



Grant Thornton

An instinct for growth™

# Bridging the gap

*Raising the growth capital you need*

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Extract from technology, media, telecommunication report  
**Building tomorrow's billion dollar businesses**



# Raising the growth capital you need

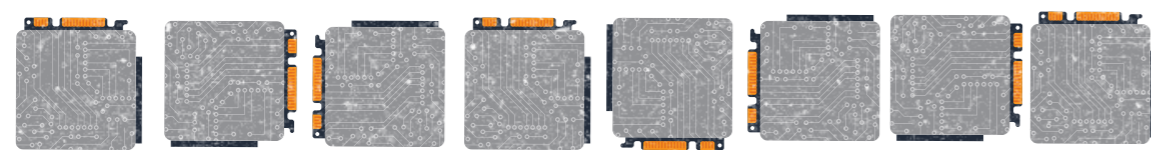
Ongoing access to finance is a key issue for high-growth businesses. Those that lack financial firepower may find their growth constrained. Others may encounter problems with cash flow during day-to-day operations. At the same time, the funding landscape has changed drastically since the financial crisis of 2008 – and continues to evolve.

While expansion and later-stage funding in the US has increased in recent years, the National Venture Capital Association's figures show the highest growth is in early-stage funding – from US\$6.1 billion invested in 1,303 deals in 2010, to \$15.9 billion in over 2,166 deals in 2014. The emphasis on start-up funding often comes at the expense of robust financing options for larger, rapidly scaling companies, where financing options are often far more limited. In India, for example, while deal values in the technology sector totalled \$11.5 billion in 2014 according to Grant Thornton's research<sup>1</sup>, early-stage businesses attracted the lion's share of this investment.

## Bridging the funding gap

On average, it took investors around seven years to 'cash out' on the current crop of non-private unicorns in the US<sup>2</sup>. Despite this, there is still high investor appetite for early-stage companies – which represents a stark challenge for more mature enterprises in search of capital to help them grow.

This difficulty is particularly acute outside the US. In North America, investors tend to feel more comfortable with uncertainty. Elsewhere, they are more likely to worry about execution risks – these are significantly amplified during the scaling-up process.



**“In Australia, you're allowed to risk losing all your money in a casino – but you're not allowed to risk losing millions of dollars by investing in a start-up that might help drive growth and create new jobs.”**

**Simon Coulton**

National head of technology & media, Grant Thornton Australia



The net result is that both start-up businesses and well-established businesses find plenty of support. Companies in the strata in-between face a funding gap.

Public policy interventions have sometimes exaggerated this problem. In the UK, government-backed approaches such as Innovate UK and the Start Up Loans project have boosted many very young companies. But later-stage businesses struggle to attract funding: one recent study found second-stage British companies raise 81% less capital than those in Silicon Valley<sup>3</sup>.

## Winning in secondary markets and private IPOs

The good news for high-growth businesses is there is a growing range of alternative financing options emerging. One possibility is the secondary market, or so-called “private initial public offering”. This was launched to cater for growing companies that wish to offer shares privately, rather than through a full-scale IPO. Often, these include companies not yet ready for the rigors of a full-scale stock market quotation – and consequent regulatory burden and extensive investor relations work. In the US alone, technology companies have raised £20 billion this year through secondary markets, compared to just \$600 million from traditional IPOs<sup>4</sup>.

<sup>1</sup> Grant Thornton – IVCA Technology Dealtracker 2014, Grant Thornton India LLP, April 2015

<sup>2</sup> Welcome to the Unicorn Club 2015, TechCrunch, July 2015

<sup>3</sup> Internet of things – the soap opera, Think Big: the innovation blog, July 2015

<sup>4</sup> Private share trading takes off as tech companies shun IPOs, Financial Times, June 2015

This space is maturing, with established exchanges such as SecondMarket joined more recently by new ventures such as Nasdaq's Private Market. The profile of private offerings has also been boosted because well-known tech companies such as Airbnb and Pinterest have opted to raise money this way. This has attracted a growing pool of investors, including institutional investors, such as mutual funds, hedge funds and even sovereign wealth funds<sup>5</sup>. With such high-profile investors interested in secondary markets, growing tech companies must ensure that they are correctly valued before trying to secure finance through this route.

This funding route does not suit everyone: it still involves an additional level of regulatory scrutiny. There is also qualification criteria – Nasdaq Private Market, for example, expects businesses to have raised \$30 million already before listing. Also, investors expect companies to work towards a full-scale IPO, as this offers them the best opportunity to cash out – although it will not suit all companies.

#### Securing government support

Another possibility for fast-growth technology companies is to piggy-back on the support that governments offer to investors in such companies. Israel is home to one of the world's most thriving tech clusters, partly because its government has offered generous tax incentives to private equity and venture capital backers of tech businesses. The UK has sought to do something similar with tax incentives such as the enterprise investment scheme.

In some cases, technology businesses are relocating to jurisdictions where the financial and taxation climate is more conducive to their growth plans. This was behind the decision of Australian software company Atlassian to move to the UK last year<sup>6</sup>.

#### Traditional IPOs – and M&A deal-making

IPOs remain an important option for fast-growing tech companies. Recent high-profile IPOs – such as Lending Club and GrubHub – demonstrate what successful tech companies can achieve through listing.

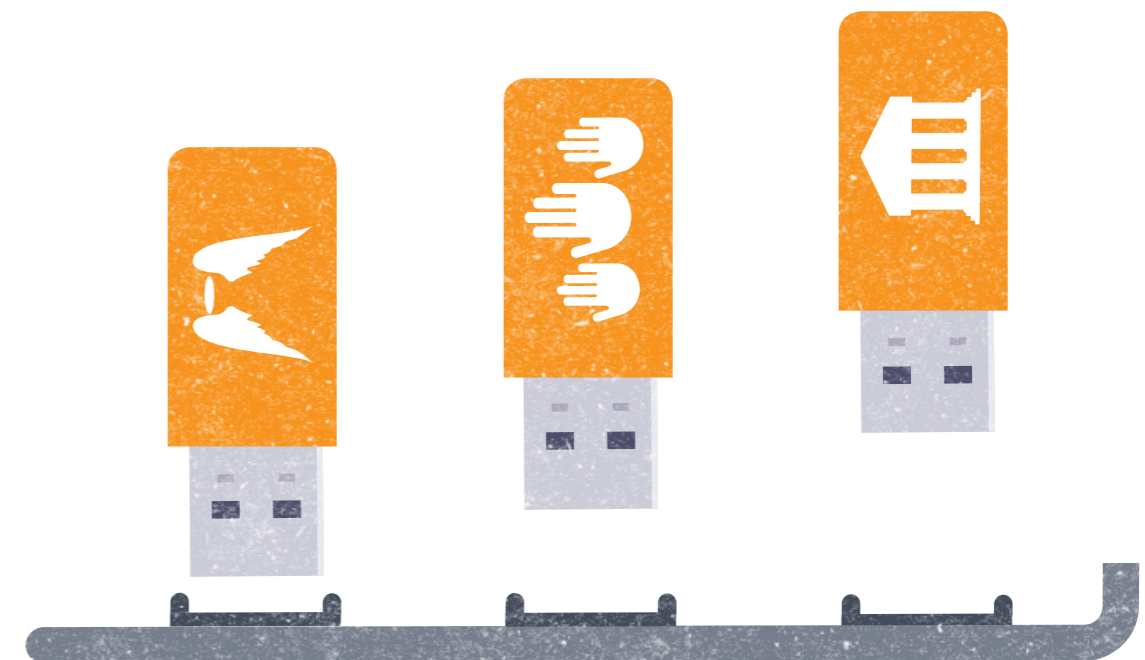
IPOs are becoming especially important outside the US. In Australia, the tech sector has been one of the bright spots on the ASX over the past couple of years, with examples of companies such as Freelancer, MYOB and Ozforex coming to the market<sup>7</sup>. India recently sought to relax requirements for certain companies, to help investors tap into the country's current e-commerce boom – and to avoid tech companies seeking to instead list abroad<sup>8</sup>.

In India, tech M&A is also booming – as it is globally. The volume and value of technology deals has risen to pre-crisis levels, as companies seek to deploy record volumes of capital reserves and access cheap debt. The technology sector had the biggest half-year M&A levels on record, according to Dealogic<sup>9</sup>, including the largest proposed tech acquisition on record in Avago Technologies' pending US \$37 billion

takeover for Broadcom<sup>10</sup>. Blockbuster deals like this might grab the headlines, but it is clear that there is significant appetite globally for rapidly scaling tech companies – to capture their IP, their talent and their growth potential.

#### Exploring alternative finance

While bank support may be harder to come by today than in the years leading up to the financial crisis, the global alternative finance sector is increasingly stepping into the breach. One recent study<sup>11</sup> suggested that, in Europe alone, the alternative finance sector grew by 144% last year, led by the UK, but with enthusiastic support from providers in countries as far-flung as France and Estonia.



“Global private equity and venture capital investment is flowing into emerging tech companies in Asia, especially in China and India where these rapidly growing companies are focusing on disruptive solutions. Many of these companies are considering cross-border M&A and overseas listings, so building a robust global corporate governance framework early on is very important.”

**Raja Lahiri**  
Partner, Grant Thornton India

<sup>5</sup> 'Data: There are now over 9x more private IPOs than actual tech IPOs,' CB insights, April 2015  
<sup>6</sup> 'Too expensive – tech start-ups move overseas,' The Sydney Morning Herald, January 2014

<sup>7</sup> 'How to profit from the IPO boom,' ASX, 2015  
<sup>8</sup> 'India eases IPO rules for startups as e-commerce booms,' Bloomberg, June 2015  
<sup>9</sup> 'M&A statshot Dealogic,' May 2015  
<sup>10</sup> 'Avago to buy broadcom for \$37 billion in biggest tech deal ever,' Bloomberg, May 2015  
<sup>11</sup> 'Moving mainstream: The European alternative finance benchmarking report,' University of Cambridge, 2015

## CASE STUDY



### Cloud Imperium breaks crowdfunding records

Cloud Imperium, the US videogame developer, has raised almost \$77 million of funding through a rolling campaign of crowdfunding pitches to investors who believe in the company's commercial prospects – but who are just as excited about playing its flagship product, the space simulator Star Citizen.

Cloud Imperium's founder, Chris Roberts – a former big-name developer who subsequently moved into feature films – saw crowdfunding as a way to reconnect with the gaming audience. That engagement has become a crucial element of the strategy, says Cloud Imperium vice president of publishing John Erskine.

“The money that comes in from crowdfunding is of huge value to a company that's looking to raise finance,” he says. “But we believe that equal or maybe greater value comes from the community engagement you get – the proof of the market.” For Erskine and his colleagues, Cloud Imperium's campaigns – which have offered investors the chance to try out features of the game as they've been developed – have been an opportunity both to promote the product and to receive continual feedback on its direction.

However, businesses should not underestimate the hard work involved in successful crowdfunding, Erskine says. “The community engagement we have is an everyday activity for our company,” he explains. “We produce a staggering amount of content for fans, and that level of engagement is core to who we are as a company.”

Alternative finance options for fast-growing companies range from peer-to-peer lending platforms to kickstarter campaigns, depending on the maturity and needs of the business raising funding. And while these platforms were originally best-suited to small-scale ventures and start-ups, our case study demonstrates that this is no longer the case.

In some jurisdictions, alternative finance providers' growth has been limited by legal restrictions – crowdfunding, for example, has been difficult legally in both Canada and Australia. But even in these territories the trend now is towards liberalisation of regulation, potentially creating further opportunities for fast-growing technology companies to raise new funding.

**“When you get past the series A and B rounds, your next round of funding may be coming from somebody who is not a native of your local market. They will be interested in larger projects and will want to see how your product is different in the marketplace. If you can show you are a disruptor, it will give them comfort.”**

**Fergus Condon**

Technology sector leader, Grant Thornton Ireland



### Key questions: raising growth capital

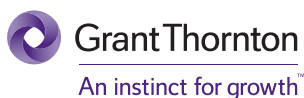
- What credit guarantee and insurance measures should we have in place to protect against non-payment?
- How can we prepare our business for success in secondary markets?
- How seriously should we consider crowdfunding and other alternative finance models?
- What happens when we outgrow our local or national funding capacity?
- What investment models should we use to guide our planning?
- What should we do to prepare for IPO?
- How much equity should we give up in order to attract capital? And how do we make choices to protect our ownership rights in the future?

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