></td>
<td>Since then between 50 and 60 businesses have raised £10 million in funding from investors. Growth was steady until 2013, comparing Q1 2013 and Q1 2012 shows growth of 500%. The business became FCA authorised during 2012.</td>
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<td></td>
<td>The team at CrowdCube believe they possess a business model gaining in credibility, reliable technology and a strong brand. They have amassed considerable expertise in equity crowdfunding and view their next step as overseas expansion. They have already launched a platform in Sweden, and Brazil, the US and Canada are next on the company’s roadmap.</td>
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<table>
<thead>
<tr>
<th>5.) ECFP Operator</th>
<th>This participant is the Marketing Director at Seedrs, the first UK ECFP to become FCA authorised.</th>
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<tbody>
<tr>
<td></td>
<td>She came to London in 2006 from Florida to undertake a Masters in International Marketing during the 2006-07 academic year. After undertaking several roles in business to business marketing after graduation, was appointed Marketing Director at Seedrs in March 2012.</td>
</tr>
<tr>
<td></td>
<td>Seedrs was founded by Jeff Lynn, who had a background in law dealing with securities, and Carlos Silva who had a background in IT &amp; digital security in 2009. They met while undertaking an MBA at Said Business School attached to Oxford University.</td>
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<td></td>
<td>Carlos was initially inspired by Kiva, a charitable donation-based crowdfunding platform. It took Jeff and Carlos 3 years of working closely with the FSA/FCA to become the first authorised equity crowdfunding platform in the UK during early 2012.</td>
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<table>
<thead>
<tr>
<th>6.) ECFP Operator</th>
<th>This participant has a background in management consulting and professional services having graduated from Kings College London in 2008 and is the co-founder of Fund the Gap (‘FTG’), an online equity fundraising platform for UK start-ups and small businesses looking to raise up to £2 million.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FTG facilitates investment from crowd investors and is aimed at enabling entrepreneurs to raise up to £2 million in start-up or growth capital for their business from investors who may include their friends and family, the local community, business angels and professional investors nationwide.</td>
</tr>
</tbody>
</table>
Collectively, the FTG team have helped raise over £500 million for small businesses and have over 50 years experience in financial services. FTG is targeted at investors who understand these risks and are capable of making their own investment decisions.

FTG is a trading name of FTG Finance Services Limited, an Appointed Representative of Sapia Partners LLP, which is authorised and regulated by the Financial Services Authority. FTG will in time seek to become authorised in its own right which will grant it more operating flexibility in future.

7.) ECFP Operator

This participant, born in Portugal, started his career as a civil engineer. He did a masters degree in civil engineering and business management at Imperial College, London. He became a chartered civil engineer and moved into project finance, working primarily on large infrastructure projects. He then did an MBA at Judge Business School at Cambridge University, graduating in 2011.

He became involved with several Business Angels in the Cambridge area during and directly after his MBA, and became acquainted and very interested in crowdfunding, but did not agree entirely with the business models of the emerging platforms in the UK.

As a result, he established Syndicate Room, which harnesses the credibility of existing Business Angels having researched live investment opportunities and offers those investment opportunities to the crowd, with a minimum investment threshold of £1,000. The platform was open to Business Angels at the time the interview was conducted but went live to crowd investors during early August 2013.

8.) Entrepreneur/ Private equity investment sector specialist

Over the last 26 years, this participant has had an extremely varied career, including working as a freelance broadcaster and being nominated for various industry awards, a visiting lecturer on (and writer of) under-graduate and post-graduate courses, a founder-director of several businesses, and a successful turn-around interim director for seven companies so far.

He has also worked as a government and an independent board advisor, including to several hi-tech firms seeking new-venture capital.

He is very experienced in the roller-coaster ride of entrepreneurialism and is a well connected professional in the board-level London tech/venture/investments industry.

At present he is engage in launching Integrity Capital, a private investment platform aimed at institutional investors, accredited investors and HNWIs to invest in high-growth SMEs using professional advisors registered with the service. This will be authorised by FCA and FINRA (the US equivalent regulator).

9.) Entrepreneur/ Crowdfunding Lobbyist

This participant has a background in marketing and communications management, but always wanted to be an entrepreneur herself.

After doing a masters degree, she started with a construction firm, which is still in existence, which were followed by interests in other small businesses, all of which were sold in 2007.

She dabbled in Angel investing and other investments, not all of which were successful, but became an accomplished networker with entrepreneurs needing expansion capital. She began to champion the entrepreneurial spirit and ecosystem in the face of bank resistance which she saw as stifling creativity and innovation due to the credit criteria the applied.

Out of curiosity she researched the area and decided to start a micro-finance initiative such as Grameen Bank (in Bangladesh) in Scotland, but realised that regulatory costs in the UK meant that this was not possible. Using contacts, she continued to research the issues involved in entrepreneurial finance to work out where the blockages in the system, as she saw them, were.
Amongst her other interests, she has started an online donation-based crowdfunding platform for seed and start-up businesses, Bloom VC, which she plans to use to enter the lending-based crowdfunding space in due course.

10.) Business Angel Industry Representative

In July 2012 this participant took the role of CEO of the UK Business Angels Association (which has superseded the British Business Angels Association), the trade body for angel and early stage investing. She had been providing strategic support to the BBAA since its establishment in 2004, supporting policy and interfacing with Government, as well as developing the trade body’s major annual events.

She has over 20 years’ experience of supporting SMEs access to investment, both in the UK and internationally. She ran her own business consultancy, which included a spell of nine years based in Brussels, working closely with the EC.

She has operated a wide range of investment readiness programmes, including projects supported by national and EU funding. She has also participated in a number of expert groups on access to finance and chaired the EC Knowledge Intensive Services group under DG Enterprise. In 2006 she took on the role of Business Development Director at GLE Growth Capital and in 2009 she co-founded Angel Capital Group where she has been acting as MD of Angel Capital Innovations focusing on demand side issues and angel investment, operating projects on ICT, nanotechnology and mobile services and applications.

She has also been a frequent judge at business plan competitions and acted as an assessor for the Technology Strategy Board for innovation grant applications. Jenny is an experienced speaker, both in the UK and across Europe. She has an MSc in Economics from London School of Economics and Political Science.

11.) Finance professionals, entrepreneurs and co-founders of disruptive finance networking group ‘London New Finance’

a) The first participant from this interview was an experienced IT professional in financial services, who moved to CTO level after completing an MBA some years ago. He left the corporate world to become an entrepreneur and has helped to establish a number of technology-driven businesses. In 2011 he helped to found London New Finance (‘LNF’), a networking group around the emergence of ‘FinTech’ (disruptive digital finance technology), working with the plethora of digital technology-based business models that are currently challenging established finance businesses. The group has grown rapidly and has over 1,000 members now. It runs well-prepared seminars and networking events in central London for people working in or interested in FinTech.

b) The second participant in this interview is a chartered accountant and holds an MBA. He was formerly finance director of an 800-unit retail chain, and held other similar roles in retail. He was also Head of Innovation for a 2,500-employee engineering firm operating in the UK and US, offering a wide range of technologies in metals-based engineering, before moving on to similar roles elsewhere. His constant goal was to place his companies as a world-leader in their chosen niche, and feels that in the 12 companies he worked in, he succeeded in helping them achieve this goal 50% of the time. He became a consultant specialising in the disposal of businesses by existing corporate parents. He became intrigued by the power of the internet and networked with young people involved in internet technologies and meetup groups where entrepreneurs pitched ideas. He started to research business models, networks and other facets of ‘digital London’. He met his co-founder of LNF around the start of 2012 and they found the match of the skillsets was ideal for this venture.

12.) Entrepreneur & Crowdfunding Lobbyist

This participant is a serial technology entrepreneur with over 30 years launching various ventures. He has had a lifetime interest in the interface between technology and society, an interest enhanced by the emergence of social media that has democratised communication on a global scale quite radically.
He is fascinated by the potential of crowdfunding and is keen to influence the debate on the regulatory framework for crowdfunding that is emerging from government and from the Financial Conduct Authority (‘FCA’). To that end he has established an all-party forum called the Westminster Crowdfunding Forum (‘WCF’) incorporating MPs, entrepreneurs, regulators, academics, Bank of England representatives, crowdfunding platform operators and others. The WCF hopes to influence the emergent regulatory regime for this nascent technology.

13.) Academic Researcher into Crowdfunding

This participant first became acquainted with crowdfunding while working in the corporate communications department of Oxfam: he noticed the potential of the medium to act as a conduit for international development funding through platforms such as US-based Kiva, and was particularly interested in the fact that default rates were very low.

He is currently studying for a PhD at Cambridge University, looking at the global crowdfunding phenomenon from the perspective of economic geography as it pertains to investment in UK firms, investigating the movement of capital and where investment is coming from in the world via ECFPs.
### Participant 1 (Business Angel) – Conducted 30th May 2013

#### 1.) What are the motivations behind your Business Angel activity?

My main areas of interest are innovation and creativity. Entrepreneurs change the world, improved and new technologies can change the world for the better. Entrepreneurial activity accelerates GDP growth and improves people’s lives. My interest is in economic and social development, and in a ‘world without borders’. And I believe in the ‘right kind’ of capitalism. I’m also interested in economic growth in the East of England. I like to make money but not my primary motivation. Most entrepreneurs I have met are not primarily motivated by money. A good philosophy to business and for life is first, to give something, and then see where this takes you.

#### 2.) How long have you been investing your own capital in unquoted companies as a Business Angel?

I made my first investment as a loan 25 years ago when still in corporate life into a good friend of my son’s nascent wine business. I lent him £8,000 to get started.

In the late 1980s when I left large corporate life and became CEO of Domino Printing Sciences I became more involved in entrepreneurial activity. In my 50s and 60s I became an ‘Angel proper’ and I’m a member of Cambridge Angels and Cambridge Capital Group, and I’m closely involved in Sophia Business Angels in France, based around Nice.

#### 3.) What markets do you invest in?

I’m a specialist in life sciences. I only invest in areas I know about. I’m into digital healthcare via one investment: cambridgehealthcare.com is a social media healthcare business.

Everything I have at the moment is in the life sciences: bioinformatics, medical devices, medical consulting, etc. We refer things across my informal network all the time. We don’t refer anything we haven’t seen or where we haven’t met the people – that’s the golden rule. I also look for ideas that are ‘worthy’ in the sense that they have the potential to really change lives for the better through innovation, particularly healthcare.

#### 4.) What development stage do you usually invest in, (seed, start-up or growth capital)?

I go as early as seed if the idea is compelling enough. I’ve helped to form two companies at the seed stage at present, although I haven’t invested money yet, I’ve spent a lot of time offering advice and support and contacts. One of these is a CIC (‘community interest company’ on a novel way of data storage for medical purposes).

I wouldn’t go in later than start-up stage because of my capacity as an investor and the attractiveness of the valuation process if the business model is interesting enough. I work for equity at this early stage when investments are formalised, but I assist greatly in sourcing funding for start-up businesses, which is where I have a lot of expertise and where I can really add value for entrepreneurs. I mentor under the SBRI (Small Business Research Initiative) that helps small businesses through the NHS and government procurement procedures.

#### 5.) Have you deviated from these parameters for a particular investment(s)?

Only in so far as I’ve invested in a social media-based healthcare company in terms of sector. But as I said, I only invest in seed and start-up business from a development stage perspective.

#### 6.) How many investments have you made, approximately?

I’ve invested in around 10 businesses over the years formally as an Angel. Currently on the board of 5 companies that I’ve invested in, including one ‘virtual’ medical consulting company that I’ve helped start with two Chinese business partners that I know from academia and which I’ve largely funded alone.

#### 7.) I realise you many want to maintain confidentiality here, but can I enquire as to the average size of your investments please?

Between £10,000 and £20,000 each time.

#### 8.) Have you invested alone ever?
The only investment on my own is the medical consulting business that I mentioned before.

9.) Do you normally invest as part of a formal syndicate or informal group of Angels?

Yes, I’m always invested via a syndicate with others. One of my investments is alongside Sophia Business Angels in a British company. Sophia Business Angels wanted to invest in early stage companies by a certain date to optimise the tax efficiency of French investors.

10.) Have you ever invested alongside other classes of investor, for example Venture Capital firms?

The great value of being in VC for 6 years was to get to know other VCs. We always invested our fund money alongside other VCs, and those networks and friendships are enduring. So I have invested money alongside VC firms that I am familiar with.

11.) How many Business Angel Networks are you a member of?

a) Cambridge Angels – this is a dining club in the ‘American’ style, with members nominating businesses to make a pitch in front of a dining club of Angels, who then debate the opportunity following the pitch, with the nominating Angel representing the company in that debate.

b) Cambridge Capital Group largely invested in Cambridge technology companies but the network is to a large extent electronic by email etc. I might leave this group soon in a formal capacity, but I will stay involved in the network.

c) Sophia Angels (France) – helping French Business Angels invest money in medical technology companies based in the East of England, where there is a cluster of excellence.

d) I’m also a member of the ‘Venture Academy’ now which is all about getting small businesses investment ready. I’m also in contact with a large number of people involved in sourcing money for SMEs. Many of my close contacts in crowdfunding since I’ve become interested are adamant that one of the main challenges with the phenomenon is that entrepreneurs do not possess enough financial knowledge and are not investment ready. The Westminster Crowdfunding Forum, founded by the MP for Huddersfield, Barry Sheerman, and Barry James, an entrepreneur who is keen in maximising the potential from crowdfunding. Barry ran the first national crowdfunding conference in February 2013 at the University of Hertfordshire. Vince Cable is now interested and the community in the UK is keen to influence him to help shape the regulatory regime in a way that doesn’t kill the phenomenon before it has a chance to get going.

12.) Do you usually invest via ordinary share capital, preference shares, convertible debt or other derivative product?

Business Angels generally prefer common stock, rather than prefs, to keep these simple. VC funds usually go for preference shares to help mitigate their downside risk, as they’re investing other people’s money, although the rights attached to preference shares are only useful when a company is in distress.

13.) When investing, what anti-dilution or pre-emption rights do you normally insist upon during negotiations? Does the existence of a VC firm as a co-investor in a deal affect your negotiating rights to this end?

Anti-dilution is difficult, but I wouldn’t want to give the impression that investments are always via formal syndicates or indeed alongside formal VC money – some of my investments are alongside people who you might call VCs or Angels on a more informal basis who don’t interfere in pre-emption rights. However, sometimes that does arise when the situation is more formalised and pre-emption rights are curtailed, anti-dilution is an issue and the incoming VC insists upon warranties etc. It really depends on the formality of the arrangement and the mentality of the VC firm.

14.) How many hours/day do you undertake on average for an investment opportunity, and on average how long have you known entrepreneurs before you invest?

I as an individual do what VCs would call superficial due diligence. But I use my own knowledge and the opinions of trusted friends and contacts to rely on for investment advice. When in VC, I obviously did far more classic due diligence using in-house and external resources to gain real insight into new opportunities.

15.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?
The whole phenomenon of crowdsourcing and crowdfunding brought about by technological advances and social networking, is a great thing. I and my contacts do worry about the challenges of managing and control in equity crowdfunding in particular— if people are investing money, the tasks of due diligence and investor relations are large, and clearly will evolve. The crowdfunding platforms do some due diligence and presenting the pitches to the public is a fascinating area as investors will usually never meet the entrepreneurs. The issue of returns and exits are things Angels worry about a lot, and are also clearly issues for investors via equity crowdfunding.

16.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

If a model of crowdfunding emerges in the mainstream whereby a deal is already supported by a lead investor, who might be an established Angel or professional investor, that could the way that equity crowdfunding develops. That will attract the ‘smaller money’ much faster via harnessing more credibility from lead investors. I can’t see the £20 category of equity investor really changing the world in equity crowdfunding – there are parameters around the quantum of investments and the number of investors.

The challenges of board representation here as well are fascinating and potentially challenging. The models of equity ownership for the very small investor are crucial here, and I’m aware that there are different models of equity ownership and board representation, but which will emerge as dominant will prove very important for the future development of the sector.

In the US I can see that through the implementation of the JOBS Act that the regulators over there want to kill equity crowdfunding, so the work in Westminster to influence regulation here is really important.

17.) Would you invest as part of ‘the crowd’ via one of the UK’s equity crowdfunding platforms? Why/Why not?

No, I wouldn’t want to invest as part of the crowd. I feel that equity crowdfunding will do best as a hybrid. As a crowd investor, I would like to know that somebody there knew what the company was really doing and how it was guided, and would help to represent the crowd on the board. I know Syndicate Room based on Cambridge, and I think that Goncalo of SR has a great model and has made himself very well known here with Angel groups in Cambridge and in London. Equity crowdfunding without the involvement of people who can represent the crowd may well prove doubtful for a lot of experienced people. The Crowdcube model acting through a nominee structure whereby the crowd’s money is to some extent ‘stewarded’ by the platform (but is this really the case – need to check in further reading and interviews?) may appeal more to the crowd, but I don’t think it will appeal so much to Business Angels.

18.) If you were to invest on an equity crowdfunding platform, would your motivation behind making an investment in this way differ from those behind an ‘Angel’ investment? Would your expectations of the end return differ? Would your expectations of involvement via board or an operational management role differ?

My motivation would be similar as described above, and I would only invest as I’ve said in crowdfunding initiatives alongside a trusted lead investor, much as I might do as an Angel already.

19.) Would you consider being the lead angel investor in a syndicate arrangement alongside sophisticated passive investors in the same deal through an online platform such as Syndicate Room? (if need be, explain Syndicate Room, which offers investors a minimum investment of £1,000 in businesses already selected by Angels and sells itself as protection from dilution for BAs from VC firms, and provides a chance to diversify one’s portfolio more widely than without the ‘sophisticated crowd; of the syndicate investor)

Yes, I would.

To quote a very topical example to illustrate your point, although not involving me directly, Eaglegenomics is 4 years old company that never had outside money committed and we now have £500,000 committed with some from VC and some from Angels but Syndicate Room may well come in and raise a further £150,000 from the ‘intelligence crowd’. The lawyer of one of the Angels involved got nervous about how the involvement of investors via Syndicate Room would fit within the context of the shareholders’ agreement, but that has now been resolved. But some law firms are specialising in crowdfunding and I have no doubt that this will evolve quite quickly.

20.) Business Angels have often fallen out with VCs on dilution when investee businesses receive VC funding in follow-on rounds. Do you perceive a similar friction emerging in follow-on rounds should you invest alongside the crowd in unquoted early stage companies?
Yes – quite possibly. One of the areas of difficulty when I was in VC revolved around the difficulties of syndicates that involved 3 or 4 VC firms, with different agendas and sometimes investors couldn’t agree on the way forward or on further investment strategies. The thing I always try to understand is ‘how much total external investment will this company need?’ In biotech, the amounts of money to get a company beyond the gestation period are now very large indeed, as opposed to other tech businesses where the initial funding is at most often in the hundreds of thousands, not in the millions or tens of millions. I’m not sure equity crowdfunding will be suitable for very large equity investments in particular sectors, or for situations were multiple follow-on rounds of capital will be required. If people are keen to see returns within a few years, will they really be prepared to sit there for 10 years with an illiquid investment?!

21.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

Investor relations, and specifically the balance of relations between large and small investors. There is like I say great virtue in a hybrid model that marries the crowd and more sophisticated, larger scale investors.

22.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

Well, I think that small-scale equity crowdfunding is a completely separate activity from the Angel model of investment at a larger scale in businesses known to the investors or in which they have invested a lot of due diligence. The hybrid model, such as that operated by Syndicate Room, could be something that Angels used alongside their traditional investment model, so in that sense, it is in competition with Angel investing, as it will attract some of a theoretically finite source of funding, but also complementary to it, as it diversifies the Business Angels’ risk profile over a larger number of investments. The key attraction of a hybrid model from an Angel’s perspective is that the crowd coming in later may obviate the need for follow-on funding from VCs, which would be a large selling point for Angels.

The Cambridge Angels network has long considered a ‘sidecar’ fund to attract sleeping high net-worth investors into invest alongside the network in opportunities, which is of course similar but conducted offline. They have never done this though, yet. The London Business Angel group has a government supported fund which is EIS/SEIS compliant which is doing just that, I think (need to research this to clarify and confirm).

As long as the Angels have a say in the company and the crowd invests alongside them, that would only be a good thing for Angels if VC’s weren’t required, as far as I can see.

23.) Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (‘syndicate investor’) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

I think the model is a good one, as I’ve explained.

24.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

Yes, I do really, as I’ve outlined before. Syndicate Room especially seems to be linking Angel investors who have sourced real opportunities with ‘smart’ crowd investors, and I think that is expanding the pool of risk capital somewhat, as these people may not be able to devote the time to source and research opportunities on their own, even if they would like to.

25.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

On sectors, I think the green or clean energy sector, and sustainability in general, that requires investment has a wide appeal as it combines the thrill of making money with addressing public interest issues such as climate change and global warming, and pollution etc. Healthcare too is a sector which combines good potential returns with altruistic motivations, e.g. infection control, dementia research, etc. Technology on a mass scale, such as the Raspberry Pie cheap computer that was developed here in
Cambridge, also has potential for attracting capital in this way.
Looking at the Syndicate Room hybrid model, this would depend on the specialisms of the Angels and the Angel networks that get involved.
Participant 2 (Business Angel) – Conducted 30th May 2013

1.) What are the motivations behind your Business Angel activity?
   A blend of investing in opportunities with good potential for returns and in technologies that have real potential to improve the state of humanity in general, should they succeed. I’ve already made my money through business and other stock market investments, so while I don’t want to lose the money I invest as an Angel, I’m not chasing large financial returns, it’s as much about the potential social impact of my investments as it is about the financial side.

2.) How long have you been investing your own capital in unquoted companies as a Business Angel?
   Around 10 years, since around 2003 or 2004, from memory.

3.) What markets do you invest in?
   I only invest in areas that I deeply understand, as I know that most technologies will fail so I use my own expertise to select worthwhile technologies.

4.) What development stage do you usually invest in, (seed, start-up or growth capital)?
   Usually seed or ‘Series A’ funding rounds: by the time you get beyond that, the amounts get too large for a private individual.

5.) Have you deviated from these parameters for a particular investment(s)?
   Not so far, although I might invest in a crowdfunding platform called Syndicate Room, based in Cambridge. I believe that crowdfunding is really important for the future.

6.) How many investments have you made, approximately?
   Around half a dozen directly one-to-one. Investments through a seed fund from Schroders total between 20 and 30 companies.

7.) I realise you many want to maintain confidentiality here, but can I enquire as to the average size of your investments please?
   Low tens of thousands, between around £20,000 and £30,000 usually.

8.) Have you invested alone ever?
   Always though informal syndicate, almost by accident 2 or 3 of us come together, different ones for each investment, and we have had a common interest and belief in an opportunity that has led us to invest together.

9.) Do you normally invest as part of a formal syndicate or informal group of Angels?
   As a ‘semi-formal’ syndicate, as I’ve described. There is a term sheet negotiated between the recipient business and the syndicate, which tend not to be that onerous.

10.) Have you ever invested alongside other classes of investor, for example Venture Capital firms?
   The great value of being in VC for 6 years was to get to know other VCs. We always invested our fund money alongside other VCs, and those networks and friendships are enduring. So I have invested money alongside VC firms that I am familiar with.

11.) How many Business Angel Networks are you a member of?
   None. All the companies I’ve invested in I’ve sourced through my own personal contacts and networks. I haven’t had to go looking for them, I have found them naturally. I don’t like clubs or formalised network syndicates. Usually I’ve been involved in the company in an advisory capacity and perhaps I’ve mentored the CEO, long before I’ve decided to get involved as an Angel investor.

12.) Do you usually invest via ordinary share capital, preference shares, convertible debt or other derivative product?
When a company is started, it makes it much harder to bring other investors in later – you’re almost setting the company up for failure if you have complex share structures at the beginning. Ordinary share capital is the norm. I’ve invested alongside much larger VC funds (millions, or tens of millions in some cases) in some companies, and if you try and put preference in place, the VCs will negotiate stronger rights attached to their preference shares later on, so it’s all a bit pointless and will only end up being a source of friction.

13.) When investing, what anti-dilution or pre-emption rights do you normally insist upon during negotiations? Does the existence of a VC firm as a co-investor in a deal affect your negotiating rights to this end?

Well, as I’ve already alluded to, it doesn’t matter what you put in a contract early on, you will lose your money if a business doesn’t raise more money later on. The more successful it will be later, providing it’s a good idea, the more funding it will need early on, particularly in biotech. In biotech, investments of £50 million are not uncommon to get a good idea off the ground. It’s a little different in other tech companies where the upfront research and development costs are not nearly so great, but in biotech, you have to accept that VC money will be required in order to make it work and you will get diluted, that’s just how it works.

14.) How many hours/days due diligence do you undertake on average for an investment opportunity, and on average how long have you known entrepreneurs before you invest?

I’ve already done the DD over weeks, months or years of involvement with the company concerned, given the way I operate. Far more than a comparable VC firm would have done in similar circumstances. So in the classic sense of sourcing an opportunity and researching from there, very little – it’s already done and if it hadn’t happened that way, I wouldn’t be interested frankly.

15.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

Crowdfunding is new to me, I’ve only got interested this year. I’m one of 3 global consultants in my area to PwC, the others being the Head of the New York Academy of Sciences and quite a crazy professor based in Sweden, a Finnish guy. We do brainstorming and scenario planning sessions at regular intervals, the best of them being a two day session in New York City every January. The most recent was around the question ‘Are you ready for the third industrial revolution?’ Talking and reading about this I really decided such a phenomenon had to revolve around three things: a new energy source, a new communication system, and a new financial system.

If you think about where we are now, the internet is clearly the new communication system, the new energy source is more interesting, although I’m coming to the conclusion it’s might be graphene, although that’s quite blue-sky still! But we certainly have a very bust financial system, which is probably going to blow up to an even worse degree over the next five years. So what’s the new financial system going to be? When I raised that question this last January, nobody had an answer. So really after that I started to notice crowdfunding, and the way that it intersects with and harnesses the internet. It will potentially provide another source of finance in the future, really democratising the financial system, cutting out the middle men. It could provide a very different form of finance in the future, potentially providing better returns, if it’s done in the right way. I researched it quite heavily in February and March and wrote a short report on what I found.

I don’t know if this is the new financial system, but it’s certainly worth investigating and being given a chance. However, I think there are two ways in which people are going to suffer from the way a lot of the mainstream crowdfunding sites are set up at present. The first is due diligence. You know, most technologies fail and people are going to get over-excited and be underwhelmed by the returns they get back. The second area is costs. I spend a lot of my time investing in the stock market, that’s why I don’t need to worry too much about money. There’s a lot of evidence, I can send it to you if you wish, that around 60%-70% of the gains from investment funds are siphoned off by the fund manager, over the long-term. The figures are out there but people aren’t really aware. A lot of the crowdfunding sites have just miniaturised this model, so a lot of return is going to the fund managers, so even if companies succeed the returns won’t be that great.

I’ve spoken to Goncalo at Syndicate Room about this, and his charges are around 5%-7%. I think he’s probably avoiding the poor scenario but I need to see more figures.
16. Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

I only really got interested in January and February and went to a conference in March. I researched it heavily on the internet after that. But it needs to be given a chance: the present financial system only works for a small group of people that run it, and doesn’t work for the huge mass of humanity outside of that group.

17. Would you invest as part of ‘the crowd’ via one of the UK’s equity crowdfunding platforms? Why/Why not?

Absolutely not, it wouldn’t cross my mind to invest in one of those things, I just wouldn’t do it!

18. If you were to invest on an equity crowdfunding platform, would your motivation behind making an investment in this way differ from those behind an ‘Angel’ investment? Would your expectations of the end return differ? Would your expectations of involvement via board or an operational management role differ?

See above – not applicable.

19. If you have viewed equity crowdfunding sites and/or considered investing this way, how does the quality of the pitches, business plans and general presentation compare with that offered offline, and would you be happy with this more removed level of contact?

See above – not applicable.

20. Would you consider being the lead angel investor in a syndicate arrangement alongside sophisticated passive investors in the same deal through an online platform such as Syndicate Room

Yes, I would. But I would really have to know a lot about the company and the people and how they worked and operated. I know how much I knew 30 years ago, and that is the age that many people are when they’re doing these things. I would potentially, but I’m going to be incredibly selective and do an enormous amount of due diligence beforehand.

21. Business Angels have often fallen out with VCs on dilution when investee businesses receive VC funding in follow-on rounds. Do you perceive a similar friction emerging in follow-on rounds should you invest alongside the crowd in unquoted early stage companies?

A really important and quite difficult question. For instance, I chair a spin-out company from Imperial College London, Imperial Innovations, I'm in there around 2-3 times a month, I'm quite involved. Whenever I've mentioned crowdfunding, they blanche and say they never want to work alongside those people and bring them into this company.

But there are some companies that can go the whole way without the need for VC money, which would be my preferred alternative, it would probably mean the original investors don’t really get diluted and will probably get decent returns. But that will depend on the sector the company is in. I think that with crowdfunding, some companies will probably get to profitability quicker and more efficiently than before. I’m working as part of a team of three in a ‘virtual’ medical research company at present, and we think we could get a drug, to combat antibiotic resistance, to the point of registration for around £20 million, whereas the industry talks about hundreds of millions. In that scenario, I think crowdfunding could perhaps take even quite complex technology the whole way.

In medical technologies, for example diagnostics, instrumentation etc., the whole thing could be done for a few millions of pounds, rather than a few tens of millions, and in IT, even for a few hundred thousand probably. So I think that crowdfunding initially might focus on the less costly technologies, IT and ‘medtech’ as we call it, machines and diagnostic machines, rather than drugs.

The whole area of potential friction with VCs later on though, is fraught with problems. A lot of high net-worth individuals in Europe for example, are rather disillusioned with VCs for example, they’ve been putting the money in, but not getting a good return. A lot of HNWIs, we’re talking in the millions here, are kind of forming their own VC fund, but not calling there. They could be the lead investors in a hybrid model.

A lot of people who’ve made a lot of money don’t actually want to make a lot more really, they want to put the money they’ve already made to good use.
22.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

Due diligence for sure. I think that people will need more expertise in sourcing the right kind of opportunities.

Also the erosion of the returns by the fund managers. The wiser crowdfunding sites will avoid this issue in the first place, because they will get found out.

The third potential issue is a backlash from the current finance industry, VCs and banks etc., they will try and lobby for regulation in order to dampen the power of these new models before it gains too much of a foothold. Such regulation won’t be protecting the public, it will be protecting the bankers. And politicians may be motivated to protect their donations, as these come from the wealthy elites, not really from the masses.

23.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

Hmm! I think it’s covering a different space with smaller amounts involved. I don’t know whether angels will be as peevd about it as bankers potentially. If Angels can see a path through to floatation or sale without involving VCs, then I think they would welcome that. If a path needs to be found from traditional mainstream equity crowdfunding through to Angel involvement and all the way through to VCs, I think that could be quite fraught. But mainstream sites are operating in a different strategic space really to the hybrid models of more restrictive platforms, like Syndicate Room.

I don’t know how Syndicate Room will work out, but it maybe has a better chance if VCs have to be involved later due to the nature of the existing investors and the lesser numbers involved. But to the extent that it removes the need for VC funding later, it is a real bonus.

Crowdfunding could develop very much a local scene to fund public and civil investment.

24.) Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (“syndicate investor”) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

I think the model is a good one, as I’ve explained.

25.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

Yes, I do, as I think we’ve touched on already, although as I’ve said, it will depend on things like regulation, on how follow-on funding works, on the level of charges levied by the platforms, etc.

26.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

Apart from tech, I think charitable causes are ripe for it. I am involved as I’ve started a charity in India where most of my spare cash goes. Some charity’s costs are very high and they’re overpaying their staff. I’m involved in a charity which sources funds with Bill Gates and his foundation, and too much of his money goes to administration and salaries.

If crowdfunding sites can guarantee that 95% of money goes to the direct cause in question itself, then that would be a real selling point.
**Participant 3 (Business Angel) – Conducted 4th June 2013**

1.) **What are the motivations behind your Business Angel activity?**

   It used to be ‘have fun, make money. do good’, but after a certain stage, depending on how you view money, I think most people naturally gravitate towards the ‘do good’ element a little more: if I could exit a few more of my current investments, to be honest. But in summary, a combination of those three.

2.) **How long have you been investing your own capital in unquoted companies as a Business Angel?**

   I don’t really consider myself a Business Angel in the classic sense of the term. I try and source deals and invest before the traditional Angel investor comes along. I invest and I like to have control to structure subsequent rounds that may well involve Angels or small-scale VC investors, even the lower half of the private equity industry at the upper end. I still operate at the level that VC firms operated at up to around 10 years ago, but luckily I had access to a source of capital that didn’t require VC involvement, at least ‘till much later on.

3.) **What markets do you invest in?**

   Often technology, social media and digital marketing related businesses. I’m open to new sectors if I believe that an idea has the potential to disrupt a sector. We’ve done environmental, medical, consumer goods etc., and now I’m involved in a business connected with financial consulting services, in connection with the financial advisory sector.

   If people say a particular produce or service can’t be delivered and made profitable, they might be right, but if they’re wrong, then of course the idea has all the more potential to disrupt that sector should it come good!

4.) **What development stage do you usually invest in, (seed, start-up or growth capital)?**

   It’s a different environment now as it’s been a really lonely five years. Pre 2008 there were more people around to invest alongside and team up with time and time again. These days I/We (alongside his brother/business partner) tend to invest at a slightly later stage of growth but in the past we have been in right from the start, particularly when we were just starting off and proving ourselves. But over time we have invested in a whole variety of stages of business development.

5.) **Have you deviated from these parameters for a particular investment(s)?**

   There are no real parameters, although as I mentioned we tend to invest at a slightly later stage of development these days.

6.) **How many investments have you made, approximately?**

   We are involved in anything from 3 to 5 at a time, usually backing management. These days as a non-Exec typically, but often at a more operational level in the past. We have been doing this for around 20 years, so the total must be in the tens of total investments. Bear in mind that often the holding period is up to 10 years these days, whereas before 2008, it averaged between 3 and 5 years very often.

7.) **I realise you many want to maintain confidentiality here, but can I enquire as to the average size of your investments please?**

   As I said I invest at the level above what I understand to be traditional Business Angels because I want to have control. So I would invest say, £200k rather than £20k or £50k in order to achieve that in a company that I truly believed in.

8.) **Have you invested alone ever?**

   Oh yes, well alongside my brother. As investments have got better and bigger we would bring others in, but we have started alone often.

9.) **Do you normally invest as part of a formal syndicate or informal group of Angels?**

   Not as part of a formal syndicate, but I run and am part of informal networks of investors of course.

10.) **Have you ever invested alongside other classes of investor, for example Venture Capital firms?**
Yes, I have invested alongside a whole range of other investor classes, from Angels and VC firms up to private equity and other high net-worth individuals.

11.) How many Business Angel Networks are you a member of?
None really, on a formal basis. I maintain my own networks.

12.) Do you usually invest via ordinary share capital, preference shares, convertible debt or other derivative product?
I have invested in a range of ways depending on the investment, the other people involved and the perceived risks inherent in the opportunity.

13.) When investing, what anti-dilution or pre-emption rights do you normally insist upon during negotiations? Does the existence of a VC firm as a co-investor in a deal affect your negotiating rights to this end?
Whenever a big player such as a VC firm comes in, then the negotiations will usurp all the rights previously negotiated through earlier term sheets and contracts. So dilution is a fact of life when you attract a really large sum of money into a company that you have previously controlled. Mostly though I look to float companies on the AIM alternative market or via IPOs on smaller exchanges – for example we have one pending in Singapore.

14.) How many hours/days due diligence do you undertake on average for an investment opportunity, and on average how long have you known entrepreneurs before you invest?
I research the sector and the technology concerned, but often at lower levels we do less than your typical VC firm for example. I don’t feel that I possess the skillset and the knowledge for that, to be perfectly honest. But I feel like I take more risk than the typical VC fund manager. I do feel though that I have a skill for seeing a deal from a helicopter view and judging it in a way that perhaps someone more intimately connected with the technology in question may find a little harder. But I’m sure we make mistakes as entrepreneurial investors who work more on gut feel and bravery than guys running PE funds or large VC funds who haven’t taken a real risk in their lives!

15.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?
I instinctively like the model, I think that is stands a very good chance of becoming a source for a new pool of money for unquoted businesses. I do think however at some stage that the regulator may catch up and restrict some of the freedom the sector seems to enjoy at present.

16.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?
I’ve only recently started to research it, but I do see it as a potentially rich source of money to invest alongside professional investors and as such, a way to expand the options of risk capital in unquoted companies.

17.) Would you invest as part of ‘the crowd’ via one of the UK’s equity crowdfunding platforms? Why/Why not?
No, not at all. I don’t need to.

18.) If you were to invest on an equity crowdfunding platform, would your motivation behind making an investment in this way differ from those behind an ‘Angel’ investment? Would your expectations of the end return differ? Would your expectations of involvement via board or an operational management role differ?
Not applicable – see the answer above.

19.) If you have viewed equity crowdfunding sites and/or considered investing this way, how does the quality of the pitches, business plans and general presentation compare with that offered offline, and would you be happy with this more removed level of contact?
I haven’t really had a chance to view many yet, so I can’t really answer that at present.

20. Would you consider being the lead angel investor in a syndicate arrangement alongside sophisticated passive investors in the same deal through an online platform such as Syndicate Room?

Yes, if it was a deal I liked and it was a round after £250k and needed £50k or £100k to top it up.

21. Business Angels have often fallen out with VCs on dilution when investee businesses receive VC funding in follow-on rounds. Do you perceive a similar friction emerging in follow-on rounds should you invest alongside the crowd in unquoted early stage companies?

Potentially, but that is because of a lack of education on the part of the crowd investors – they must become educated to the fact that follow-on funding will almost always be required to avoid dilution, and to the fact that when large investors get involved, dilution is a fact of life.

22. What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

The greater the number of shareholders, the greater the potential hassle for management and lead investors. There are rules on disclosure if you have large numbers of shareholders (look this up online). So investor relations and the regulatory impact of large numbers of shareholders are potential sources of strife.

Investors will also come to realise that follow-on funding will often be required to avoid dilution during later funding rounds. This will be a surprise to some and there may well be a reaction against it.

The platform operators may have a hard time staying out of things post-investment in my view, perhaps they may get involved in investor relations or reporting.

In summary, what concerns me is that the disadvantages outweigh the advantages potentially, but this will become clear over time.

23. Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

It’s a welcome source of capital, but the crowd don’t determine the value through a model such as this, so to an extent it’s ‘dumb’ money. In that sense it’s a complementary model to Business Angels, as they come alongside and don’t compete per se.

24. Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (‘syndicate investor’) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

I don’t think it’s a competitive model as the Angel investor will be in before the crowd. The negatives as I’ve mentioned relate to regulation, disclosure, managing different classes of investor, those kind of things. But instinctively I’d say it was entirely complementary.

25. Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

Yes. Following the financial crisis, it seems to me that world is lacking enough investors willing to take a risk on great concepts offered by unquoted companies and entrepreneurs. This model offers a chance to expand the pool of money, albeit some it tending towards the ‘dumb’ end of the spectrum as the crowd in this model, even if they are educated and relatively sophisticated, have not engaged in the due diligence stage of the deal and have to accept the price that is set before them. However, solutions that expand the pool of money are good things.

In my view, there are lots of investors who avoid the responsibility of investing in early rounds because then they carry the burden of helping to source capital for subsequent rounds later on. For the more powerful investor, it is better to wait and command the price for a third or fourth round of funding because you know you can satisfy this (or you can alongside trusted associates) and the company has proved itself more to that point. This model goes some way to addressing that problem, it would seem.
26.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

I think that technology is an obvious sector where it could work, but to be honest, if the idea is compelling and the initial funds required are in the sub £1 million range then any idea could be a viable investee.
1.) What are the motivations behind your activity in the crowdfunding strategic space?

Both co-founders had experienced first-hand starting and financing those businesses. The model of angel investors hadn’t changed for decades or arguably hundreds of years – the idea of entrepreneurs seeking out wealthy individuals and requesting investment and we felt there was simply a better and more democratic way of doing this, harnessing the power of the internet, where the entrepreneur wasn’t reliant on one or two people to finance a business. We loved the idea that ordinary people, who understood the risks involved, could invest in businesses, to move away from the elitist model of Angel investment and to give people the opportunity to invest in good British businesses.

2.) What type of markets or sectors are you open to facilitating investment in?

Any! It depends on the quality of the business plan, accompanying financial projections and the pitch put together – then the potential investors can decide for themselves.

3.) Are you exclusively involved in raising money for start-ups or seed stage businesses, or does your platform, or any activities you’re involved in outside of that, involve investing in later-stage companies?

It’s primarily early stage businesses but that hasn’t stopped more established businesses raise money through Crowdcube – the Rushmore Group being a well-quoted example.

4.) Approximately what size is the average equity investment that your platform facilitate, or aim to facilitate?

We’ve raised nearly £10 million for between 50 and 60 investors now, so that works out at an average of between £167,000 and £200,000 for each fundraising.

5.) Does your welcome any class of investor, i.e. do you restrict investors to those investing over a certain amount, or conversely do you ensure that access is completely open to anyone with a very small amount of money to invest?

Anyone can invest, but most fundraisings operate a system of ‘A’ shares and ‘B’ shares: The A shares carry full voting and pre-emption rights and are available to investors putting up over a pre-specified amount by an entrepreneur, but often around £20,000, whereas B shares are minority shares without voting and pre-emption rights.

6.) Would you, or do you, encourage more professional investors such as Business Angels to invest as part of the crowd on your platform?

Yes, absolutely. Crowdcube is not just for people who are new to investing, but also existing Angel investors to invest. The way we structure our deals is similar to what many Angels would expect offline, that is, if you invest over an amount specified by the entrepreneur, you get full voting and pre-emption rights associated with the equity you purchase. We have tended to attract quite a lot of Business Angels and the diversity of investment opportunities available is attractive to many Angels – we have over 5,000 investors registered with our site now who class themselves as high net-worth or sophisticated investors. So if you think about it, that makes us one of the biggest Business Angel Networks in the UK!

7.) If yes, have you marketed yourself exclusively to this or any other more rarified investment market sub-sector yet?

Not explicitly but we are a member of the UK Business Angels Association and we do know that particular Angel networks or Angel investors are using us more and more to invest part of their portfolio via our site.

8.) Do you offer equity investment via ordinary share capital, or are other derivatives possible to purchase, such as preference shares, convertible debt or other derivative products?

Ordinary share capital always, but split between ‘A’ shares with ‘B’ shares. The A shares carry full voting and pre-emption rights and are available to investors putting up over a pre-specified amount by an entrepreneur, but often around £20,000, whereas B shares are minority shares without voting and pre-emption rights. But our market research indicated that investors have a deep emotional attachment to investing in ordinary share capital and owning equity in a business rather than by any other instrument.
9.) When facilitating equity investments, what anti-dilution or pre-emption rights do you normally offer crowdfunded investors? Do you see this as a potential source of future friction between crowdfunded businesses and follow-on investors from either the Business Angel or VC communities as some of the more successful of these businesses grow?

See answer above.

10.) What kind of due diligence or pre-screening do you undertake on average for an investment opportunity facilitate on your platform? What kind of investor warnings does your site carry to warn people of the dangers or risks involved in investing in unquoted companies?

All business that apply to us need to submit a business plan and 3 year financial projections – all the information that a would-be investor needs in order to help them make a judgement themselves on an investment. We don’t check the details of the business plan, we leave it up to individual investors to make their own decisions. We also perform background checks on the directors concerned to check that they haven’t been disqualified as a director. Of the applicant businesses, probably only around 20% of them make it onto the Crowdcube site – asking for a detailed business plan in the first instance acts as quite a good natural filter to weed out the less serious applicants.

11.) Is there any liability involved connected with your platform or indeed any ‘lead investors’ that are marketing a funding via your platform, should the company subsequently go into liquidation or require funding that severely dilutes the position of the investors already in, including and maybe especially those that have invested via the platform?

No – it’s definitely ‘caveat emptor’ and up to investors to ask questions of the entrepreneurs via the website and forums available to enable them to make up their own minds on the basis of the information supplied. We’ve been really pleased since day one that those forums are really well used and that some really tough questions are being asked of the would-be investees on the site to test out their vision and strategy and the detail behind their plans.

12.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

I think the future is really bright – the existing model as I’ve said needed to be disrupted and equity crowdfunding has given entrepreneurs a genuinely new source of capital but has also given investors new opportunities into which they can place some of their capital. You can see from the traction that we’re getting that it’s certainly going in the right direction.

13.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

We’ve always been very positive about the potential of crowdfunding, that’s why we started the business, but I’m actually much more positive now after the past couple of years and seeing the way things are starting to take off. Our site has over 35,000 registered investors now, but you can see that the potential clearly exists for that to progress to 350,000 very quickly over the next couple of years if you believe some of the projections for the industry and that recent growth in the first part of 2013 on Crowdcube certainly bears that out.

14.) What kind of investment readiness advice and support does your platform offer entrepreneurs and fundraisers using it? For example, do you offer or source advice for them with regards to the quality of the pitches, business plans and general presentation, and would you be happy to offer a greater level of service on this front for a greater share of funds raised as an additional income stream?

We may ask for a more detailed business plan if we don’t think it’s robust enough, but that’s about it – as I said the would-be investors can make up their own minds.

15.) Do you think that the challenge of communicating with many new investors is a problem for the businesses that have been funded through Crowdcube?

No, I’m not aware of that as an issue. Of the 50 plus businesses that have been supported through our site, I’m not aware of one that has flagged that as an issue. Whether you send an email detailing progress to one investor or 100 investors doesn’t create a huge amount of new work for someone trying to run a business. So from that point of view technology helps things enormously. That being said, we
are developing an Investor Relations portal to give entrepreneurs and investors a closed portal on which they can communicate and keep up to date with developments and ask questions in a secure closed online community environment. Most entrepreneurs actually find it a pleasure rather than a chore keeping their investors up to speed. We did envisage it being more of an issue but that’s not the way it’s worked out – we have raised money twice now through our own platform and have 162 investors now and we have a great online and offline relationship with many of them.

16.) What are your views on so-called ‘hybrid’ crowdfunding sites whereby access is restricted to a wealthier and more sophisticated class of investor (e.g. CircleUp, SeedUps, Syndicate Room)? Do you think this is a good model whereby the credibility and due diligence work of a sophisticated investor(s) is harnessed, even so far as a lead investor who has already sourced a deal offline making it available to others online?

The more restrictive model that harnesses Angel investor credibility has a model based on the view that there will be an Angel community or network set-up still around in 5 years time. My view is that Crowdcube already does that – I don’t really see where the innovation is with those restrictive sites – you can come on to Crowdcube with some existing Angel investment pledged or lined up and pitch your business in the same way that you can if you have sourced absolutely no funding. Crowdcube has always seen itself as a portal through which a diverse range of businesses can pitch themselves, including their existing funding status. If you have already received or been pledged investment, it may be important to you to reflect that in the way that you sell yourself and the proposition on the site itself. It’s a tough marketplace and the more flexible and open you can be, the more opportunities you have in the end to attract investment without tying yourself down to a niche investor community.

17.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

Investors need to be aware that most start-up businesses do fail and be fully cognisant of the fact that they may not get their money back, or that they will get diluted down in future. But we make a point of saying to people to diversify their investment risk across a variety of businesses to ensure that if one business goes down, then they have a variety of other ‘live’ investments still going, some of which may hopefully be going really well. I think that message of diversification is important for the future of the industry, as it is already with the established model of Angel investing, of course.

18.) What about liquidity and the ability of people to be able to realise the capital gains they may have locked into investments made via your platform?

The lack of liquidity has been a challenge we’ve identified since day one. At the moment there is no ready solution to this problem, but we do have it in our development roadmap to try to offer that to people who invest via Crowdcube. This may be through a partnership or through something that we develop ourselves. You can become regulated to run an exchange if you wanted to, it’s one of the options that we have.

19.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

Certain Business Angel Networks do a really good job of helping businesses, by offering advice on their business plans, by refining their business models and they add a lot of value to businesses, and they charge for that. Other BANs just profitteer – they charge a lot of money just to register and be afforded the opportunity to pitch without adding any value, and that latter model is I think quickly becoming archaic and is dropping away, partly through the rise of the crowdfunding alternative that entrepreneurs clearly have now. So the best Angel networks will continue because they have something to offer, but the bad ones will fall away under the competition of alternatives.

20.) Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (‘syndicate investor’) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

See answer to 16.) above – Luke is not convinced about the value proposition in the medium term of restricting a crowdfunding platform to one class of lead investor, even if the site allows others to invest alongside them.

21.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?
Ultimately, no not really, certainly not more than the model we are operating.

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<th>22.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?</th>
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<td>Certain industry sectors have used crowdfunding more effectively to date because of the nature of their operations, but ultimately I think that any industry can use it if it knows how to.</td>
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<th>23.) Do you think that equity crowdfunding will genuinely expand the pool of early-stage risk capital for businesses in the UK, and indeed, worldwide? Why?</th>
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<td>It already has! The people using our site are clearly people who did not have the opportunity to invest in this way before.</td>
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1.) What are the motivations behind your activity in the crowdfunding strategic space?

Carlos and Jeff were chiefly motivated by a combination of a desire to foster growth for innovative businesses unable to source funding elsewhere, growing a successful business themselves and providing a hitherto elusive investment opportunity to anyone who understood the risks involved in investing in young businesses.

2.) How long have you been involved in the crowdfunding area?

Seedrs received FCA accreditation in May 2012 and went live in July 2012.

3.) What type of markets or sectors are you open to facilitating investment in?

Seedrs focuses on seed stage companies requiring up to £150,000. Increasingly these businesses are too early for Angel syndicates and far too small for VCs. Seedrs concentrates more on the fact that firms are innovative and potentially disruptive rather than in which sector they operate in – if the firm has high growth potential because of innovation and a potentially disruptive business model, then Seedrs are definitely interested.

4.) Are you exclusively involved in raising money for start-ups or seed stage businesses, or does your platform, or any activities you’re involved in outside of that, involve investing in later-stage companies?

At this stage, exclusively seed-stage businesses that tend to be less than a year old.

5.) Is your platform live yet and open for business? If so, approximately how many successful campaigns or fundraisings has it completed to supply equity to unquoted companies, as yet?

Seedrs went live in July 2012 and has funded 27 deals in 24 businesses to June 2013 (some investee businesses have received follow-on funding via Seedrs too).

6.) Approximately what size is the average equity investment that your platform facilitate, or aim to facilitate?

The average deal size is around £58,000, the smallest is £9,500 and the largest raised £150,000.

7.) Does your welcome any class of investor, i.e. do you restrict investors to those investing over a certain amount, or conversely do you ensure that access is completely open to anyone with a very small amount of money to invest?

Seedrs is open to anyone with £10 to invest, although all investors have to complete a questionnaire about the risks inherent in investing in unquoted businesses before being allowed to invest or self-certify as HNW (High Net Worth) or a sophisticated investor. Seedrs also promotes the idea of diversification and spreading risk.

8.) Would you, or do you, encourage more professional investors such as Business Angels to invest as part of the crowd on your platform?

Business Angels are one group of people we target with our marketing campaigns. We see ourselves as a platform that can help this investor market streamline their deal flow and spread their risk for at least a part of their portfolio. We’re actively engaging with the UKBAA to educate angel investors about equity crowdfunding and its benefits.

9.) If yes, have you marketed yourself exclusively to this or any other more rarified investment market sub-sector yet?

Seedrs hasn’t marketed itself exclusively to Business Angels, but they are one target market.

10.) Do you offer equity investment via ordinary share capital, or are other derivatives possible to purchase, such as preference shares, convertible debt or other derivative products?

All investors receive ordinary ‘B’ shares but the nominee arrangement means that Seedrs are the sole legal shareholder, which they feel is a boon for a variety of reasons. Firstly, it helps when Angels or VCs show interest later and there is a simpler shareholder capitalisation table to deal with. Secondly,
entrepreneurs only have to get consents from one rather than many shareholders relating to the investors sourced through Seedrs. Seedrs has legal rights under the shareholders agreement on behalf of the shareholders it represents. – they maintain the benefits.

Seedrs takes 7.5% of any subsequent profit on disposal of the shares by investors, and 7.5% of all funds raised for entrepreneurs.

11.) When facilitating equity investments, what anti-dilution or pre-emption rights do you normally offer crowdfunding investors? Do you see this as a potential source of future friction between crowdfunded businesses and follow-on investors from either the Business Angel or VC communities as some of the more successful of these businesses grow?

Investors always have the right to maintain their percentage within subsequent fundraisings, and within the shareholders agreement their right to ‘tag and drag’ on subsequent transactions involving shares in the company. The agreement also gives the nominees the right to veto certain things that management are proposing, such as bonuses.

12.) What kind of due diligence or pre-screening do you undertake on average for an investment opportunity facilitate on your platform? What kind of investor warnings does your site carry to warn people of the dangers or risks involved in investing in unquoted companies?

We start with an initial ‘sniff test’ – we make sure the proposition is legal, ethical and apparently viable and not absurd. Then we go through legal due diligence and verify all facts supplied in their listing (we do not accept business plans). Then entrepreneurs can post a video pitch, and then go live, when they have 90 days to raise their funding as requested. Seedrs supports investors with SEIS eligibility and paperwork and their shareholders agreements.

Before investors proceed to viewing listings and have the opportunity to invest, we make it very clear that this is a risky asset class and suggest developing a diverse portfolio and do not allow investors to invest more than 20% of their disposable capital through Seedrs.

13.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

Well, the UK is very strong at the moment as the regulatory framework is relatively fluid and flexible compared to many places. We plan to expand into Europe at some stage and we see that there is huge potential in the BRIC countries with a strong entrepreneurial ecosystem and countries with relative wealth or a sizeable ‘mass affluent’ potential investor population.

The other potential area of growth is more niche equity crowdfunding sites. While we focus on seed stage companies, others could emerge on a more sector-driven basis, particularly for the creative industries such as film etc.

We also think there’s an opportunity for secondary markets to emerge. As the market grows in legitimacy this is definitely an area which has huge potential for attracting more capital into SMEs and decreasing some of the hesitation among potential investors.

14.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

One thing we are increasingly aware of is that while it’s great to have all types of businesses on the platform so that investors can choose which ones to fund, it’s also great to partner with the growing group of incubators and accelerators that can help to make firms ‘business ready’ before they start looking for investment.

15.) What kind of investment readiness advice and support does your platform offer entrepreneurs and fundraisers using it? For example, do you offer or source advice for them with regards to the quality of the pitches, business plans and general presentation, and would you be happy to offer a greater level of service on this front for a greater share of funds raised as an additional income stream?

This is limited at present, other than the screening and vetting processes I’ve already described, but as I’ve also mentioned, we are looking to partner increasingly with incubators and accelerators whose expertise is very much in this area, so to that end we are moving towards this more and more.
16.) What are your views on so-called ‘hybrid’ crowdfunding sites whereby access is restricted to a wealthier and more sophisticated class of investor (e.g. CircleUp, SeedUps, Syndicate Room)? Do you think this is a good model whereby the credibility and due diligence work of a sophisticated investor(s) is harnessed, even so far as a lead investor who has already sourced a deal offline making it available to others online?

We have nothing against the more restrictive sites, but in some ways they appear to be Angel syndicates that are online. We see ourselves very much as actually opening up a new asset class for the mass affluent investors who aren’t Angels, which is a very different proposition. The more restrictive sites are much closer to just making Angel investment more efficient, whereas we are trying to make investing in start-ups accessible and possible for everyone else – perhaps creating a different type of investor, someone who isn’t quite in the ‘Angel’ category but is invested in a number of unquoted innovative companies.

17.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

The high failure rate of businesses is clearly a challenge for investors but we, like the other regulated platforms, are transparent about the risks. Another potentially less visible risk for investors at present is that people’s interest may not be looked after well by everybody when businesses are successful – e.g. they get diluted the day after they receive them. That is why regulation and investor protections (through structures such as our nominee role on behalf of the shareholders) are so vital. What do the ‘good stewards’ like Seedrs do when this type of thing happens in future? That is a challenge for us potentially.

18.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

I think both! I think it’s complementary to those investing hundreds of thousands of pounds in Angel investment and diverting a small portion of their funds online over a wider range of businesses. Perhaps it’s slightly in competition with less active Angels who could divert a greater proportion online to take advantage of the streamlined deal flow available. But in general, I think we see it here as very complementary, as a lot of the ‘crowd’ money using our site is genuinely new money that may invest alongside wealthier investors who are often classed as Angels and who are also using platforms. In that way we give access to mass affluent individuals who are not angels, we are different in that they cannot access startup investing otherwise.

19.) Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (‘syndicate investor’) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

Not really – I think the distinction I made between the type of Angels and the amount of money they have to invest, and whether equity crowdfunding is in competition with or is complementary to that class of Angel, still stands to be honest.

20.) Do you think the motives of Angels differ from those of the crowd when they invest on crowdfunding platforms?

I think it depends on the individual businesses and the investor’s motives with respect to particular or specific investment opportunities: it could be primarily financial, a passion for the sector, an altruistic motivation or some mix of these. And ‘ordinary’ crowd investors think along similar lines too – they often feel it’s a more interesting way of investing in shares than in investing in quoted companies on recognised exchanges. So in that way, the motives differ but they’re pretty similar on the whole!

21.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

I think that both the very open and the more restrictive forms of equity crowdfunding have their place in the market. Both could be said to be expanding the pool of risk capital available for business.

22.) Do you think that Angels and ‘the crowd’ investing alongside each other plugs a larger part of the existing equity gap than is possible with the two groups working independently of each other?

I’m not sure about that – it’s safe to say time will tell which platform formula that is emerging at present
will prove the most successful. There will definitely be winners in the space, but there’s nothing wrong with working together to satisfy the demands of niche investor segments.

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<tr>
<th>23.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?</th>
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<td>See my answer to 3.) above – here at Seedrs we concentrate on firms that are potentially high-growth and that usually means innovative and potentially disruptive, whatever the sector they are involved in. And that is not really affected by the particular slant of the equity crowdfunding model, unless that platform is specifically labelling itself as targeting one particular sector.</td>
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<th>24.) Do you think that equity crowdfunding will genuinely expand the pool of early-stage risk capital for businesses in the UK, and indeed, worldwide? Why?</th>
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<tr>
<td>Absolutely – it attracts new money into start-up investment.</td>
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## Participant 6 – Conducted 21st June 2013

1.) **What are the motivations behind your activity in the crowdfunding strategic space?**

Derek’s has a background in Corporate Finance. FTG’s target audience is the more sophisticated investor, who would be previously have used Financial Advisors to bring them investment opportunities but now may start to use other sources of information for investment opportunities with the advent of the Retail Distribution Review regulation that came into effect on 1st January 2013. Now with fees being disclosed, he believes these investors can be educated on a direct basis and targeted to use his platform to make their own investment decisions. Derek also believes in the importance of funding small businesses to help foster economic growth in the UK.

2.) **What type of markets or sectors are you open to facilitating investment in?**

FTG has not closed the door to any specific sectors. They are looking for credible robust business plans which they can see being sustained and help build a good track record to demonstrate FTG Due Diligence skills.

3.) **Are you exclusively involved in raising money for start-ups or seed stage businesses, or does your platform, or any activities you’re involved in outside of that, involve investing in later-stage companies?**

At the moment is it for just start ups and seed stage businesses. FTG are in talks about expanding this and potentially using the platform to raise money for Corporate Finance House deals and offer portions of these, but at present this prospect is some way off.

4.) **Approximately what size is the average equity investment that your platform facilitate, or aim to facilitate?**

The average individual investment is around £3,500 at the moment, the minimum of £500 hasn’t proved necessary to be honest. The total number of deals that FTG has funded at present is 10, although the total invested in these deals is not disclosed.

5.) **Does your platform welcome any class of investor, i.e. do you restrict investors to those investing over a certain amount, or conversely do you ensure that access is completely open to anyone with a very small amount of money to invest?**

We have a minimum threshold of £500 for an individual investment as specified above, but that is really to help ensure that our investors are a little more sophisticated and knowledgeable about finance, investment, and the risks and rewards associated with those investments. So although we welcome anyone with more than £500 to invest, that helps to restrict things slightly by definition, we find.

6.) **Would you, or do you, encourage more professional investors such as Business Angels to invest as part of the crowd on your platform?**

We really like working with Angels and value their experience. We think the most powerful combination is a cornerstone Angel investor with a lot of experience, rounded out by the crowd money, although that crowd is slightly more educated, perhaps young professionals with some money to invest and who know and understand the risks involved.

7.) **If yes, have you marketed yourself exclusively to this or any other more rarified investment market sub-sector yet?**

No exclusive marketing has been undertaken per se to Angels etc., but it is one of the key customer segments that we are aiming our services at.

8.) **Do you offer equity investment via ordinary share capital, or are other derivatives possible to purchase, such as preference shares, convertible debt or other derivative products?**

At present we simply offer for-risk ordinary share capital as this are eligible for SEIS or EIS tax incentives. Over time, we can introduce more complex instruments such as convertibles if appropriate.

9.) **When facilitating equity investments, what anti-dilution or pre-emption rights do you normally offer crowdfunding investors? Do you see this as a potential source of future friction between crowdfunded businesses and follow-on investors from either the Business Angel or VC communities as some of the more successful of these businesses grow?**
All shares have pre-emption, tag rights and voting rights. We make no distinction between sizes of investment made in the rights attached to those shares. We bundle all of the shares together in each investment under a nominee arrangement and offer one shareholder representing the others on the board of the company concerned. So the company gets one legal shareholder to deal with.

As such, the company concerned only deals with one shareholder in respect of their investment that they have received through FundtheGap, and we as facilitators have an ongoing involvement through the facilitation of the nominee arrangement post investment. We don’t manage the investment, let me make that clear, but we do undertaken an investor relations role, helping with administration, tax planning, share certificates. We at FTG have the right to speak to management, receive management accounts, etc., so we have an ongoing interest in progress on behalf of our investors, which again we feel is a differentiating factor and something that in time we may emphasise more.

10.) What kind of due diligence or pre-screening do you undertake on average for an investment opportunity facilitate on your platform? What kind of investor warnings does your site carry to warn people of the dangers or risks involved in investing in unquoted companies?

The idea is to grow companies over a 3 to 5 year period which is what FTG investors should be looking for. We gear up to this end, with our team having a private equity and VC background with finance technical skills, corporate finance experience and legal skills that are relevant. Some platforms just check that people are who they say they are, but we do full business plan DD, verifying management experience and the range of skills in the management team, checking their market research, their social media strategy, their financial projections for prudence, realism etc., and all stated facts in a business plan. The end result is that we’ve rejected 90% of the 100 companies that have come to us to date. We offer a lower volume of investments than our main competitors, but in our view a much higher quality of investment.

We also do investor events, where potential investors can personally meet the entrepreneurs and quiz them over specific elements of the model, which is not a service that any of our competitors provide to our knowledge.

We plan to sustain the expense of this value-added service through building a reputation for excellence and having a lower failure rate of our investment opportunities than our competitors. That should lead to a higher funding rate for our businesses, and thus generate higher fees in the longer term, commensurate with the quality of our service.

11.) Is there any liability involved connected with your platform or indeed any ‘lead investors’ that are marketing a funding via your platform, should the company subsequently go into liquidation or require funding that severely dilutes the position of the investors already in, including and maybe especially those that have invested via the platform?

To an extent we do take on some liability. We’re very rare in that the pitches on our website comply with certain standards for representation of financial and commercial information – every fact on the pitch has been checked. Most of our competition do not go into that level of detail.

12.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

There are two different camps in equity crowdfunding. The first is one that doesn’t do much due diligence, that is very open to who they let on their platforms, that tend to fund local businesses, lifestyle businesses, smaller average investments. The source tends to be local money from relatively unsophisticated investors. The other is a where we feel we sit, as we are performing more checks, we have a team with a large amount of experience, we are more restrictive in terms of entrepreneurs and investors.

The former is bringing a new source of money to small businesses in the UK, in the sense that these people have never invested before. The latter I feel is attracting both new money from the crowd, people who haven’t previously been able to invest in small companies because of restrictions and the cost of due diligence and transaction costs. But we’re also hoping to attract existing Angel investors or high net-worth and sophisticated investors, who we hope view us as an intuitive and easy to use portal for investing some of their portfolio of capital.

13.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

If anything I have become more enthusiastic about the potential for the medium and more optimistic
about the potential it has to help fund the growth businesses the UK economy needs.

14.) What kind of investment readiness advice and support does your platform offer entrepreneurs and fundraisers using it? For example, do you offer or source advice for them with regards to the quality of the pitches, business plans and general presentation, and would you be happy to offer a greater level of service on this front for a greater share of funds raised as an additional income stream?

See the answer to 10.) above – we do quite a lot of work vetting business plans and checking financial projections, and we’re pretty rigorous here, so to that extent, we’re do offer investment readiness advice to entrepreneurs. As such, we feel that in time our funding rate and failure rate of businesses will be superior, and that as a result, we will be able to charge more for a premium service.

15.) Do you think that the challenge of communicating with many new investors is a problem for the businesses that have been funded through FTG?

Not so much given that we retain an investor relations role as I’ve explained, and the nominee structure makes that information flow process easier, with only one representative shareholder for the investors that have come via FTG.

16.) What are your views on so-called ‘hybrid’ crowdfunding sites whereby access is restricted to a wealthier and more sophisticated class of investor (e.g. CircleUp, SeedUps, Syndicate Room)? Do you think this is a good model whereby the credibility and due diligence work of a sophisticated investor(s) is harnessed, even so far as a lead investor who has already sourced a deal offline making it available to others online?

We feel that that kind of model ultimately stands a better chance of plugging the equity gap that exists. Ultimately that means more money in the medium term will flow into businesses as the calibre of our investments is proven. And the smaller investors should become ambassadors plugging the service to their friends and networks.

17.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

I think that a scandal will happen on one of the platforms given that the risks are high and fraud is possible, whether that be in the reward-based model or on an equity-based model. We hope that the way we go about things stands a better chance of mitigating the risks of this happening on FTG.

18.) What about liquidity and the ability of people to be able to realise the capital gains they may have locked into investments made via your platform?

There is no liquidity for many start-up investments often. The only way of realising an investment is via an IPO, a refinancing, or a trade sale, or if you can find someone who will buy your stake in a business. That’s a fact of life in VC investment, and you can’t really change it in my opinion – you’re trying to change the risk-reward profile of unquoted company investment. Information asymmetry is a real issue with the secondary market – how do you agree on a price? What disclosure requirements will there be? Maybe I’ll be proven wrong, but even smaller companies on the AIM exchange show that there’s an issue with pricing etc. in that environment too, which to some extent helps to prove my point.

19.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

I see them very much as complementary. Angels get overwhelmed by companies seeking funding. We feel that we are very useful to Angels as the amount of pre-screening we do mean that Angels or high net-worth investors know that the calibre of investment they find on FTG is of a certain calibre or quality.

20.) Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (‘syndicate investor’) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

I would see a restrictive model of operation as ultimately more complementary given that the failure rates of businesses through this route should be lower and the knowledge of the investors scrutinising financial and strategic information will be higher.
21.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

Well, we do more due diligence we think than Syndicate Room, who rely on the DD undertaken by the Angel investor alone, so to that extent we see our service as differentiated from theirs. But to the extent that a restrictive model for investors and entrepreneurs stands a better chance of expanding the pool of SME risk capital than the entirely open crowdfunding model, then the answer would have to be yes.

22.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

Not really – I’m relatively agnostic about sector to be honest. I am much more interested in the robustness of the value proposition and business plan, and the level of growth potential and innovation inherent in the business.

23.) Do you think that equity crowdfunding will genuinely expand the pool of early-stage risk capital for businesses in the UK, and indeed, worldwide? Why?

Yes! The corporate finance space hasn’t innovated for a long time in reality. Now with operations going increasingly online, things are genuinely changing, and that’s a structural shift in my opinion.
1.) **What are the motivations behind your activity in the crowdfunding strategic space?**

People should be allowed to invest in start-ups, regardless of how wealthy they are. Before crowdfunding, only high net-worth individuals had access to the sort of investments opportunities available to Angels and the like. Crowdfunding has enabled people to start investing in start-ups, but not necessarily in the calibre of opportunities that Angel investments offer. There's a big difference in my opinion. So I started Syndicate Room to provide that opportunity to the crowd, to invest in real Angel investments. Obviously nobody should invest more than, say, 10% of their investments in this type of thing, but you don't have to be a millionaire now to access that kind of investment opportunity.

2.) **How long have you been involved in the crowdfunding area?**

Syndicate Room has been in development for around 12 months, so since summer 2012.

3.) **What type of markets or sectors are you open to facilitating investment in?**

We are a sector-agnostic platform. There must be at least one Business Angel involved as a lead investor, and thus investments tend to be in sectors attractive to Angels, i.e. highly scalable, high potential tech or biotech companies that are seeking more money than other platforms tend to be able to provide will be found on SR. We will be able to facilitate rounds of up to £1 million due to the substantial involvement of the Angels.

4.) **Are you exclusively involved in raising money for start-ups or seed stage businesses, or does your platform, or any activities you’re involved in outside of that, involve investing in later-stage companies?**

Not exclusively – it really depends on the opportunities that the Angels bring to us and wish to offer to the crowd. They are often start-up stage, but providing the sums required are not too large, they could be a little later than this as well. The lead investors are the ones who dictate that.

5.) **Is your platform live yet and open for business? If so, approximately how many successful campaigns or fundraisings has it completed to supply equity to unquoted companies, as yet?**

The platform is live now but in a closed ‘beta’ state, i.e. it’s only accessible to a limited number of Angel investors who are already constructing deals online. It will be open to the public within 2-4 weeks who would like to invest alongside the Angel investors. But we plan to close at least one deal between an Angel-only syndicate before the platform goes live to the public.

6.) **Approximately what size is the average equity investment that your platform facilitate, or aim to facilitate?**

We will operate to raise funds between c. £150k and £1m, with a sweet spot of around £450k-£500k. We have a minimum of 25% to be invested by the lead investor (or investors if it’s an existing syndicate of Angels, often between 3 and 5 investors), but in practice what we’re finding now before deals have closed, is that they will put up around 50% or even 75% of the funding themselves and try to source the rest on SR.

Those lead investors will have undertaken their own due diligence on the company, and their own research, and most if not all will want ongoing involvement in the company. So the company gets their expertise and on top it also gets a layer of more passive capital, which is a further attraction to the company concerned.

7.) **Does your welcome any class of investor, i.e. do you restrict investors to those investing over a certain amount, or conversely do you ensure that access is completely open to anyone with a very small amount of money to invest?**

We have a minimum £500 investment threshold for crowd investors. That is designed to ensure investors think about it and make a considered investment. There is talk of the FCA instituting a £1,000 minimum for equity crowdfunding, which I believe is wrong: just because someone is wealthy doesn’t make them a sophisticated investor, and just because they don’t have as much money, doesn’t automatically make them an unsophisticated investor.

8.) **Would you, or do you, encourage more professional investors such as Business Angels to invest as part of the crowd on your platform?**
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<th>Question</th>
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<td>9.) If yes, have you marketed yourself exclusively to this or any other more rarified investment market sub-sector yet?</td>
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<tr>
<td>We market ourselves very heavily to Angel investors as we depend on them to be the lead investors that more ‘passive capital’ will be happy to follow.</td>
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<tr>
<td>10.) Do you think the motivations of Business Angels differ from those of the ‘crowd’ when investing on equity crowdfunding platforms?</td>
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<td>I think that Angels’ motivations are slightly different. The crowd often invests money because they like the idea or the person behind the opportunity. With Angels, making money is probably higher up their list of motivations, and because they like the business and they like the team.</td>
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<td>11.) Do you offer equity investment via ordinary share capital, or are other derivatives possible to purchase, such as preference shares, convertible debt or other derivative products?</td>
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<td>Only ordinary share capital is offered. The crowd investors get exactly the same type of shares as the lead investors, with the same pre-emption rights, the same drag-along and tag-along rights too. If the lead investor makes money, so does the crowd.</td>
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<td>12.) When facilitating equity investments, what anti-dilution or pre-emption rights do you normally offer crowdfunding investors? Do you see this as a potential source of future friction between crowdfunded businesses and follow-on investors from either the Business Angel or VC communities as some of the more successful of these businesses grow?</td>
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<td>Anything requiring shareholder approval, all shareholders get a vote if they have the same voting rights, as they indeed will with SR, and the same pre-emption and drag-along or tag-along rights apply too, as I’ve said. Now, ordinarily the crowd may not be able to block the lead investors from reaching the 75% of votes required to pass resolutions unchallenged under company law, but the alignment of interests goes a long way to solving this issue. Similarly, if the company gets acquired or new investment is attracted in that dilutes existing shareholders, the lead investors and the crowd make the same pro-rata profit or are diluted to exactly the same pro-rata degree, as they hold the same kind of shares.</td>
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<td>13.) How will the crowd investors’ interests be represented on the boards of the companies concerned? Do you think that the nominee structure of shareholding practiced by Seedrs and Fund the Gap is preferable to the direct ownership model (Crowdcube, SR). Why/Why not?</td>
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<td>The lead investors usually require to sit on the boards of the companies concerned. Now, they’re only representing themselves and not the interests of the crowd investors, but their interests are so perfectly aligned, in that the crowd make money only when the lead investors make money, that this is in practice what occurs. Thus with the SR model, the nominee structure is not required.</td>
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<td>14.) What kind of due diligence or pre-screening do you undertake on average for an investment opportunity facilitate on your platform? What kind of investor warnings does your site carry to warn people of the dangers or risks involved in investing in unquoted companies?</td>
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<td>SR do basic legal due diligence: that the directors and the company exist, that anti-money laundering checks have been performed, but as regards commercial due diligence is concerned, the platform makes no judgements and the crowd are invited to make their own choices based on their own knowledge and instinct. SR don’t vet all the facts in a business plan, but the lead investors do because they are putting in £100,000, or £200,000, or £300,000 of their own money into a business. Who are we to suggest that they have not researched something like that properly and sufficiently thoroughly? It’s then up to the crowd to look at the deal and make their own judgements about the investment offered.</td>
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<td>15.) Is there any liability involved connected with your platform or indeed any ‘lead investors’ that are marketing a funding via your platform, should the company subsequently go into liquidation or require funding that severely dilutes the position of the investors already in, including and maybe especially those that have invested via the platform?</td>
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That’s what our model revolves around, so yes!
None connected with my platform, but the entrepreneurs have to sign off on the contents of their business plans and pitches that go live on Syndicate Room with accompanying warranties, both to the lead Angel investors and to the crowd that follow the lead Angels. That way there is accountability to the investors and a liability is formed, but not by Syndicate Room.

16.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

I like the idea, I just don’t think it’s being done properly by existing equity platforms, mainly because investors don’t have the right protections in place. For example, having only ‘B’ shares with no voting rights or pre-emption rights: if the company gets acquired, the incoming purchaser may not bother buying your shares as you can’t vote anyway, so why bother? Additionally, without pre-emption rights, the night before a potential IPO the company could technically issue a massive amount of new shares and you’re suddenly diluted down to a miniscule percentage holding just before the company goes public and lose out on a huge windfall.

With some sites, the crowd can look at judge what are good investments, but without the knowledge of pre-emption and voting rights and the legal niceties therein, they are in a very weak position. They don’t have to know all the details of course, they just have to have their interests looked after properly, and respected. Now some sites have a nominee structure that attempts to do this through the crowdfunding platform representing shareholders on the company’s board. SR does it through the alignment of interests between Angel lead investors, and the crowd that follow them.

17.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

There will be better models out there, including but not restricted to ours of course. I think that there will be a large degree of differentiation in the marketplace in the near future, and then a large amount of consolidation as the dominant players in each segment or type of equity crowdfunding emerge and acquire the others. If I was the regulator, I wouldn’t be worried about whether investors can or cannot invest on equity crowdfunding platforms, but that they are afforded an appropriate level of investor protection when they do so in terms of their rights under law.

18.) What kind of investment readiness advice and support does your platform offer entrepreneurs and fundraisers using it? For example, do you offer or source advice for them with regards to the quality of the pitches, business plans and general presentation, and would you be happy to offer a greater level of service on this front for a greater share of funds raised as an additional income stream?

No, we don’t need to offer investment readiness advice on the basis that it is much harder to attract Angel investment than it is crowd money. So if you’ve got Angel interest, in our view you’re pretty much investor ready.

19.) Do you think the ‘open’ and ‘restrictive’ models, in terms of being open to investors, can both co-exist? Some have said that the more open, less restrictive platforms stand more chance of opening up a new asset class, whereas they say the restrictive sites are just a variation on a theme that existed before and could just morph into online BANs or something similar?

I think that both models can co-exist. More open crowdfunding platforms are geared towards the needs of entrepreneurs. It’s great for them, but not so good for investors often.

SR are coming at it from a completely different angle – we’re working hard in the interests of the investors, to add real value. So rather than look at it as an online Angel syndicate, view it as a means of allowing ordinary investors the chance to access those syndicates in a much more democratic way, but still relying on the expertise and knowledge of those Angels.

20.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

For entrepreneurs, the challenge revolves around the fact that if you fail to raise the required level of funding on a platform, that failure is very public and it’s very hard to convince subsequent potential funders of the merits of your model. If you set your price too high, you can easily suffer that fate.

For investors, the risk of this asset class is obvious, it is what it is, nobody should pretend otherwise. The main point as I’ve alluded to before is that their interests are not looked after properly, and that is one of the key challenges for investors. The other key challenge is trust: how do I know that the
entrepreneurs will not spend the equity on expensive offices and fast cars? The Angels provide that in the SR model, as they are usually not there to control every tiny detail, but simply to provide a control against the entrepreneur doing foolish things or making basic mistakes that threaten the value of the company in the future.

21.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

I think equity crowdfunding platforms in general are complementary to Angel investing. In general, they are very early stage things that invest in businesses earlier in the life-cycle than Angels do. Often they facilitate investment in lifestyle businesses, which an Angel would never look at as they can’t make money from those. There will be some overlap between the two categories: equity crowdfunding in its most open sense, and Angel investing, but I see them evolving a little separately. SR seeks to combine the two explicitly.

That being said, if Angels are not offering value to their entrepreneurs, equity crowdfunding offers those founders an alternative, whereas if they are offering value-adding services such as access to networks and expertise, that’s something that can’t be found online nearly as easily, and means that equity crowdfunding is complementary to that class of ‘genuine’ Angel operator.

22.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms? Presumably you think that the lead investor is very important? How do you check the credentials of the Angels that become lead investors on SR?

Yes, absolutely I do. A lot of people are becoming interested in crowdfunding and investing in start-ups. But many realise that while they are interested, they are not convinced quite yet if they are a little more sophisticated because of the perceived risks. So SR is giving more educated passive capital the chance to invest on a more informed basis alongside real Angels in investment opportunities they have researched thoroughly.

23.) Are you seeking FCA authorisation for SR?

We will be. We are waiting to close the first deal, and then we will start the process.

24.) Do you think the emergence of larger Angel syndicates beginning to fund deals of up to £2m will threaten the USP of SR to the lead investors of avoiding the need to go for VC funding until later?

Not at all, quite the opposite! If syndicates want to do larger deals, that is better for SR because some of those large deals can be funded by the educated crowd, and that’s good for us. That’s exactly what we’re here for. Syndicates are using SR just to engineer deals, we’re just moving offline activity online, with the added attraction of passive capital on top.

25.) Do you think that Angels and the crowd investing alongside each other on SR or other crowdfunding platforms plugs a bigger part of the equity gap than Angels would investing alone?

Absolutely, no doubt about it. Leveraging that passive capital can only bridge the gap to a larger degree.

26.) Do you think that equity crowdfunding will provide competition for Angels, substituting those that offer questionable value through expertise, contacts etc., but being complementary to (deal flow, proof of concept etc.) those that are ‘good Angels’ that genuinely add value to their investee companies?

Yes, I totally agree with that sentiment. You can’t replicate the quality of expertise, contacts and networks that high-quality Business Angels bring to a deal through an online crowdfunding platform. However, if the Angels concerned are not delivering on promises, then platforms will provide competition for funding from the entrepreneur’s perspective.

27.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

On more open crowdfunding platforms, retail-related opportunities are more popular as people can
relate to them easily. This is a sector that Angels often don’t go near. Angels prefer biotech, tech, medical or B2B businesses that seem far more obscure to the typical crowd investor, but which provide the much more robust opportunities from an investor perspective very often.

28.) How important do you think the emergence of a genuine secondary market for shares in non-quoted companies will be for the ultimate success of the equity crowdfunding model?

I don’t agree with the concept of a secondary market, for two main reasons. Firstly, it gives investors the impression that shares in unquoted companies are potentially liquid investors, which I don’t believe to be the case. Secondly, and this is the reason why they are illiquid investments, the information asymmetry between vendor and purchaser is simply too great. Vendors could be selling simply to realise some cash from their investment, but they could also of course be aware of problems that the purchaser is unaware of, and stands very little chance of finding out about unless they have insider information. So pricing these shares when the level of legal and financial disclosure and the amount of publicly available information is usually so thin is very hard.

The only option I see is that in subsequent funding rounds, existing shareholders are able to sell at the same pre-money valuation as an incoming investor is willing to purchase equity at. Then there is some market evidence of a fair price arrived at through negotiation by third parties. Otherwise I don’t see how a purchaser can validate a price given the low frequency of trading in these assets, and not enough public disclosure of previous trades.

29.) Do you think that equity crowdfunding will genuinely expand the pool of early-stage risk capital for businesses in the UK, and indeed, worldwide? Why? What do you think the regulatory response will be in the UK, given that this debate is very live and ongoing?

I think crowdfunding will grow hugely and exponentially over the next few years, and will provide a lot more new capital if the regulators allow this to happen. The UK’s regulatory response is emerging currently – let’s hope the FCA are not too heavy handed here.
### 1.) What are the motivations behind your activity in the crowdfunding strategic space?

To make money and facilitate a more efficient investment experience through a private market online platform, comprising in the first instance 3,300 accredited investors and professional advisors. This grew out of his personal business network and the desire to make investment in private companies easier and more streamlined, but by ‘making the status quo much more efficient’ rather than introducing a disruptive new model.

### 2.) How long have you been involved in the crowdfunding area?

I’ve been trying to start the platform in various guises for around 5 years but sourcing funding from the right places, perfecting the technology, and building the right team has taken time.

### 3.) What type of markets or sectors are you open to facilitating investment in?

High-tech and tech industries in the first instance.

### 4.) Are you exclusively involved in raising money for start-ups or seed stage businesses, or does your platform, or any activities you're involved in outside of that, involve investing in later-stage companies?

More established businesses generally, that are looking for a significant amount of funding (£100k plus) in the form of equity, debt or whichever other derivatives the counterparties decide to engage through.

### 5.) Is your platform live yet and open for business? If so, approximately how many successful campaigns or fundraisings has it completed to supply equity to unquoted companies, as yet?

Integrity Capital ([www.integritycapital.com](http://www.integritycapital.com)) will open in August 2013.

### 6.) Approximately what size is the average equity investment that your platform facilitate, or aim to facilitate?

For debt, from around £100k, for equity from around £250k.

### 7.) Does your welcome any class of investor, i.e. do you restrict investors to those investing over a certain amount, or conversely do you ensure that access is completely open to anyone with a very small amount of money to invest?

Investors must be authorised and regulated by the relevant regulatory authority (e.g. in the UK, by the FCA).

### 8.) Would you, or do you, encourage more professional investors such as Business Angels to invest as part of the crowd on your platform?

The platform operates above the usual level of Business Angel investment, who usually invests around £10k-£50k in each investment.

### 9.) If yes, have you marketed yourself exclusively to this or any other more rarified investment market sub-sector yet?

n/a – see answer above.

### 10.) Do you offer equity investment via ordinary share capital, or are other derivatives possible to purchase, such as preference shares, convertible debt or other derivative products?

Debt and equity in various forms may well be offered through the platform, depending on various deals as they come to market.

### 11.) When facilitating equity investments, what anti-dilution or pre-emption rights do you normally offer crowdfunding investors? Do you see this as a potential source of future friction between crowdfunded businesses and follow-on investors from either the Business Angel or VC
communities as some of the more successful of these businesses grow?

This will depend on the nature of the deal, the business development stage of the company and the relative negotiating stances of the counterparties. Integrity Capital will not offer standard terms or documentation templates – these will be produced by the counterparty’s advisors.

12.) What kind of due diligence or pre-screening do you undertake on average for an investment opportunity facilitate on your platform? What kind of investor warnings does your site carry to warn people of the dangers or risks involved in investing in unquoted companies?

Investors will see company documentation in a virtual data room which will be bespoke for each deal. The platform itself will undertake no due diligence other than pre-screening.

13.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

Mainstream crowdfunding is a retail product in essence. The government may try to regulate the industry in the same way as gambling, but this will be difficult as the phenomenon is global and hard to restrict. Limits may be placed on how much individual investors may invest in each year or as a proportion of their income (as set out in the US JOBS Act).

14.) Have your views on equity crowdfunding evolved and changed over the last couple of years as this form of the phenomenon has emerged?

I’m more interested in what I call ‘funding platforms’ that operate at the level above ‘retail equity crowdfunding’ that have emerged, such as Funding Circle in the UK and www.gust.com in US.

15.) Have you, or would you yourself invest as part of ‘the crowd’ via one of the UK’s equity crowdfunding platforms? Why/Why not?

No, as the number of funding propositions are too great and the level or risk is too high.

16.) What kind of investment readiness advice and support does your platform offer entrepreneurs and fundraisers using it? For example, do you offer or source advice for them with regards to the quality of the pitches, business plans and general presentation, and would you be happy to offer a greater level of service on this front for a greater share of funds raised as an additional income stream?

This will be provided through the cadre of professional advisors that have been allowed access to the platform.

17.) What are your views on so-called ‘hybrid’ crowdfunding sites whereby access is restricted to a wealthier and more sophisticated class of investor (e.g. CircleUp, SeedUps, Syndicate Room)? Do you think this is a good model whereby the credibility and due diligence work of a sophisticated investor(s) is harnessed, even so far as a lead investor who has already sourced a deal offline making it available to others online?

I think it is a reasonable model, but I don’t think these should or will usurp the status quo. They are just another way of helping to source the right investors with the right amount of funding for the right company.

18.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?

For investors, it is undoubtedly the issue of trust, which ordinarily is built up over many years, to answer questions such as i) which opportunities should I be looking for? ii) of those, which is the best one for me?

For entrepreneurs, it is the inverse: who is the right type of investor and what is the right form of investment.

Online environments, if set up carefully, can reduce the noise created by the sheer volume of investment opportunities by helping both sides to narrow down the choices and focus on what is relevant.

19.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?
I think mainstream ‘retail’ equity crowdfunding is a different product altogether. Syndicate investing as practiced by Business Angels relies on sourcing the right lead investor(s) who is the right person for exactly that deal.

20.) Would your view change at all considering a model such as Syndicate Room, which offers a restricted class of crowd investor (‘syndicate investor’) investing at least £1,000, the chance to participate alongside lead investors (BAs) in deals (this offers BAs the chance to remain the lead investor in a deal, potentially removing the need for VC involvement, and means they can diversify their portfolio more widely)?

As with the offline environment, the ‘right fit’ of lead investor in a particular deal relating to a particular sector is crucial.

21.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

It may well do, given the right regulatory and market conditions.

22.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

I mentioned that tech opportunities not requiring more than around £500k in total may be good initial proving grounds for the model.

23.) Do you think that equity crowdfunding will genuinely expand the pool of early-stage risk capital for businesses in the UK, and indeed, worldwide? Why?

There are 4 key things that could happen over the coming months or years that will heavily influence how crowdfunding impacts economic progress:

i) The mainstream marketing of debt and equity crowdfunding sites will be permitted
ii) The government’s regulatory approach may change, possibly treating crowdfunding, particularly the equity model, akin to gambling
iii) Crowdfunding sites begin to splinter and specialise in specific sectors
iv) Crowdfunding sites begin to specialise by region too – there is a market for local people to invest in small-scale but viable retail or consumer businesses in their geographic vicinity
Participant 9 – Conducted 11th June 2013

1.) **What are the motivations behind your involvement in the area of crowdfunding?**

Amanda discovered the real shortage was at the pre-revenue stage for businesses and that unless you had a really high-growth proposition, there is no funding available for such businesses as a result of the equity gap moving down to the earliest level for business since VC and BA money moved up the funding escalator. Amanda was really enthused by the Kickstarter reward crowdfunding model in the US and has engineered a platform like it based in the UK called Bloom VC.

2.) **What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?**

I’m a massive enthusiast for the concept of crowdfunding, although equity crowdfunding does concern me.

What I found was that people I talked to wanted to help their friends and neighbours start a business if the need was there. The only difference between crowdfunding now and the same thing in past centuries in my view is the internet. I’ve created Bloom to help people raise seed and proof of concept cash, but not selling equity. It gives people a chance to prove their concept and their market and show an Angel investor or a bank for lending or investment that there is a demand for their product or service.

On one level it’s a reward model in the same way as Kickstarter or Indiegogo are in the US. 1 in 3 of projects are funded and the average donation is around £48, usually from people backing a project from outside the friends, family and social connections circle of the entrepreneurs. Around 20% of the cash comes from outside the UK, and around 30% of backers don’t accept the rewards offered to them by entrepreneurs! There are some great case studies of businesses that have raised money through Bloom that have gone onto flourish and actually receive equity investment from the people that originally backed them on Bloom.

So what differentiates Bloom from the typical reward model is that the reward stage is seen as a stepping stone on the way to more substantial investment from the backers sourced through Bloom, or indeed other Angels, investors or banks. We’re providing a pipeline of projects that has more depth to it than simply a business plan.

3.) **How much money have you challenged through Bloom VC so far?**

In our first year from April 2012 we have channelled for businesses. Bloom get 5% of funds raised. We’re also doing some sponsorship deals with corporate that want to promote some of the concepts launched through the site. We have one or two partnerships with banks and VC firms who see the benefits of the model.

4.) **What due diligence procedures does Bloom VC perform?**

Only that the entrepreneur is a real person, and that they have a bank account. That’s it. The challenge for the entrepreneur is to get backers to help support them.

5.) **What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments into unquoted companies via crowdfunding platforms, in your opinion?**

Well the reason I developed Bloom in the way I did was that I don’t see an equity model that is sustainable. I’ve started 6 businesses and only 2 of them survive to this date in any shape, way or form. So the high failure rate is a real issue for equity crowdfunding in my view, but that’s a good thing so that the tough customers survive from another perspective. Hats off to Crowdcube and Seedrs, but I can’t see in the long term how they play out.

6.) **How do you think the almost inevitable failure of many crowdfunded business will play out in the media and public arena in the coming years, given the high failure rate of startup businesses in general which will surely apply to crowdfunded business as well to a large degree?**

I think this is crucial and will become a real problem. I have my doubts about the equity based model. In future, I do see Bloom being involved in facilitating funding on a larger scale for the more successful businesses on our site, but this is likely to be through the form of debt, not equity, partly because of the regulatory differences between marketing these two forms of funding.

7.) **How involved do you think equity crowdfunding platforms should be in due diligence to screen**
investment opportunities, given that many do not bear any legal liability for investments made through their portals?

I think that due diligence is trying to manage risk, which is understandable but just increases cost. As I have said, the equity-based model is fascinating but may become unsustainable in the medium term because of regulatory concerns, the failure rate of businesses and the lack of education on the part of investors.

8.) Would you yourself invest via equity crowdfunding, and would your answer to that change if the option was a more restrictive model (from the investor and entrepreneurial perspective) that harnessed the credibility of, and opportunities sourced by, recognised Business Angel investors, such as ‘Syndicate Room’?

I would see a restrictive model like Syndicate Room as a variation on a theme – starting with an Angel investment, and some completed due diligence etc., but because of regulatory constraints and a lack of education on the part of the public, I’m not convinced about equity crowdfunding in general.

9.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

My view is that Angel investment is a good thing but it’s really expensive because of the amount of professional advice and consultancy that is demanded as part of that process. So it is prohibitively expensive for both investor and entrepreneur for anything but the really high-growth potential prospects. People try to eliminate risk by spending this money, but that’s impossible, and it thus costs lots of money to lose more money! Bureaucracy is strangling a very simple concept with rules, regulations.

There are lots of people that want to invest in small businesses with some of their spare cash, but many of them don’t understand the risks involved at all.

I do think that Crowdcube and Seedrs are doing a great job and that they are complementary to the status quo of Angel investment, but I’m not sure in the medium term how they play out and actually change the way investment is really done, given the high failure rates that are bound to occur in the next few years.

The lack of a secondary market is a really important point. In Scotland many investments through the LINC Scotland Angel network are into their 7th and 8th rounds now and the investors can’t get out because an exit route is not attainable. So the existing Angel model is not ideal, and the lack of a secondary market is a large part of that, so Angels are dependent on VCs.

10.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

See answer to 9.) Amanda believes that SR is just a variation on a theme and thus is no more likely that other equity crowdfunding models to genuinely expand the pool of risk capital.
## Participant 10 – Conducted 12th June 2013

1.) **What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?**

Well, broadly I’m very supportive as it’s an important emerging way through which Angels can enact investments.

One factor that is crucial is regulation. I’m working with a lot of US colleagues on crowdfunding at the moment and it’s fascinating how the JOBS Act is influencing the development of regulation there in comparison to the UK. The US framework appears to be differentiating much more between accredited Angels, who have to prove that their reasonably high net-worth, not just sophisticated, in comparison to the ‘crowd’. I’m speaking at Berkeley in California about this and the UK is ahead of the curve in this area, so they are interested to hear what I’ve got to say on the emerging UK approach, whereby there are now 3 equity platforms (Seedrs, Crowdcube and CrowdBnk) that are officially sanctioned by the FCA. All of which are now Uk BAA members: I wanted to show our confidence in the most reputable platforms that have been sanctioned by the government regulator, and encouraging Angels and platforms to interact.

2.) **What are some key developments you’ve noticed lately regarding the way that Angels and platforms are interacting?**

Well, one of our member networks, Envestors (a reasonably large London-based private investor club) has recently done a very interesting deal with Crowdcube which I see as quite a breakthrough, so that was interesting to see a network use a platform in that way. Obviously there are a number of large individual Angel investors who themselves are backing some of the equity platforms, for example there are a number of high-profile Angels backing Seedrs, so there’s an interesting multi-faceted relationship between Angels and platforms. Then you have groups of Angels who are investing a portion of their wealth through platforms (perhaps totalling around £10,000-£15,000) but also have the majority of their portfolio invested offline, or ‘normally’ still, whereby they invest typically around £25,000 in each investment.

I think there is a level of reluctance to invest through platforms on the part of Angels, which is mostly to do with the quality of investments offered by some of the platforms. Having said that, there’s definitely evidence now of networks, syndicates and groups accepting some of those deals to put before their members for them to decide upon, but seeing the crowdfunding platforms as an additional source of deal-flow, and an increasing acceptance of them as such.

If you look at some of the deals done in the market, you can see a very large ‘crowds’ of Angels investing up to £1.5 million or £2 million in an investment between 30 and 40 individual Angels. Now is that a ‘crowd of Angels’?! Obviously they wouldn’t describe themselves as such, but this more organised and formalised approach is one way of addressing the need for larger investments. These groups can sit inside a network or syndicate or there are syndicates forming naturally for such deal purposes, crucially with a lead Angel usually who acts as a gatekeeper and heads up the due diligence process with the entrepreneur, etc.

The other development to note is that the ‘network’ as recognised previously is fading within the BA community, and investment syndicates are emerging more strongly, based on relationship of trust built up over time and are more prolific and active. The role of a network is to develop social interaction and build up trust. Syndicates need a new supply of investors in order to participate in potentially two or three or four rounds of funding for particular opportunities.

Networks are starting SEIS/EIS funds where members pool some funds to spread across a range of investments and diversify their portfolio, which is akin to a crowdfunding operation in some ways.

3.) **Have you seen the attitude of Angels and your membership change as the crowdfunding phenomenon has emerged?**

Yes, of course. The UK BAA Summit in 2011 discussed crowdfunding with a lot of scepticism. In 2012 a few platforms presented again, and the tone was much more positive and curious. Now 3 platforms are members of the UK BAA, applying the benchmark of FCA approval as I felt I could use that for the purposes of reputation management. The 3 platforms have been endorsed by UK BAA board members.

It’s partly for the purposes of encouraging dialogue and communication. I think the UK has the fastest-moving evolution of the entrepreneurial and business-funding space around at the moment, not by the quantum of deals done, but by the level of innovation, considering small syndicates, super-Angels,
accelerators, crowdfunding, etc.

I don’t think you will replace any time soon Angels’ enthusiasm with face to face interaction and the level of knowledge that Angels like to have about an entrepreneur and business model before investment. Platforms have widened the opportunities for deal flow, and can act as a showcase for a more significant potential investment later on. You could see a pattern emerging of passive money investing through the platforms alongside Angels who then take the entrepreneur concerned further forward ‘offline’ and introduce them to their syndicate or invest a larger amount into that business on slightly different terms. It all depends on the size of the deal – you can invest a small amount with a lesser degree of understanding and intimacy with the entrepreneur and business, but the platform experience as it stands today doesn’t look like substituting the established model of Angel investment. It’s hard to replicate the social interaction and communication in ‘real life’ in traditional Angel investment on a platform, however hard they try.

4.) What are the main challenges faced by investors and entrepreneurs that have engaged in equity investments via crowdfunding platforms, in your opinion?

One of the main challenges I see with equity crowdfunding is that often there is not a lead investor within the crowd. I see having a lead investor has important as a conduit through which the investors can communicate and dialogue with the entrepreneur, and that lead investor or Angel can act as the strategic input into the business. I know that Crowdcube and Seedrs are moving towards this model whereby there are some serious investors that will act as lead Angels in an investment. I think the savvy platforms understand this – it won’t matter how big the crowd is behind the lead investor, as long as they are capable enough of heading that grouping up.

As an entrepreneur, approaching the crowd, that’s largely passive or ‘dumb’ money. To add some value I think a business needs some ‘smart’ money too that has experience and the potential to add value to a business through networks, expertise etc.

Another key point is liquidity and the potential for the emergence of secondary market platforms or exchanges. A good example of this is ‘Liquity’ established by Barry Shrier, an American entrepreneur and businessman who has already established considerable wealth but is looking to expand a secondary market platform that he has started and is still in Beta. From a regulatory perspective I’m not sure where this model sits, but he’s looking to trade shares and so the relationship with crowdfunding will be crucial here. There’s another secondary market model which is a UK BAA member too, so this is an emerging and crucially important area not just for the future of equity crowdfunding but for Angels too of course, and the emergence of secondary markets is very much part of this. The Business Growth Fund sits a little further up the line and is increasingly high-profile in the UK, but secondary markets are very important to increasing deal flow and activity and liquidity as a result.

5.) Do you think that the investor relations challenge for small unquoted companies in dealing with numerous small investors will be one that proves problematic, given that these investors will welcome contact and communication on the progress of their investment just as much as much larger shareholders in listed companies do?

Well, that builds upon my last point about the need for a lead investor with some expertise really. You can have good communication and relations with a larger group of shareholders, but I place a lot of importance on at least one of those investors having the expertise and gravitas to be able to contribute more to the business in question and represent his or her fellow investors really well in terms of dialogue and input with the business and with the entrepreneur.

An entrepreneur has to think of the consequences of having a large numbers of shareholders for follow-on funding too – if platforms are differentiating somehow between classes of investors in terms of voting rights, representation and pre-emption rights etc., then that will make follow-on funding more easy to source, negotiate and complete upon.

6.) How do you think the almost inevitable failure of many crowdfunded business will play out in the media and public arena in the coming years, given the high failure rate of startup businesses in general which will surely apply to crowdfunded business as well to a large degree?

That is exactly the same story as it was with encouraging people to invest in small businesses via the SEIS tax incentive scheme, fully endorsed by government in a ‘tell Sid’ way. The way it was sold was ‘get a tax break if you invest in SMEs’, not ‘are you interested in investing in SMEs, if so, you can also get a tax break’. Crowdfunding and SEIS investors will both produce a lot of disappointed people. 58% of Angel deals fail and that’s a fact of life, so you can imagine that failure rate may well be higher for open crowdfunding opportunities where the due diligence procedures followed are likely to be a lot less rigorous and detailed.
7.) How involved do you think equity crowdfunding platforms should be in due diligence to screen investment opportunities, given that many do not bear any legal liability for investments made through their portals?

I think it’s vital, given that you need to protect reputation, protect investors and protect the entrepreneurs as well to be honest.

8.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

I think at present from what I’ve seen, they are largely complementary in that platforms give established Angels and syndicates a new source of deal flow. Over time, that might change to being at least partly in competition.

9.) Do you think that the more restrictive business model of equity crowdfunding platform stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

I think that there are two clear platform models emerging: those that accept more or less anyone as an entrepreneur and anyone as an investor, and look to me to be relying on volume to generate their own fees, and those that do more in the way of pre-screening and protect their investors and their entrepreneurs in a more responsible way, which to me is the way to go if you want to become a really serious player in the market over time. But regulation takes time – it was a long process for Seedrs and Crowdcube and CrowdBnk, for instance.

The crowdfunding model could well emerge as a proving ground for concepts and early funding for businesses that attract the interest of Angels in the longer term, I think that could well happen. When you think about the growing power of syndication in the Angel community, and the power of the Angel Co-Fund, which is a £100m fund and is increasingly a massive player in the market and invests alongside Angels and has done over 20 deals at an average of £300k funding for deals of around £1.5m that could involved as many as 4 Angel syndicates, then this lends credence to how this could work in the future. If you get the model right where they are genuinely complementary, then that’s total symbiosis and really valuable. There will be grey areas between online and offline where Angels are investing in both at the same time. To an extent, platforms could provide an early network that feed the existing networks or Angel syndicates, but clearly time will tell.

10.) What do you think about the Syndicate Room model whereby an existing Angel opportunity where due diligence has already been performed is marketed to the crowd?

For me, the jury’s out. We as a trade body are launching a deal platform showcasing existing Angel-sourced deals which require more funding and which will only be open to registered accredited members of the UK BAA to complete the funding round. So it’s a closed membership platform. We’re not making money out of this process, it’s just a service to our members. 25% of Angel deals don’t close as the funding is not complete and that’s hard for both sides, so really ours is a ‘deal closing model’.

Syndicate Room sources crowd investors that the Angels don’t know, which is very different to my mind. I think it’s early days how the Angels will perceive this. I can’t really give a definitive opinion until it emerges whether Angels really are using this platform. It gets more complicated when you add a further fee structure on top, which of course is what Syndicate Room does.

Angels put in several rounds now so this means that the VC involvement is deferred anyway, which is one of Syndicate Room’s selling points. Multiple rounds mean that this is happening anyway within syndicates, more and more, many deals are closing at between £1m and £2m in the first round, trying to plug the growing equity gap. If you really need a further source of funding from outside the Angel community, well fine, maybe this model is a good one.

11.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

Well, the classic examples are project-based business ideas, most often in the creative industries, which have been well-documented, and which are not at all suitable, usually, for Angel investors to consider. Crowdfunding for these businesses is absolutely perfect and there’s no competition here, so it’s a new source of money. As an early stage or start-up business, as an entrepreneur you do have a choice now for some businesses and through Angels you have more intensive due diligence and a lengthier deal process in general. If you need money more rapidly, then crowdfunding offers a real alternative.
Participants 11 a) and 11b) – Conducted 27th June 2013

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<td>1.)</td>
<td>a) equity crowdfunding has real potential to provide new capital to businesses up to, say around £150k in my opinion. But it's more than that, it's about entrepreneurs being driven away from Angels and VCs due to the way in which they typically operate as investors. Angels and VCs often have different agendas in terms of timescales for investments, the way they try and renegotiate term sheets or make them extremely complicated, the way they suggest that their successful investments should compensate them for their failed ones at the expense of the entrepreneur of the successful model, etc. Entrepreneurs have become more savvy as a result in general, I think it's fair to say, and the crowd investor by contrast is an attractive proposition for entrepreneurs as they are a source of funding that allows a business founder to remain in control and removes the need for a heavyweight investor who may want to micro-manage you. From the investors’ perspective, you can invest small amounts through equity crowdfunding and diversify your investment risk to some extent across a range of investments, really without investing large amounts of money – down to £500 if you want as a portfolio. The sector is becoming larger and more mature and some of the outlying deals are firmly in the VC or BA syndicate territory. I think that marks the start of a trend and that increasingly we will see crowdfunding supporting larger and larger deals and providing bigger and bigger opportunities. I think it's a real threat to existing models, I think it provides a new asset class and I think it deals with a lot of inefficiencies in the market that have been created by bad investment practices on the part of Angels and VCs in the private equity space. I think it will become a major new force. b) I take a more long-term view, in that equity crowdfunding is a rediscovery of what a ‘joint stock company’ is all about. If you look at how private infrastructure was funded in the 19th century in the UK for example, syndicates of primarily local investors formed in order to fund these companies in ‘joint stock’ format. This was highly prevalent up until the First World War in the early 20th century. Since then, capital formation for individual projects has migrated to be the preserve of financial markets such as AIM or the London Stock Exchange, or through financial advisors, all of which are very expensive in terms of transaction costs – AIM floatation will cost around 6% of your company, the LSE implies around 10% of value in fees and costs. Crowdfunding enables investors and projects to get together for far less money!</td>
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| 2.) | a) My take on this is that you’re seeing technology moving up the funding escalator if you like: basically quite an inefficient value chain for private equity investment being systematically disrupted and democratised by technology. An example of those inefficiencies is that Angels often promise valuable networks and contacts in exchange for valuable equity in your business, and dare I say that often those claims are overblown. Entrepreneurs often find this investment extremely expensive in the final analysis, especially when they can source equity funding that doesn’t cede control in the same way often. So Angels are going to be pushed into delivery value in a much more efficient and tangible way in the fact of competition from crowdfunding in my view. Angel investors often have a sophisticated financial education and background, and entrepreneurs often are relatively naive, but we’re moving away from that balance of power and to a situation where providers of capital are just another service provider in an age where services such as cloud computing space and the like are much cheaper to source than before. They’re no longer having to ‘work for’ the lead investor, and so it transforms the value chain around finance. b) BA and VC finance is often complex, time-consuming, with often questionable added-value and means that you lose control over the operation of your business and your exit from it. The structure of the way this is done in the UK is one of the reasons why we don’t have more billion-dollar start-ups here: Angels and VCs sell out at the first sign of big money such as £10-20 million coming along for an exit on a fast-track timetable. a) the bottom line is up to now, investment means effective takeover by a supplier, because that supply is capital. The timescale question here is also very important. Compare this to the new alternative on Seedrs or Crowdcube, where timing and destiny remains in the hands of the initial founders. Investors will have to up their game if they are to compete with crowd investors – only the very best who can genuinely add value will be able to stay in the game. The rest will probably end up investing via platforms themselves, as otherwise why would entrepreneurs want to deal with them? So the question of whether crowdfunding is complementary to or in competition with...
traditional Angel investment models hinges on the quality of the Angel themselves and what they bring to an entrepreneur – it will be complementary to the best Angels or VCs who provide great advice, networks, contacts as well as funding and perhaps provide them with another source of deal flow; and it will compete with the rest, who don’t really offer anything more than the crowd, but are a lot more expensive.

3.) Do you think that the more restrictive equity crowdfunding platforms that limit investors to larger investments, often into deals which have undergone more due diligence, stand a greater chance of genuinely expanding the pool of 'smart money' risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

a) I think that the hybrid platform model will ultimately be very short-lived. They may represent a slightly special case, but the only real differentiating factor here is the level of due diligence that has been carried out, and that doesn’t have to be done by the investor, it could be carried out independently be accountants and lawyers or some other qualified professional who were not investing and were therefore seen to be more impartial by the crowd investors. If there is a lead Angel who has sourced a deal and already carried out due diligence, the credibility of this depends on the integrity and track record of the Angel, which is hard to establish even for sophisticated crowd investors. When you smash the two models of equity crowdfunding and Angel investing together, it’s inevitable that you will get many different strands of the combination of the two emerging in competition, but my guess would be that the more open platforms will end up dominating, as they bring in more new capital into the funding market, because of the lower barriers to entry for would-be investors and also for entrepreneurs on those platforms too.

b) There are many Angels that attract other money into deals offline that trade on their reputation and track record, but that claim is hard to verify for their fellow investors until it is often too late in my opinion. So taking that model online doesn’t really help remove that lack of transparency, and the only way of testing whether the quality of investment opportunity is better is by investing and seeing what happens. So time will tell...

4.) How do you think the almost inevitable failure of many crowdfunded business will play out in the media and public arena in the coming years, given the high failure rate of startup businesses in general which will surely apply to crowdfunded business as well to a large degree? Do you then think that platforms that perform more due diligence and can show lower failure rates will thus be insulated from this risk to some extent?

b) I don’t think there’s any connection between diligence and failure rates.

a) I think due diligence is a hygiene factor. A platform may say they have a great in-house team to do due diligence work, but I don’t know what that means without some sort of kitemark to tell me that that work was up to a certain standard. The definition of success is about market opportunity and market fit more than verifying facts and figures. So market analysis is key here really and being able to benchmark that work against an independent standard. It's an immature market for platforms and picking winners is really hard as many existing investors will tell you. Platforms should perhaps concentrate on facilitating investment rather than try to pick winners, the crowd are best placed to do that.

b) I think regulation is key here for platforms to maintain standards. The second thing is financial literacy amongst investors, that’s just as important to understand risk.

5.) Are there certain sectors that lend themselves to equity crowdfunding?

a) It all comes down to the type of investors and businesses matching themselves up with each other. Injecting equity is a way of perverting the market if you like, so sectors in which that injection has a greater effect than in others, where you get the biggest bang for your buck. People are motivated by values and goals in investing as well, and that is not new or restricted to crowdfunding sites, look at the values-based investment funds that steer clear of oil, or concentrate on green energy or whatever.
I have made the decision to continue my role as CEO of a cloud computing business, but I could do more good ultimately by helping the industry to find its way and influence the way it evolves. I then started a social enterprise called the Social Foundation for that purpose, which we used to mount the first ‘Deep Impact’ conference into the crowdfunding phenomenon in February 2013, the first UK conference into crowdfunding. The Social Foundation aims to address the area through the three planks of research, education and policy development. We’re planning a string of events to those ends, and helping to support the WCF.

There is a general view that crowdfunding has been around for centuries, but I think that’s just wrong! I think there’s something different happening here – for me it started in 1997 when music fans started to fund tours and concerts of their favourite artists through an early prototype of crowdfunding. Social media has meant that we can not only communicate with many more people, but we can build bonds of trust with people that we’ve never met in person in ways that has never been possible before. We’re now dealing with a game that has different rules. So I see crowdfunding is a discontinuation rather than a continuation of history – it’s a game-changer. I think that reward-based crowdfunding is very powerful potentially as it offers entrepreneurs a source of concept-proving capital that is genuinely new and democratises entrepreneurialism at its earliest stage. You can create a new business, with a full order book, with no debt, ceding no equity and help develop a proven product right at the beginning of the funding escalator at the start of the chain, with equity crowdfunding and Business Angel investment are able to follow on. Clearly the donation model is powerful in its own right but is distinct in my view from the business applications that encompass reward and equity models as well as peer-to-peer lending.

From the entrepreneurs’ side it’s more of an opportunity than a challenge, but the challenges are being able to identify clearly for people what the investment opportunity is and why people should support it.

From the investor perspective, obviously if you’re a traditional Angel investor you’ll be spending a lot of time with investees and a lot of that is traditionally face to face. Crowdfunding is often a ‘distance model’, so I guess there’s a challenge there in relating to potential investees in the same way and on a similar level: video is an intrinsic part of trying to address this issue. Crowdfunding does alter the balance of power in my view between investors and entrepreneurs, because up to now the power has very much been in the hands of potential investors such as Business Angels. This power change is almost immediate: if you think how an entrepreneur raises money through an arduous process of courting investors and before now, almost always Angel investors or people like them took the opportunity to rethink, re-open negotiations and change the terms of investment once they had ostensibly been finalised, and often way down the track once these terms have been finalised. This diverts attention away from growing the business often on the part of the entrepreneur. With crowdfunding, the entrepreneur has control of the deal – the pricing, the stake in question, the deal terms are on the table and that is it.

I think it will only be a challenge should the crowdfunding platforms and/or the companies concerned are unprepared for it. It shouldn’t be overly complex. The issue is essentially one of fairness and trust involved from the perspective of the crowd investor. Long term the equity crowdfunding model will only really work if investors that have shown trust and commitment through investing what are relatively small sums of money feel that they are ultimately getting a fair return on their investment. With power goes...
responsibility, so companies are duty bound to communicate well with those people.

5.) How do you think the almost inevitable failure of many crowdfunded businesses will play out in the media and public arena in the coming years, given the high failure rate of startup businesses in general which will surely apply to crowdfunded businesses as well to a large degree?

It is a given that investing in unquoted startup businesses is risky and the majority even will fail, so you’re banking on getting a good enough from the investments that do come good to compensate for the ones that don’t. Everybody should know that or it should be pointed out very clearly to them. Crowdfunding a business won’t make that factor go away of course. The press can be extremely irresponsible sometimes in painting things very negatively – lots of people often seem to confuse failure with misbehaviour. There is an education issue here, not least with the press. Having said that, there is some evidence that the failure rate of crowdfunded businesses have a lower failure rate for a variety of reasons, although it’s very early days to be drawing conclusions on this – perhaps though it’s due to the effect of self-regulation as people are very publicly asking for commitment from strangers and the risks of defaulting are high in terms of reputational risk.

6.) How involved do you think equity crowdfunding platforms should be in due diligence to screen investment opportunities, given that many do not bear any legal liability for investments made through their portals?

It’s a difficult area as to an extent you’re damned if you do and damned if you don’t. I don’t think there’s a simple answer to this one – platforms want to have a minimum quality threshold in place but they don’t want to be held responsible for the investment decisions of others. I suspect that both approaches – that of no due diligence and that of rigorous pre-screening of investment opportunities – will thrive in their own ways in the future, and I know that there are developments in the ecosystem that are trying to address this exact point right now, but I’m not at liberty to say how as I’m bound by confidentiality.

7.) Would you yourself invest via equity crowdfunding, and would your answer to that change if the option was a more restrictive model (from the investor and entrepreneurial perspective) that harnessed the credibility of, and opportunities sourced by, recognised Business Angel investors, such as ‘Syndicate Room’?

I have invested relatively small amounts of money via equity crowdfunding platforms. To address the second part of the question, people should always invest in areas that they know well and understand. However, if I know that a person I know and trust that does know more than I do in a particular sector, then it would make me more likely to invest and thus it does expand the pool of investments that I might consider myself.

8.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

My own view is that crowdfunding will impact the traditional Angel investment model simply because it will provide alternatives to some investors and Angels won’t always be the only game in town for entrepreneurs, and I think, speaking from experience, that that’s a very good thing! The existing investment systems are incredibly complex and in my view very inefficient and crowdfunding is a huge opportunity to address some of the issues and inefficiencies therein.

9.) Do you think that the Syndicate Room business model stands a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

I think in the final analysis there is room for both the more restrictive model of equity crowdfunding that builds on existing Angel knowledge and expertise, and other more ‘open’ models. However if you have lots of crowd investors, perhaps in a more open model, these people can also be advocates and potential customers and these things could prove to be very important. But to summarise, I think there’s room for both and that they can co-exist as different variations on a theme.

10.) Do you think that particular industry sectors are particularly ripe for the equity crowdfunding model, and does your answer to this question change at all when considering the Syndicate Room model?

To state the obvious, the video game and creative sectors that appeal to distinct niches of consumers are clear areas of opportunity and which are doing very well from crowdfunding. The lead Angel model is a good one that could influence and expand the number of investments that you might seriously consider.
Participant 13 – Conducted 14th July 2013

1.) What are your instinctive views on crowdfunding in general, and on equity crowdfunding in particular?

Equity crowdfunding is particularly useful for entrepreneurs to access a new source of funding for seed capital: the funds required are relatively small and investors can diversify their portfolios into crowdfunded businesses with a small amount of capital.

The investors active now on crowdfunding sites could be characterised as early adopters. There is considerable room and demand for increased education and information as to the risks and rewards of investing in this way. There’s tremendous room for growth in the sector when you think about the sums that have been invested so far on some of the most popular sites: CrowdCube has facilitated around £10 million of investment, Seedrs less but it’s taking off really fast, and on the peer-to-peer side, Funding Circle around £100 million on debt to SMEs.

It’s also an interesting time as equity crowdfunding will be subject to more regulation soon from the FCA, and peer-to-peer lending from March 2014. In this regard, national boundaries are still important as the regulatory frameworks are still based on national jurisdictions.

2.) Is it your instinct that equity crowdfunding in general is a complementary or separate model to traditional model of Business Angel investment, or is in competition with it?

My view is, it depends. You could say they are both true instinctively, depending on the circumstances in play for each crowdfunding campaign.

It depends on what stage of development the business in question is at, and therefore how much they require – equity crowdfunding is generally only used for relatively small amounts of money up to £100,000 or £150,000 at present, although there have been some notable exceptions to that rule.

It also depends on which sector and industry that business sits in – whether the level of knowledge and expertise is very high and ‘niche’, such as in biotech or the life sciences, or lower in all likelihood if the product is a consumer facing one.

The nature of the existing shareholder structure is also very important here, and how many people are still involved.

So you could argue it both ways, depending on how those variables sit for any one business, and who the Angels are as well.

From the perspective of entrepreneurs, crowdfunding capital is assumed to be ‘dumb’ or ‘passive’ but there isn’t enough empirical evidence to justify this view yet, and who is really investing on platforms so far, and how sophisticated those investors are.

From the Business Angel’s perspective, equity crowdfunding is a great way to test a concept in a marketplace: Angels often inject follow-on funding and crowdfunding platforms provide a good way of testing public reaction to a product or service that needs validation for them to feel comfortable committing some more capital.

But to be able to answer this question with more confidence and rigour, you would need to conduct a lot of interviews and collect a lot of quantitative data, in my view.

My sense is that at the beginning, VCs and BAs were sceptical and reserved about crowdfunding, but as time goes one, they are increasingly accepting platforms as part of the investment ecosystem – through curation of deal flow, through the conduct of some due diligence, as the crowd can also do in an informal way and this is perhaps part of the reason why the default or fraud rates on most platforms are incredibly low.

The challenge for crowdfunding is that the offline mentoring, support, networking and coaching that Angels provide is hard if not impossible for platforms to provide.

The make-up of the shareholding structure through platforms as well. My view is that the nominee structurefavoured by Seedrs (and FundtheGap) is smart as it reduces the number of shareholders that a BA or VC investing later on in a series ‘A’ or series ‘B’ round of equity funding has to deal with.

These complications mean that equity crowdfunding has in general been slower to take off than lending.
based, which is far easier to understand as a transaction and where the risks are more clearly understood by potential investors.

The Australian Small Scale Offering Board is an interesting case study as it’s the oldest equity based platform open for business since 2005. I think I’m right in saying it's only open to ‘sophisticated’ registered investors in Australia and there is a limit of 25 people investing per deal maximum. The statistics are interesting: if I remember rightly around 45% of funded firms have expanded significantly, with around 3%-5% actually going public so far in the 8 years it has been in existence, and the fraud or failure rates are extremely low too.

As I say, failure rates so far, while it’s early days, are very low. The platforms can be very selective sometimes plus they conduct some due diligence. The whole process is very public too, and for seed capital you will probably get family and friends money in at this stage, so this will be a large deterrent to any wrongdoing or fraud. Plus the scrutiny that a deal comes under from the crowd is a pretty thorough tool at times to explore a business’ owners, business model etc.

### 3.) Do you think that the more restrictive equity crowdfunding platforms that limit investors to larger investments, often into deals which have undergone more due diligence, stand a greater chance of genuinely expanding the pool of ‘smart money’ risk capital for early stage growth companies in the UK compared with other equity crowdfunding platforms?

I think again it really depends!

Conducting more exhaustive due diligence is very expensive and so I’m not sure how sustainable that level of cost will be for a platform like that works that way, for example. I think perhaps the most sustainable methodology, the best combination is for a platform that does some checks on the founders (that they’re of good character, their stakeholder structure is clear, their identities are verified, their fundraising target is realistic for a sensible proportion of equity) and the business plans posted, but then relies on the power of the crowd to undertaken the due diligence in a relatively information but still quite thorough way by asking the right questions of the founders to make sure the end goal and the equity stake offered is reasonable. That doesn’t require a huge amount of effort, it just needs to happen. Success rates for fundraising on platforms are hard to come by, but I sense that they will be relatively low, certainly not as high as 40%.

### 4.) How do you think the almost inevitable failure of many crowdfunded business will play out in the media and public arena in the coming years, given the high failure rate of startup businesses in general which will surely apply to crowdfunded business as well to a large degree? Do you then think that platforms that perform more due diligence and can show lower failure rates will thus be insulated from this risk to some extent?

No amount of work that a platform does in due diligence can really reduce the failure rate in a meaningful way to my mind. That is an inherent investor risk that just exists for seed or start-up stage business. Platforms must just be very frank to publicise the risks involved.

I would say that a lot of crowdfund investors in equity platforms are relatively sophisticated and that most know about the risks involved already. But others coming in will be less educated as to the risks and the nature of these investments. The risks must be transparent, as transparency is key to crowdfunding and the nature of it transacting over the internet.

I think equity crowdfunding will give a greater number of small businesses a shot at developing and progressing, I really do. If you look at the failure rates for businesses funded by VCs for example, they are still really high, and those guys are very smart people and they really know what they’re doing.

I think the crowdfunding will actually encourage entrepreneurs to take a few more risks perhaps, as there is a source of capital for a wider range of projects now, and that could be a good thing.

### 5.) Do you think the motivations for Business Angels differ when they invest online with platforms, as opposed to offline in syndicates or on their own?

To be honest, not really, I think the motivation is overwhelming one of financial gain and profit in both cases.

### 6.) Do you think equity crowdfunding is a new asset class?

Yes it is, to the extent that the sums required are relatively small, you almost enter into a social and business contract but do it online, with platforms sourcing deal flow and investors can diversify their portfolio very easily.
It’s the same investment model but carried out in a very different way, so in my mind it qualifies as a new asset class.

7.) **Do you think a secondary market will emerge for equity crowdfunding shares, and how important is it to the success of the model?**

I think it will emerge. We’ve already seen the emergence of a platform called Secondary Market in the US, but only working with one platform I think, so only available for registered investors on one site to start trading shares after investment for businesses whose pitches and business plans are still visible on the platform: ‘intra-platform trading, not inter-platform trading’.

Setting up a genuine secondary market for unquoted shares will always be difficult because of information asymmetry, but trading peer-to-peer loans is a lot less problematic in that regard, and I think we will definitely see that emerging.

8.) **Do you think that Angels and the crowd investing alongside each other on SR or other crowdfunding platforms plugs a bigger part of the equity gap than Angels would investing alone?**

Yeah, definitely. It’s about sharing the risks. You can test the market and get market validation from crowd investors, which you can’t do with Angels investing alone. That’s really unique, and you can utilise the market signal created by the crowd and use that to strengthen your conviction, whether you’re an entrepreneur or an Angel.

9.) **Are there certain sectors that lend themselves to equity crowdfunding?**

Biotech is really difficult – you have to divulge a lot of intellectual property to seek funding and that’s hard for people to do often. Plus the sums required are often very large. Hi-tech and gadgets, particularly consumer facing ones, are ideally suited to crowdfunding.
Appendix H: Summary charts - quantitative data from equity crowdfunding platforms

Seedrs: distribution of investment numbers by quantum since inception

Crowdcube: distribution of investment numbers by quantum since inception