FINANCIAL TIMES

February 9 2016

Tomorrow's Global Business

Part One: Raising Capital

The new faces of funding

Fragmentation Bank lending may be drying up, but newcomers are increasingly filling the vacuum

Inside

Innovators change funding landscape
European investors cast eye on panoply of US vehicles
Page 2

Challenger banks make their mark
Businesses seek alternatives to traditional lenders
Page 3

Limitations of imitation
New urban tech hubs challenge Silicon Valley
Page 6

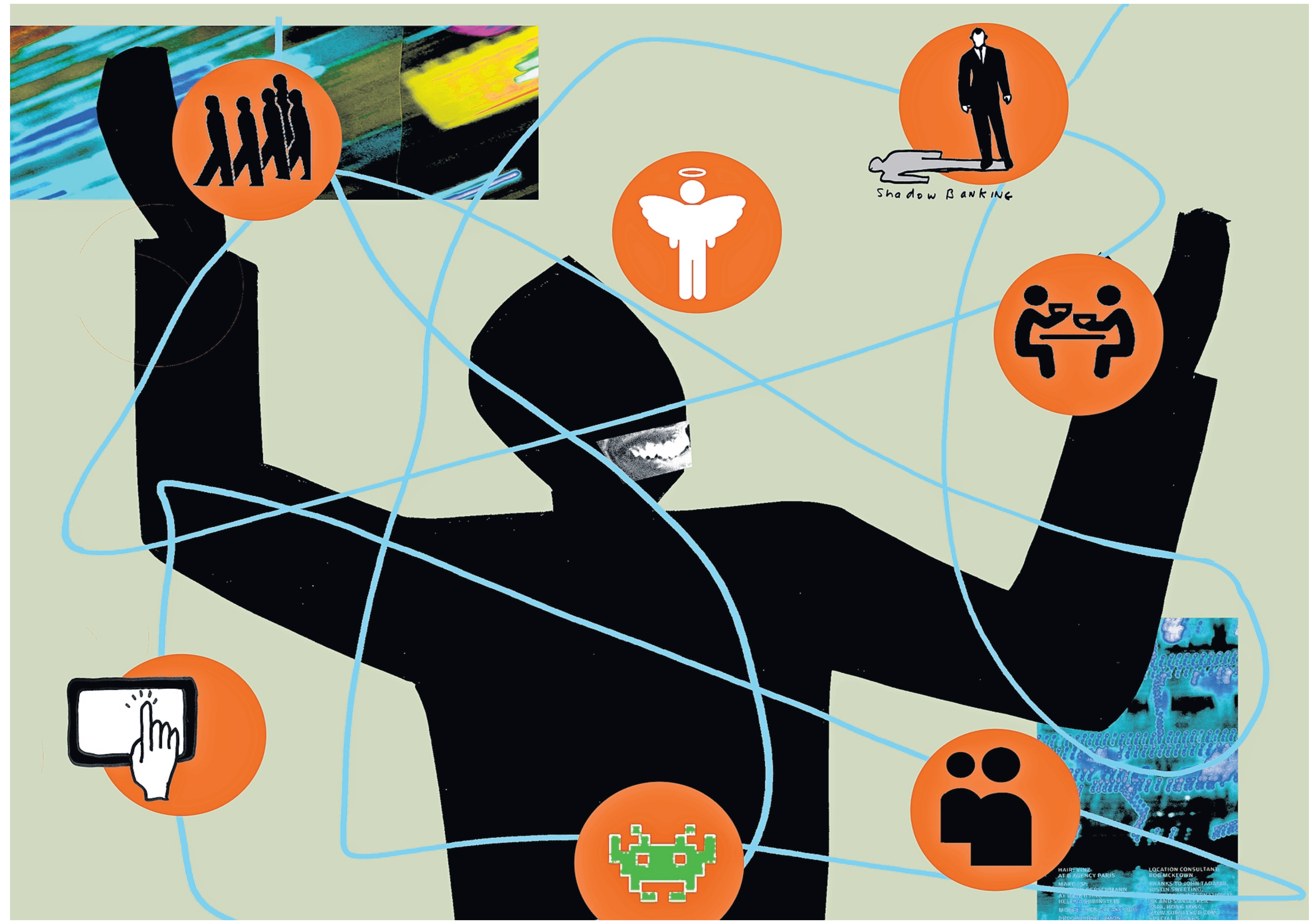
Time to hug a banker . . .
. . . as the oil and gas industry's revenues plummet
Page 8

Women beset by funding blocks
Tips for female entrepreneurs to tap into more cash
Page 9

On FT.com
Video: It's all about sector and timing
ft.com/global-business

Europe casts envious eyes at depth of US capital markets and broad range of investment structures available, writes *Stephen Foley*

Flurry of innovation prompts easier access to funding



Illustrations: Huntley Muir

Even by the hyperbolic standards of Silicon Valley, the declaration by Stewart Butterfield, founder of the messaging software business Slack, stood out.

"This is the best time to raise money ever," he said, last April. "It might be the best time for any kind of business in any industry to raise money for all of history, like since the time of the ancient Egyptians."

It would be easy to dismiss his comments as top-of-the-cycle baloney. Late-stage start-ups like Slack were indeed pulling in money from venture capital funds last spring on a scale and at valuations that were unprecedented: Mr Butterfield's company had raised $160m. But in the months since, the financing environment for these so-called unicorns, private companies valued at more than $1bn, has cooled substantially.

In a wider sense, however, Mr Butterfield is right. Entrepreneurs eager to build tomorrow's global business have a broader range of funding sources to choose from than ever before, for almost every stage of their company's growth. A little frothiness may come out of some markets, but the structural changes of the past few years remain in place and there is likely to be more progress.

What are the drivers? In an era of moderate economic growth and perpetually low interest rates, investors on the debt and equity sides of the capital structure need to find fast-growing businesses as ferociously as entrepreneurs desire capital. New investment vehicles and structures, from crowdsourcing platforms to listed funds, are being used to bring the two sides together.

Local and national governments, meanwhile, need to spur employment and are trying to create entrepreneurial hubs on the Silicon Valley model. Internationally, governments are working together to improve and expand the functioning of capital markets, such as through the EU's plan for a capital markets union which it hopes will boost securitisation of loans and attract new money for financing growing businesses.

European leaders are looking with some envy at the depth of US capital markets and the panoply of investment structures that channel money to small and medium-sized or growing companies. These include collateralised loan obligations, which are debt-funded pools of bank loans, and business development companies, or BDCs, which can be private or publicly listed vehicles investing in small business loans or equity. These have grown tenfold in the past decade to $64bn.

> The growth of interest in fintech may become 'a game changer for small businesses'

Even without regulatory help or government sponsorship, investors and entrepreneurs are finding each other. AngelList, a five-year-old US website that brings together individual investors and start-ups in need of seed funding, has spawned a wave of copycats including DealShare, a platform from the UK Business Angels Association, which aims to tap and expand the UK's £1.5bn angel investment market. A consequence of the millennial generation's interest in working for and founding start-up companies, is that those who achieve modest wealth are well-positioned to act as angels to individuals who follow in their footsteps.

These appear to be generational changes, although enthusiasm for angel investing will be tested if there is a prolonged contraction in the venture capital world. That contraction was in evidence late last year in the wake of disappointing flotations of start-up tech companies such as Square, Jack Dorsey's payments company. CB Insights, the venture capital and angel investment data provider, recorded a sudden drop in activity in the fourth quarter, just 1,743 fundraising deals globally compared with 2,008 in the previous three months, for the worst quarterly total since early 2013. For now, the downturn in fundraising activity is most pronounced among unicorns, whose valuations arguably got carried away relative to public market prices.

Perhaps the biggest structural change in capital raising for tomorrow's global businesses is due to technological innovation. A wave of invention has resulted in a raft of new investment platforms. It has shaken up traditional bank financing, too.

The rapid growth of interest in fintech — financial technology companies — "has the potential to become a game changer for small businesses", Michael Koenitzer and Giancarlo Bruno of the World Economic Forum wrote in a report last year. "Because fintech solutions are efficient and effective at lower scale, small businesses will be one of the main beneficiaries of its disruptive power."

From 2013 to 2014, funding for fintech companies quadrupled to more than $12bn, the WEF report said, and it could be as much as $30bn this year. That means new products "tailored to the needs of small businesses", says the report. "These include marketplace [peer-to-peer] lending, merchant and e-commerce finance, invoice finance, online supply-chain finance and online trade finance."

There has been a blizzard of innovation. Kansas City-based C2FO, a platform for working capital finance, has won accolades in the past year, including being named to the KPMG/H2 Ventures FinTech 100 list of most interesting start-ups. The length of time it takes a big customer to pay an invoice can be a matter of life and death for a small, growing company; C2FO is a venue where a start-up can be paid immediately by a third party, which collects from the customer at a later point. Another KPMG favourite is New Zealand-based accounting software company Xero, which has integrated its technology with that of National Australia Bank, allowing the bank to make a quicker and deeper dive into a company's finances to try to make loan approvals easier.

Not all these innovative products, practices and platforms will prove successful, but enough will do so that more innovators will follow in their wake, says Jeremy Anderson, chairman of KPMG's global financial services practice. When it comes to expanding financing, the options for tomorrow's global businesses are only likely to grow, regardless of cyclical blips, he adds. "There are certainly many more channels, it is certainly easier, and the good news is, the cat is out of the bag."

Challenger banks move to stand out from the crowd

Lending

Risk-averse incumbents prompt small businesses to turn to other providers, writes *Laura Noonan*

Here lies the big bank that once loaned billions to local businesses, but is now unwilling and unable to support the economy. Fondly remembered by its risk-adverse managers and overzealous regulators, its passing is deeply regretted by local business owners. Rest in peace.

The eulogy for banks' business lending has been on the chalkboard for years as massive losses, regulatory pressure and more nimble competitors threaten a perfect storm.

Surveys from the Bank of England chart an almost uniform contraction of lending to UK businesses from banks and building societies in recent years, despite initiatives such as Funding for Lending, which lets commercial banks borrow funds cheaply from the Bank of England so that they can pass it on in the form of cheap lending to companies. A similar downward trend in lending is evident across much of the developed world.

Meanwhile, investors globally have raised almost $80bn to invest in direct lending funds in the last two years, according to data from industry watchers Preqin. New peer-to-peer lenders such as Lending Club and Funding Circle are aggressively hunting for market share, and even insurers want a piece of the lending game. And policymakers including the European Central Bank are pushing for a more developed bond market to make it easier for companies to access non-bank finance.

Yet like other industry experts, including those that do not work for banks, Steve Dwyre, who heads Lloyds Bank lending to global corporates in industry, technology, media and telecoms, insists the narrative is not simply one of alternative lenders such as crowd funders triumphing over unpopular and ailing banks.

"There's probably too much focus on the crowd and peer-to-peer [sector] which is very small and may well be a flash in the pan," says Conrad Ford, who runs Funding Options, an online marketplace where small businesses can choose between different capital providers.

Mr Ford analysed a sample of 50 UK small business loans that were sourced through his website in the first nine months of this year with an average loan value of £123,000.

He found that just 18 per cent of loans were met by crowd funding, peer-to-peer lending and wealthy individuals.

Deposit-taking banks were a smaller percentage, at 14 per cent. Still, Mr Ford thinks banks' lending efforts should not be dismissed to the extent they have been. "You have two [UK] challenger banks which came about the same time as crowd funding, both of them individually have lent far more than the entire crowd funding industry," he says.

Size matters
Crowdfunding is only a small part of the whole market, says Conrad Ford of Funding Options

The banks, Aldermore and Shawbrook, have collectively loaned more than £10bn, versus the £5.5bn that has been lent by the UK's peer-to-peer sector and crowdfunding combined, according to the Liberum AltFi UK Volume index.

Bank lending is enjoying a helping hand from new forces in the market as well.

Credit Data Research is offering credit "passports" to small and medium-sized enterprises with detailed analysis of their finances that makes it easier for them to obtain loans from banks, which are wary of losing money, and to access market finance. The company started out in the Italian market 16 months ago. This year it will expand to the UK, France, Spain and Portugal, says founder Alessio Balduini. It has backing from Moody's Analytics, the analysis arm of the rating agency giant.

The biggest lenders in Mr Dwyre's space — accounting for 68 per cent of the 50 loans he analysed — are wholesale funding and debt funds, whose lending is typically short-term.

Among larger companies, funds and wholesale markets (serving banks and other financial institutions) are often the suppliers of choice for longer term debt. Doug Paolillo, an analyst at New York-based data firm Preqin, says direct lending funds typically target loans of five to 10 years' duration to companies with annual earnings of between $5m and $95m.

Mr Dwyre insists alternative lenders' success in this space is not a problem. "We don't want to have the longer term debt on our books because it costs us more," he says.

"We don't compete on product, we compete on developing a relationship with a client," says Alison Rose, head of commercial and private banking for Royal Bank of Scotland. When RBS "can't help" customers, it introduces them to other lenders, she adds. The Business Bank, a government-owned service that helps small businesses to obtain funding, wants banks to be compelled to refer small businesses to other finance providers if banks reject their loan applications.

Lloyds is also looking to act as matchmaker between its clients and their ultimate non-bank lenders, by building out its capital markets business. "That's the big change that came out of this [last few years]," says Mr Dwyre. "We've been forced to think about who is on the other side of this trade."

Contributors

Steven Foley
US investment correspondent
Laura Noonan
Investment banking correspondent
Jonathan Moules
Business education correspondent
David Ricketts
Associate editor, Ignites Europe, FT
Brian Groom
Freelance writer
Alan Livsey
Lex writer
Sarah Murray
Freelance writer

Joseph Cotterill
Private equity correspondent
Jonathan Wheatley
Editor, EM Squared
Gavin Jackson
Capital markets correspondent
Emma Dunkley
Retail banking correspondent
Attracta Mooney
Asset management reporter

Emma Boyde
Commissioning editor

Steven Bird
Designer
Alan Knox
Picture editor

Technology opens up new options

Start-ups There are more ways for entrepreneurs to find funding, writes *Jonathan Moules*

Chance: an unclaimed necklace found in the street helped Sir Richard Branson start in business — Getty Images

Sir Richard Branson used the proceeds from the sale of an unclaimed necklace that his mother had found in the street to fund his first business venture in the 1970s, a magazine aimed at teenagers. A decade later, Nick Wheeler combined an inheritance from an aunt with a personal bank loan to buy a £25,000 Aston Martin that he sold 12 months later for four times the price, providing the money to launch his shirt business, Charles Tyrwhitt.

Raising capital to fund a start-up has seldom been conventional. But the arrival of the connected online world has led many people to believe the chances of securing the necessary money to launch a venture have increased considerably and being able to do so is now less about the good luck and family connections that helped the likes of Sir Richard or Mr Wheeler.

Crowdfunding — pitching your idea on an online fundraising platform — has fuelled excitement about the potential to raise large sums in the early days of a start-up.

In the UK, the volume of fundraising conducted through crowdfunding and peer-to-peer lending more than doubled in size in 2013 to £1.74bn, according to research body Nesta in a recent report on the subject. It also estimated that this UK market could reach £15bn by 2020. However, it is important to keep such figures in perspective. Even at these levels, online fundraising marketplaces still represent only a fraction of conventional bank lending, and official data shows that the vast majority of entrepreneurs self-fund their ventures in the early days.

Data from the Global Entrepreneurship Monitor (GEM) — an annual trawl of start-up activity, which started in 1999 as a joint venture between US-based Babson College and London Business School — have consistently shown that only about a third of early stage funding comes from external sources. Much is from family and friends, plus the last of the so-called three Fs: fools.

Angel investors, wealthy individual backers of start-ups, make up less than 5 per cent of funding in the early stages, according to GEM.

"There is no doubt that the availability of crowdfunding has given many nascent entrepreneurs another avenue of options and helped inspire people who might otherwise have been less likely to start," says Andrew Corbett, a faculty director at Babson.

Accumulating funds is only part of the justification for raising capital in the early stages of a company's life. As important is the support and advice a backer can provide, says Mr Corbett.

"There is money and then there is smart money, meaning funding that comes with insight, counsel and networks," he says. "The advice, insight and networking that comes from the close ties you can develop with experienced former entrepreneurs or family members or advisers who have significant business experience can be as valuable as the money itself." Such support can make the difference between being able to successfully execute or not, he adds.

> 'Fundraising is not easy and is a time-draining and frustrating activity'

Carlos Espinal a partner at Seedcamp, a London-based accelerator fund aimed at helping to nurture early stage technology companies, has recently published a book on the subject.

Fundraising Field Guide discusses how to acquire a "fundraising mindset". Mr Espinal says recent technological developments have not made raising capital easier.

"Fundraising is not easy. In fact, it is one of the most frustrating and time-draining activities you as a founder will have to do as part of your company's growth strategy," says Mr Espinal.

Crowdfunding is not yet the norm for the majority of early stage ventures looking to raise funds, he says.

"People are still working out how crowdfunding will be used because it ranges from people selling T-shirts on Kickstarter all the way to equity funding on platforms like Seedrs and Crowdcube."

Mr Espinal says fundraising is a process of building the right relationships and these take time to develop. The process, from when founders start taking meetings until they seal a deal, can take up to eight months for an early stage round, and an average of six months for subsequent rounds, says Mr Espinal.

Founders cannot afford to procrastinate when it comes to financing a start-up, he adds. "If you wait until you've nearly run out of cash you'll be in desperation mode and it will make the process considerably more stressful and more difficult. Your idea is of no use . . . if you run out of money before making it a reality."

Technological developments such as cloud computing and the increased processing power in ever-smaller, cheaper and more user-friendly devices has also driven down the cost of starting a business.

One consequence is that it may not be necessary to raise funds at all, says John Mullins, associate professor of marketing and entrepreneurship at London Business School, and author of the book, *The Customer-Funded Business*.

"For many services businesses, all you need is a first customer who will write you a cheque," he says. "If you're solving a compelling problem for your customer, they will pay you in advance to do so. And if you're not, maybe that is good information to have up front, before you waste too much of your precious time and money."

Asset managers step into the frame

Direct lending

EU capital market initiative will provide further opportunities, says *David Ricketts*

Asset managers have gone to great lengths in the years following the financial crisis to dissociate themselves from banks and stress to regulators that they do not pose the same kind of systemic risks to financial stability.

But they have struggled to shake off the "shadow bank" label that watchdogs and central banks continue to use to describe fund houses' encroachment into territory previously occupied by banks. A report by the European Central Bank in October, for example, examined traditional investment funds together with money market funds and so-called financial vehicle corporations under a shadow banking category.

The direct lending activities of some fund groups now closely resemble those of companies operating in the banking sector. Asset managers have been able to step into the frame after intense regulatory pressure to shore up their balance sheets has forced many banks to reduce their direct lending.

Direct loans, commercial mortgage lending, social housing, property and infrastructure — lending activities once synonymous with the banking sector — are now a staple for asset managers.

A rebound in the global economy has further boosted asset managers' direct lending activities as companies look to finance growth or bolster existing loans. Figures point to a buoyant future in the direct lending market. According to data from Preqin, the alternative assets data provider, Europe's fund managers have \$41bn ready to deploy in direct lending deals, twice as much as in 2012.

Assets in the direct lending industry in the US and Europe have more than tripled since 2006 to \$441bn by the end of 2014, according to figures from Brown Brothers Harriman, the financial services group, and Preqin.

Tom Brown, global head of investment management at KPMG, says while asset managers have spotted the opportunities posed by direct lending, their involvement has also been backed by clients including pension funds, life insurance companies and sovereign wealth funds. "As they look at their portfolios, investors realise this is an attractive asset class," says Mr Brown. "There has been a rotation out of sovereign debt into private debt and [direct lending] loans fit into that spectrum."

A key initiative in Europe is under way to develop more non-bank sources of finance — a move which could give asset managers further opportunities to become involved in direct lending. One aim of the EU's Capital Markets Union initiative, launched by the European Commission in September, is to reduce small and medium-sized companies' reliance on bank finance and emulate the broader style of capital market that exists in the US.

Upbeat: KPMG's Tom Brown

Emerging centre: an advertisement for Ola, a taxi-hailing app, which is one of the unicorns based in Bangalore, India's tech hub city — Bloomberg

Exposing the limitations of imitation

Digital clusters Silicon Valley's main advantage lies in support for scale-ups, writes *Brian Groom*

From Beijing to New York, London, Berlin, Tel Aviv and Bangalore, technology hubs around the world have drawn inspiration from Silicon Valley. While their number is growing, however, their model in many cases differs significantly from the original Californian template.

Emerging technology centres are typically located in cities rather than out-of-town business parks or suburban corridors like Silicon Valley, the nickname for the area around San Francisco Bay. Even within California, urban San Francisco and Los Angeles have grown in importance.

Not that the valley is about to hand over its crown. It remains the world's pre-eminent technology hub, though some believe Asian cities may eventually overhaul it.

Silicon Valley is home not only to giants such as Facebook, Google and Apple, but also — if we include San Francisco — to a new wave including Uber, the taxi app company, Airbnb, the app challenging the hotel industry, Palantir, the software solutions company and Snapchat, the social media darling.

"Silicon Valley will continue to be in a class by itself," says Bruce Katz, centennial scholar at the Brookings Institution think-tank in Washington DC and an authority on innovation. "Cities around the world shouldn't try to mimic Silicon Valley, they should leverage their own, distinctive innovative strengths, of which there are many."

The valley's supremacy has been built during the 75 years since Fred Terman, who was provost at Stanford University, encouraged his engineering graduates to create companies, among them Hewlett-Packard.

Factors behind the valley's rise included strong academic institutions, government research, availability of land and an attractive climate, along with a culture that was risk-taking, meritocratic and entrepreneurial.

Its current advantage, according to Reid Hoffman, co-founder of business network LinkedIn, lies not so much in start-ups, which many parts of the world do well, as in its ability to support "scale-ups" or fast-growth companies. That has been enabled, Mr Hoffman says, by its concentration of engineering talent and venture capital and by founders' willingness to reshape their organisations and processes as they expand.

Silicon Valley is also heavily involved in the convergence of technologies such as mobile, robotic and artificial intelligence, producing applications and devices from voice-activated software to self-driving cars. Emerging city hubs, though, also see themselves as benefiting from convergence.

According to Atomico, the London-based venture capital group led by Skype co-founder Niklas Zennström, two-thirds of private software start-ups that have gained a $1bn valuation in the past decade — so-called "unicorns" — hail from outside Silicon Valley. It calculates that Silicon Valley and San Francisco account for 75 out of 236 unicorns, followed by Beijing (28), New York (17), London and Shanghai (10) and Berlin (8).

Unicorns are perhaps a crude yardstick, given uncertainty over valuations (Atomico's tally is higher than some other estimates). Asia has been the fastest-growing region. North America accounted for $59bn of venture capital investments in the first nine months of 2015, Asia $28bn and Europe $10bn, according to research firm CB Insights and KPMG.

> Many non-US tech groups are better positioned than their US peers

Beijing's Zhongguancun district — home to search engine Baidu, computer manufacturer Lenovo and smartphone maker Xiaomi — is a particular hotspot, but Chinese cities including Shanghai, Guangzhou and Hangzhou also have concentrations. India's Bangalore is home to unicorns including ecommerce champion Flipkart and taxi-hailing app Ola.

Michael Moritz, who chairs investment company Sequoia Capital, believes that "many non-US tech groups, particularly those born and raised in China, are better positioned for the next 25 years than their American counterparts".

In the US and other countries, Mr Katz sees a shift in the geography of innovation towards cities rather than the suburban model. His work has tracked the rise of "innovation districts" in cities such as Atlanta, Baltimore, Detroit, Houston, Philadelphia, Pittsburgh and St Louis.

Globally, similar districts are found in places such as Barcelona, Berlin, London, Medellín, Montreal, Seoul, Stockholm and Toronto. Factors behind this, Mr Katz says, include young people's preference for city living, the rise of "open innovation" (companies using networks of researchers) and the presence of advanced research universities. He adds: "What cities need to think about is what is that interplay between universities, companies, investors and the quality of place that will encourage companies to start up and grow?"

In Europe, fears persist that the region will lag behind the US and Asia despite an influx of venture capital and a growing pool of entrepreneurs and talent, notably in London, Stockholm and Berlin.

Gerard Grech, chief executive of Tech City UK, a government-backed body, says that while Silicon Valley has had decades to establish itself, London's growth as a tech centre has largely been achieved in the past seven years. Its advantage lies in combining software with traditional strengths such as finance and advertising.

"You have got so many different types of expertise here, that mix in well with the world of technology and digital innovation, that it will definitely continue to develop," he says.

Tech City UK has identified more than 20 digital clusters including Manchester, Liverpool, Bournemouth and Brighton.

Oil explorers learn to hug bankers as commodity prices crash

Energy Many smaller producers who used their reserves as collateral face a fight for survival in a turbulent bear market, reports *Alan Livsey*

A vicious bear market has taken hold of world energy markets. Following the oil shock of 2014, the price of oil has halved again during the past year.

As revenues disappear for global oil and gas companies, so have their opportunities to finance any growth. Most exploration and production (E&P) companies invest beyond their cash inflows, counting on equity and debt investors to fill in any gaps.

These E&Ps have had to slash their spending to save money, not just in shale oil regions, such as North Dakota's Bakken, but worldwide.

Capital spending for US oil and gas explorers fell about 40 per cent last year, according to Credit Suisse. A drop of a third is forecast for 2016 and, as a result, equity and debt issuance declined 35 per cent in 2015, says data provider Dealogic — the largest drop since 2000.

Those numbers tell only part of the story. US equity financing actually held up well — roughly flat on 2014 — owing to a strong first half.

Helped by a brief rebound in oil prices last spring, investors seemed prepared to offer capital believing that energy prices could rebound.

Outside of North America, E&Ps have struggled, raising only about half of the debt and equity that they raised in the previous year, according to Dealogic. In Europe, companies have had to rely mostly upon refinancing via bank credit facilities.

Last summer was a busy one for some European bankers. Exploration companies borrowed or refinanced, sometimes using their oil reserves as collateral. Some, such as EnQuest and Premier Oil, used the opportunity to renegotiate terms with their lenders.

Christophe Roux, head of reserve based finance in Europe, the Middle East and Africa for Société Générale notes "the oil finance market was very liquid", in other words active, during the summer. Relying on debt, rather than equity, also forced some E&Ps, such as EnQuest, to employ more hedging to protect their ability to repay these loans and credit lines.

Yet, any optimism in a recovery for oil prices back in the summer has vanished. Oil executives have resigned themselves to energy prices that will be lower for longer.

Of the smallest explorers, those listed on the UK's AIM, almost all were making pre-tax losses in their most recent accounts, says research firm Company Watch. Last month, AIM-listed Iona Energy called in the administrators.

"You don't hear the level of conviction [from other oil executives] you heard in March-April," says a former chief financial officer at a UK-listed E&P. "Hope has sort of dissipated."

European oil companies have already increased the focus on their banking relationships, but US E&Ps will also need to hug their banks more than ever in the coming months.

For one thing, the US equity market has little appetite for the energy sector as it becomes less relevant to portfolio managers chasing key index benchmarks. Energy as a proportion of the S&P 500 index has halved since 2011 to 6 per cent, according to S&P Dow Jones Indices.

Meanwhile, the threat of further increases in US interest rates, following the Federal Reserve's decision in December to raise rates for the first time in nearly a decade means the high-yield bond market — formerly a popular option for US energy companies — is also effectively closed.

High yield spreads relative to US Treasury bonds have moved to their widest since 2011, indicating that the prices of those bonds are falling (or their yields are rising) faster than US Treasuries. Bonds in the high-yield energy sector have twice the spread of all the non-energy sectors.

The disappearance of alternative sources of finance means that the banks' valuation of each company's hydrocarbon reserves, used as collateral against bank loans, will be vital.

In the US, these discussions between lenders and their clients over the value of their reserves will probably go less well than last year.

"If oil prices are in the mid-30s, banks are finally going to drop the hammer a bit more than they have in the past," thinks Paul Grigel, E&P analyst at Macquarie.

Reserve values: the oil industry's ability to tap capital markets has lost its energy
Getty Images

> Banks' valuation of each company's hydrocarbon reserves, used as collateral, will be vital

Apart from a major recovery in energy prices, one factor that could drive increased activity in oil and gas equity and debt issuance is a forecast rise in merger and acquisition activity. "Should the current pricing gloom persist, we expect that deal flow will increase in 2016," note energy consultants Wood Mackenzie.

"The drivers behind deals, and the types of deals we see, will differ this year as potential sellers come under increasing financial pressure," they add. Similar sentiments were expressed following the announcement of Shell's $82bn acquisition of BG Group last April. Yet that takeover did not spark more activity. Remove that deal and energy M&A worldwide fell by two-thirds in 2015.

Another group to watch will be the oil-producing countries themselves. Saudi Arabia surprised the market last month when the government said it would consider listing part of its state oil company, Saudi Aramco. Nigeria has announced similar aims. Both Brazil's Petrobras and Rosneft of Russia will also need to consider alternative ways of financing to meet investment plans.

Whatever happens to energy prices, pressure on balance sheets will continue. While the likes of Exxon and Shell worry simply about meeting the dividend demands of shareholders, a larger drama will play out among the smaller oil and gas producers fighting for survival.

‘Shadow capital’ rises behind ‘patient capital’

Private equity

$287bn was raised in 2015, but some report that deployment has slowed, writes *Joseph Cotterill*

The $5.6bn leveraged-buyout fund raised by the founders of KKR in 1987 as they pursued the takeover of RJR Nabisco was seen as enormous at the time. But the size of the LBO fund — which was made famous in the book and later film of the same name, *Barbarians at the Gate* — would barely raise an eyebrow today.

According to US Securities and Exchange Commission statistics on SEC-registered private funds, at the end of 2014, private equity funds managing at least $2bn collectively had $1.2tn in net assets.

Even these funds are increasingly raising capital surrounded by an ocean of other long-term, private markets also vying for the cash of institutional investors. Private equity firms such as the modern KKR have long since become alternative asset managers for the purpose of serving institutional investors seeking higher returns than can be obtained from bonds and equities.

Globally, according to Preqin, a data provider for alternative assets, over 1,000 funds last year raised $550bn of private capital, broadly defined. That made 2015 the third year in a row in which funds tapping investor demand for assets in infrastructure, private debt, and real estate — not only buyouts and venture capital — have raised half a trillion dollars for investments.

Private equity's $287bn share of this pie in 2015 is still a sizeable amount. But the weight of capital flowing into private markets — looking for higher yield, despite the lack of liquidity and high fees demanded by private equity investment — is making traditional private equity funds and their lifespans less relevant.

Classically, private equity funds lock up investors' capital for about 10 years. After raising the capital, fund dealmakers spend time picking assets with the goal of returning the money in five to seven years' (hopefully having doubled or tripled it) through a sale or

How confidence, networking and tenacity attracts funding

Women

Female entrepreneurs face a range of barriers when trying to raise capital, writes *Sarah Murray*

When she thinks back over the time she spent raising business funding, entrepreneur Lynne Laube remembers meeting only a handful of female venture capitalists.

"If you're a woman out there raising money, you're going walk into offices dominated by male partners who have male perspectives," says Ms Laube, president, chief operating officer and co-founder of Cardlytics, which uses online and mobile banking channels to track consumer spending.

Today, women create and lead a growing number of businesses. In the US the figure is 36 per cent, according to the government's Washington-based Small Business Administration.

Companies with senior female leaders are making some progress in raising the capital they need to start and expand these businesses. Babson College's 2014 Diana Project research found that from 2011 to 2013, US companies with a woman on the executive team received more than 15 per cent of venture capital investment, up from less than 5 per cent in 1999.*

Even so, 15 per cent leaves plenty of room for improvement. And companies with a woman chief executive received just 3 per cent of the total venture capital funding invested during this period, according to Babson's research.

The first barrier, as Ms Laube suggests, is that few women occupy senior positions at venture capital firms. "There are just not a lot of people that look like you," says Kate Mitchell, co-founder and partner of Scale Venture Partners, a Silicon Valley-based firm that invests in early-in-revenue technology companies.

The statistics bear this out. Research conducted for the Diana Project found that the proportion of women partners in US venture capital firms has fallen to 6 per cent from 10 per cent in 1999.

In such an environment, subconscious bias can come into play. "The pattern recognition is much higher for a male-to-male conversation than it is for a female-to-male conversation," says Ms Mitchell, who is also co-chair of the Diversity Task Force at the US's National Venture Capital Association.

Faced with this, women may find it more difficult to come across as self-assured when presenting their business idea to venture capitalists.

Another barrier women face is in gaining access to the networks that often play a big role in funding decisions.

Outnumbered
There are few high-ranking female venture capitalists, says Lynne Laube of Cardlytics

"Venture capitalists tend to provide capital to the people they know," says Patricia Greene, professor of entrepreneurship at Babson. "It's still a very tightly networked system and women tend to be not embedded in those networks."

This means working hard to tap into all kinds of networks, including friends and family, says Swati Chaturvedi, co-founder and chief executive of Propel(x), an online platform that connects angel investors with early stage technology start-ups. "Talk to as many people as you can about your story and what you're trying to do and the connections will happen," she says.

Ms Chaturvedi also advocates persistence and building stamina. "You have to knock on more doors," she says. She adds that having a family the process could be especially difficult because you have to be prepared to work long hours.

Once an initial meeting has been secured, the next challenge is to demonstrate self-assurance in presenting to a group that is likely to be dominated by men.

"Men have a definition of confidence that's often different from a woman's, so learning how to be confident in front of a room of men is a skill women need to have," says Ms Laube.

However, Ms Laube believes the most critical success factor for women entrepreneurs is their ability to demonstrate a mastery of the business they want to start and to convey that with confidence and passion.

Meanwhile, support mechanisms for women entrepreneurs is expanding, with "gender-lens investing" (investments whose priorities include increasing access to capital for women entrepreneurs and women-led businesses) gaining momentum and groups such as The Women's Organisation in the UK providing training and advice for women-led businesses.

But the Babson College researchers argue that the number one priority is to increase diversity in the venture capital industry.

"The model for venture capital that has been in place since the 1980s should be reconsidered and re-evaluated in order to effect change," say the Diana Project authors.

* *Diana Report: Women Entrepreneurs, 2014: Bridging the Gender Gap in Venture Capital Babson College, 2014*

> ‘The ... capital flowing into private markets is making traditional private equity funds less relevant’

stock market listing. Yet only a third of private equity backers now invest in the industry purely through classic 10-year funds, according to a survey late last year by Palico, an online private equity fund marketplace.

Just as many investors now invest at least a 10th of their assets in private equity either by taking stakes alongside managers in deals — so-called co-investments — or in direct deals they have sourced on their own, Palico found.

Only a handful of large pension and sovereign wealth funds around the world have the in-house investment teams with the expertise for such direct investment at scale.

The rise of such "shadow" capital over traditional fundraising may grow larger however as other investors look to bring the pace of deploying capital in private equity into their own hands. According to Palico's survey, three-quarters of investors reported that it took managers three years or more to invest half of the capital they had committed to funds. Waiting a long time for buyout executives to find and make deals is part and parcel of private equity investing and the "patient capital" it is supposed to represent. Yet 43 per cent reported that the pace of deployment has slowed down, a sign of prices for buyouts being pushed up by the rush of capital into the industry.

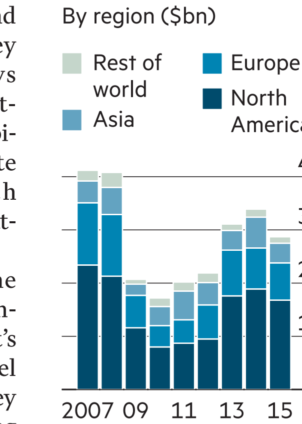
This is problematic for many investors given the 1 to 2 per cent management fees they are paying on the capital they have committed, not to mention the opportunity costs of keeping cash on-hand in a low interest-rate world until it is drawn down for deals.

Hence the appeal of so-called shadow capital investments. "What is really important is what you do with the money between commitment and it being drawn down, and what you do with the money after it's returned," says Jonathan Bell, chief investment officer at Stanhope Capital, a London-based private wealth manager which launched a private equity platform for its clients last year.

Funds "need to have the cash to be able to make commitments," Mr Bell adds. "It's important to keep it at a level where you can keep the money working when it's not being invested."

Annual private equity fundraising

By region ($bn)



Source: Preqin

From mineral water to rich pickings — with a little help

Emerging markets

A small company's experience in Georgia offers valuable lessons for other developing nations, writes *Jonathan Wheatley*

Small and medium-sized enterprises (SMEs) form the backbone of any market economy and this is especially true of emerging markets. In emerging Europe, between 70 and 95 per cent of all registered companies are classified as SMEs, providing 60-80 per cent of growth in gross domestic product, according to the European Bank for Reconstruction and Development (EBRD).

Despite their outsized role, SMEs in emerging economies struggle to secure finance for growth. Typically, entrepreneurs use their own capital or turn to family or friends. Sometimes it is more arbitrary. In the case of Marneuli Food Factory, a Georgian manufacturer of tomato paste, pickles and sauces, seed capital came from a Swiss tourist.

It happened in 1997 when Thomas Diem, a psychiatrist with an interest in Georgian folk music, visited the rundown facilities of a Soviet-era mineral water producer. Inspired, the company story goes, to do something to help revive a region struggling to shake off the legacy of its Soviet past, he put up $40,000 to get the company back on its feet.

Local investors joined him to create JSC Healthy Water and, later, a holding company that today owns four companies: the water bottler, a distribution company, an agribusiness company and Marneuli Food Factory, or MFF. Few businesses have such luck and Irina Gaprindashvili, director of MFF, says small Georgian businesses struggle to raise finance, in spite of pro-business reforms enacted since the "Rose Revolution" of 2003.

Practical state support for small businesses includes help drafting business plans and training in company administration. But actual financial support is limited: the government provides funding of up to 5,000 lari ($2,065) per small or micro business entrepreneur. Otherwise, with average commercial interest rates to private borrowers north of 20 per cent a year, according to the central bank, ordinary bank lending is out of the reach of most SMEs. "When we were looking for options to expand, the offers we got from the banks were at such high interest rates that we struggled to expand and to be competitive on export markets," says Ms Gaprindashvili. "Today, a small company that wants to become large has to do it very gradually."

MFF was founded in 2007 using capital generated by the success of the mineral water business. It has been able to expand quickly since then due in part to loans from the EBRD in 2010 and 2011. It has now secured what it says is the first institutional private equity investment in Georgia, from Swiss GeoCapital.

MFF's success also owes much, Ms Gaprindashvili says, to the reforms enacted since the 2003 revolution — including more flexible labour laws, and faster customs, licensing and court procedures.

"It was a very big incentive for companies to grow. It was a lot easier for business people to found a company, regulations and taxes were simplified, it was a very liberal approach."

Georgia's reformist drive has slowed since president Mikheil Saakashvili, who now advises Ukraine, left office. But Ms Gaprindashvili insists that reforms are permanent. "We know the situation in our neighbouring countries," she says. "They really admire the changes made here." Claudio Viezzoli, head of the EBRD's Small Business Initiative, says development has come most quickly to countries that make life easier for small entrepreneurs. "This is true in Georgia and in other countries that understand that wealth and growth will come as a result of people risking their money in successful ventures," he says. Conversely, he adds: "Those countries that are stuck in a complex setting of difficult administrative systems are bound to be more prone to corruption. Unfortunately, this is still true in a lot of countries in the region."

Mr Viezzoli does not name names but Ukraine is an example of a country where corruption and an opaque business environment obstruct entrepreneurship. After two popular uprisings in the past 12 years, it has failed to tackle corruption and institute reforms. A small country, Georgia, perhaps, had it easier than Ukraine because its problems were more manageable. Certainly, Mr Viezzoli says, financial and other support to SMEs can have a greater impact in small countries "due to the demonstration effect". In Serbia, for example, the EBRD has invested in 10 SMEs — a modest investment that has punched above its weight.

"There has been a real impact on business transparency," he says. "It has an incredible impact on those companies' peers because everything is so visible in a small economy."

Practical: state support helped entrepreneurs such as Irina Gaprindashvili
EBRD/Alexander Grigorian

'Wealth and growth come as a result of people risking their money in successful ventures'

Bumpy public markets weaken the appetite for IPO activity

Initial public offerings

Amounts raised have declined, but markets are more forgiving of postponed deals, writes *Gavin Jackson*

If you give companies a choice between bumpy public markets and friendlier private ownership they are likely to go for the latter, which is why 2015 saw a decline in the amount of money raised from initial public offerings.

Experts say this development, which follows several strong years for IPOs, is likely to continue in 2016 against a backdrop of negative indicators.

Equity markets suffered severe market turmoil at the beginning of the year after sharp falls in China, exacerbated by fears of a global slowdown and perceptions among investors that stock market valuations have been driven too high by loose monetary policy.

Globally, the value of IPOs fell by 36 per cent between 2014 and 2015 from $263.8bn to $193.9bn, according to Dealogic, the data provider, as a number of shocks led companies to stay away or delay deals.

"We've had a very good and robust run of IPO activity over the past few years," says Mark Hantho, global head of equity capital markets at Deutsche Bank, who believes last year's decline was more of a reduction to a "normalised level".

As IPOs are a way of discovering the correct price for a company's equity, bankers traditionally do not like to float when markets are volatile.

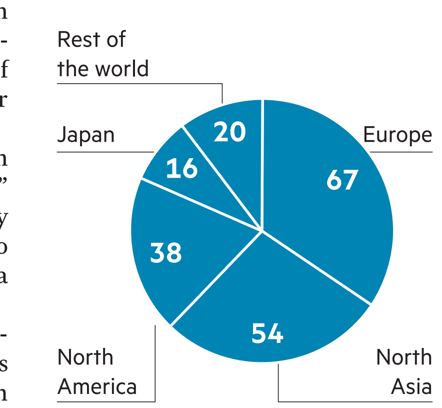
A rough guide is that a company should not list when the Chicago Board Options Exchange Volatility Index (Vix), which shows the market expectation of short-term volatility, is above its long term average of 20. On only two days in 2016 has the index been below this level. There was not a single US IPO in January.

Fast-growing tech companies stayed away from equity markets over the past year.

While Facebook floated in 2012, followed by Twitter in 2013 and Alibaba in 2014, newer companies such as Uber, the taxi-hailing app, Airbnb the accommodation app, and Snapchat, the social media platform, all remained in private hands.

In an indication of cooler investor sentiment towards the sector, Square, the San Francisco-based payments company, priced its shares at $9 at its November IPO, a 40 per cent drop from the level paid by investors in a private fundraising a year earlier.

Global IPO issuance
2015 ($bn)



Source: Dealogic

Europe, however, had the busiest first quarter for at least a decade in 2015, according to PwC, after the fall in the oil price and geopolitical uncertainty in 2014 led to a number of deals being delayed. The market was further boosted by some large privatisations.

"We had a very choppy first week last year and we had a series of similar conversations with prospective issuers, but, in the end, January and February [2015] were a great time to come to market," says Martin Thorneycroft, head of European equity syndicate at Morgan Stanley.

Participants say that after such experiences, the market is more forgiving of IPOs that are postponed.

Now, say market participants, delaying an IPO can give a company more time to build a record of performance and enable investors to become more familiar with it.

So some flotations that were delayed last year may expect a friendly welcome over the coming months thanks to a lessening of the stigma associated with a pulled deal.

In the US, grocery chain Albertsons, department store Neiman Marcus and SoulCycle, a cycling-based fitness group, all pulled IPOs in the last quarter of 2015.

In Europe, in spite of a number of big privatisations, other deals including French music streaming company Deezer, Xella of Germany, which makes building materials, and Shield Therapeutics, a Newcastle pharmaceuticals group, were all postponed.

But now because the negative associations of pulled deals are fading, testing the waters for a public listing as opposed to staying private is becoming less risky for companies looking to raise capital even at times of market volatility.

Online platforms ride to the rescue of many SMEs

Crowdfunding

Value of funds raised online looks set to double again, as banks retrench, says *Emma Dunkley*

The retrenchment of banks from riskier forms of finance — such as to new companies — following the financial crisis has helped raise the status of crowdfunding platforms such as Kickstarter in the US and Seedrs in the UK.

Jeff Lynn, founder of Seedrs, says: "Crowdfunding has fuelled a tremendous transformation in the way SMEs [small and medium-sized enterprises] think about finance."

Nesta, an innovation charity that provides research on the start-up funding industry, says crowdfunding offers "an opportunity to bypass traditional funding streams such as grant applications or bank loans".

Crowdfunding falls into three broad categories. The simplest sees investors hand over cash in return for goods and services.

UK record: BrewDog

The second is debt crowdfunding, which allows investors to lend money that, in theory, they receive back with interest. Finally, in equity crowdfunding investors buy shares that they hope will be worth more in the future.

Figures show that the value of crowdfunding expanded globally by 167 per cent to $16.2bn in 2014, up from $6.1bn raised in 2013. In 2015, the industry is on track to more than double once again, according to a report by Massolution, a US research firm.

"UK really leads the world on crowdfunding," says Mr Lynn.

Craig Asano, founder of the National Crowdfunding Association of Canada, says the concept is struggling to get off the ground in many countries, including Canada, due to slower adoption rates and regulatory constraints.

However, investing in early stage ventures, especially as an equity investor, is high risk. Many start-ups eventually fail, often meaning investors will not be able to get their money back.

In the UK, one in five companies that raised money on equity crowdfunding platforms between 2011 and 2013 has since gone bust, according to a study by AltFi Data and law firm Nabarro.

But investors with an appetite for risk can gain high returns. Limited data are available, but Bill Morrow, co-founder of Angels Den, which describes itself as an angel-led crowdfunding platform, says investors can triple their original investment.

Last year, the independent brewer BrewDog broke equity crowdfunding records in the UK by raising £5m in the first three weeks of its fundraising round, using its own platform — Equity for Punks.

Infrastructure Institutional investors show interest but lack of suitable opportunities is holding back pension funds

When the London Pensions Fund Authority and the Greater Manchester Pension Fund teamed up to create a £500m vehicle for infrastructure investments, it took them 10 months to commit £60m. A year later the two pension funds are still seeking to invest the remaining £440m.

Chris Rule, chief investment officer at the LPFA, which manages £4.6bn on behalf of local authority workers in London, says finding suitable infrastructure investments is challenging.

This view is shared by many other institutional investors.

"There are too few concrete projects to invest in, too many investors looking for investable projects and too low returns," says Matti Leppälä, chief executive of PensionsEurope, a trade association for pension funds.

The lack of suitable, available projects comes despite "a massive need for infrastructure investment", says Mr Leppälä. In fact, $57tn is needed globally by 2030 to finance energy, water, transportation and social projects, according to McKinsey, the consultancy.

There is huge scope for institutional investors to finance projects once funded by governments, says Boe Pahari, global head of infrastructure equity and managing director at AMP Capital, the A$130bn ($90bn) Australian asset managers.

"Australian [pension funds] already have allocations of 10 per cent-plus to infrastructure, whereas in Europe, the average is closer to one or two per cent," he says.

Mr Pahari adds: "We fully expect demand for infrastructure to grow through 2016 and beyond, as institutional investors continue to search for more stable, long-term cash flows and capital preservation."

This is already playing out at PFA Pension, Denmark's largest commercial pension, which recently increased its allocation to infrastructure and plans to raise this even further, says Allan Polack, group chief executive.

Mr Rule, meanwhile, says 5.5 per cent of LPFA's assets is invested in infrastructure, but this is likely to increase to 10 per cent.

Nonetheless, many institutional investors are hesitant to invest in infrastructure — often because they lack the expertise to carry out the due diligence that is required. Few institutional investors have specialist infrastructure teams.

"One of the key barriers to pension fund investment in infrastructure is the challenge of assessing and managing risks with which pension funds are not familiar, such as construction risk," says Mr Leppälä.

Then there is the problem of finding projects to invest in.

Duncan Hale, global head of infrastructure at Willis Towers Watson, which advises institutional investors, says: "The constraining factor around infrastructure investment is not institutional investor willingness to invest, but rather a lack of appropriate, well-structured projects."

Attracta Mooney

Risk: Matti Leppälä says pension funds lack the right expertise