# Funding & Finance

Every business needs money - for capital investment and to provide working capital. This can come from a variety of sources with different associated costs, partly reflecting the different risks.

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## Private Funding

### Banks (Technology)

The advantage of a bank loan as a means of raising development finance is that, if the development is eventually profitable, you only pay out the bank charges (i.e. set up costs and interest payments). As the bank does not become an equity partner, it won't benefit from the increase value of the business or take a share of the profits.

The rewards a bank receives are fairly small (i.e. 3%-10%) and as a result the risks the bank is willing to take are minimal. The main downside of loans is that banks want to be sure that they do not lose out if a business development fails. They are therefore unlikely to back companies that do not have a significant cash-flow unless they can secure the loan against assets (e.g. equipment, buildings etc). that can be readily sold by the bank if repayments are not on schedule.

The government has been aware that banks shy away from risky start up technology businesses so has tried to help by setting up the Small Firms Loan Guarantee Scheme (SFLGS). The DTI guarantees the lender 70% of a loan up to £100,000. Whilst normal banking criteria apply the SFLGS can help make a viable business proposal for a bank – see www.sbs.gov.uk/sflgs

### Family and Friends

Raising investment in the current economic climate is very difficult. In order to secure a first round of investment it may be that you need to turn to friends and family members as well as dipping in to your own pockets in order to get your company started and in a position to go seeking larger sums of money.

Many companies start up this way but it is worth proceeding on this path with caution. A basic principle of investment in high risk businesses is: 'do not to invest more than you can afford to lose'. Taking out a second mortgage and putting all your money into what is ultimately a risky venture is a dangerous strategy.

Whilst friends and family are often a necessary route to funding, the rules of investment still apply. Make sure there is a written agreement, make sure the share structure and valuation of the company has been thought through and make sure that everyone has realistic expectations of the company and knows exactly what risk they are taking.

## Business Angels

The stereotype of a business angel portrays someone who is a self-made, high net worth and who invests funds in one or more start up businesses in return for a equity stake in the business. These wealthy individuals have a certain appetite for risk and a healthy respect for reward. They generally invest between £5,000 and £250,000 and are willing to invest in sectors and stages that are considered too early for the Venture Capitalists and too risky for the banks.

To track down a wealthy individual and approach them with a business plan can be very difficult. Use as many contacts as possible to get you the introduction you need. For example speak to your accountant and ask if he can pass on your details, ask the same of your bank manager and lawyer etc. If these contacts do not come up trumps then you might need to go to a business angel network. Business angel networks introduce investors to early stage companies through targeted mail shots, presentation meetings and one-to-one introductions.

There are over fifty business angel networks based in the UK. To find out more try the following websites:

National Business Angels Network:

http://www.nationalbusangels.co.uk/

European Business Angels Network:

http://www.eban.org

Oxfordshire Investment Opportunity Network:

www.oion.co.uk

British Venture Capital Association:

www.bvca.co.uk

## Venture Capital

Venture Capital is a generic term for the process by which investors fund risk oriented business endeavours. A venture capital funding arrangement will typically entail relinquishing some level of ownership and control of the business. The investment is usually in the form of stock or and instrument, which can be converted into stock at some future dates.

Venture Capitalists can invest in high risk capital to fund new technology. As a rule of thumb they tend to invest over £1 million and they would expect at least a 20%-50% annual return on their investment at the time they are bought out. The level of due diligence (a study about the background and financial viability) of your company, management team and industry is likely to be thorough and their standards are usually very high.

To find out more about almost all the Venture Capital organisations in the UK see the British Venture Capital Association website at www.bvca.co.uk.

## Useful links

National Business Angels Network: http://www.nationalbusangels.co.uk/

European Business Angels Network: http://www.eban.org

Oxfordshire Investment Opportunity Network: www.oion.co.uk

British Venture Capital Association: www.bvca.co.uk

Venture Capital Trust Guide: http://www.inlandrevenue.gov.uk/pdfs/ir169.htm

Corporate Venturing in the UK: www.corporateventuringuk.org

The London Stock Exchange: www.londonstockex.co.uk

The Alternative Investment Market: www.londonstockexchange.com/aim

OFEX: www.ofex.co.uk

## Venture Capital Trusts

Venture Capital Trusts were established by the government in 1995 as a vehicle for investing in early stage companies. VCTs are tax efficient funds listed on the London Stock Exchange and must invest at least 70% of their funds in qualifying companies within three years.

Not all early stage companies qualify under VCT rules. VCTs must invest in UK-based companies which are privately-held or AIM-listed. Companies in certain industries (such as property development) do not qualify for VCT investment and there is a limit on the gross assets that the investee company can hold at the time of the investment. VCTs cannot invest more than £1m in any one company, nor can they control an investee company or invest in a company controlled by another firm.

The Inland Revenue has produced a short guide to VCTs, available at http://www.inlandrevenue.gov.uk/pdfs/ir169.htm

## Corporate Venturing

Corporate Venturing is a form of Venture Capital whereby large companies use financial instruments to track and acquire new technology. In an effort to boost the enterprise culture through the promotion of corporate venturing the Inland Revenue has put in place a number of tax relief incentives targeted at the corporate investors.

In the UK, finding companies that are active in corporate venturing is usually very difficult. While some will be prepared to consider ad-hoc investments, currently there are few large companies that have a venture capital fund. To track down these companies and learn more about Corporate Venturing in the UK see www.corporateventuringuk.org

## Flotation

With the availability of several investment markets that provide opportunities for raising equity finance, going public or floating on the stock market, is an important option for companies that are unable to support their growth plans from cash-flow alone. It also enables companies to access additional capital through further share issue.

For technology based companies in the UK there are three options for businesses seeking a 'listing':

*The official List* (www.londonstockex.co.uk) - Main market of the London Stock Exchange

*AIM* (www.londonstockexchange.com/aim) - The Alternative Investment Market

*OFEX* (www.ofex.co.uk) - Unregulated Off-Exchange Trading Facility

Going public is rarely a source of funding for start-up businesses and in the current economic climate has almost ground to a standstill. For those contemplating a public listing in the medium term it is still however worth knowing what the process involves.

### Further reading

The guides section of our website allows members to access information and resources on the key stages of the commercialisation process - taking a diagnostic product or process from concept through to marketplace.

Guides, resources and downloads are available covering the following main topics:

- Research & technology
- Intellectual Property
- Funding
- Networking
- Partnering
- Resources
- Starting a business
- Regulatory
- Development
- Manufacturing
- Marketing