The need for liquidity

The rise in popularity for private company investing must come with the ability to exit

STUART LUCAS

Here's a conundrum. What do all those private businesses that have raised funds through the new wave of alternative finance do with their shareholders? Once the companies have got the cash there is a temptation to treat them like mushrooms – feed them rubbish and keep them in the dark.

Crowd-funders are becoming more demanding, albeit led by more sophisticated investors. Like their quoted counterparts they expect access to investor information and regular updates. Crucially investors want to know how and when they can expect an exit.

Providing liquidity in unquoted companies has always been a problem and the regulator, the Financial Conduct Authority, also raised concerns on this issue in its consultation paper on crowdfunding toward the end of 2013. To attract investors, newly funded businesses often make vague promises of an IPO (initial public offering) or trade sale in three to five years. Until then shareholders just have to sit tight unless the management are willing to buy back the shares. Even then how do you determine price? Shares in private companies are typically bought and sold at a value that both parties can mutually agree on, rather than at a market derived one.

I once found myself in this position and was locked in a successful private business for over 12 years; with no transparent mechanism to value my shares I was compelled to hold on.

PRIVATE ENTERPRISE

There are over 2,500 sizeable private companies with turnover above £15 million in the UK that have at least 10 shareholders and many more start-ups with over 50 shareholders. A back of an envelope calculation puts an equity value of around £300 billion of tied-up assets. Only a tiny fraction of these companies will ever go public, some may find a buyer, more won't survive.

Shareholders also need to be aware that the people behind many of these businesses may have no real intention of providing an exit any time soon. After all the greatest advantage of being private is retaining control and making decisions without having to ask anyone's permission.

Stuart Lucas
co-founder and chief executive officer of Asset Match

Share auction services like Asset Match used to be perceived as the go-to places for delisted stocks that couldn't cut it as a public company. With some companies paying in excess of the value of the shares being traded to maintain their listing, it is no wonder they begin to question their status as a public company. The private market is also changing. The growth of a nation of angel investors, EIS schemes and better access to private business investment opportunities means that demand for a secondary market to trade illiquid assets is on the rise.

TASTY STORY

Aberdeen based craft brewery BrewDog is a good example of a one-in-10 crowd-funded success story. It has completed three 'Equity for Punks' share issues since 2009; the latest in 2013 at £95 per share. An early commitment to shareholders to provide a liquidity event was recently actioned. Buyers and sellers were corralled in a five-hour auction where 220 investors took part. Participants were able to see the range of bids and offers which spanned from £25 to £300 and adjust their orders accordingly. In the end, 118 individuals traded successfully. The smallest seller sold just one share while the largest buyer invested over £80,000. At the close, shares were transacted at £125 per share giving BrewDog a market cap of just under £150 million. Not bad for a company that was founded in 2007 and has sourced most of its funds from fans.

Liquidity doesn't just affect up and coming companies. Any private business with investors faces the same issue, whether it is a private equity-backed company, a family business with a myriad of biologically-related shareholders or companies with EMI (Enterprise Management Incentive) schemes.

Financial technology firms are offering simpler, more transparent and cheaper ways to solve long existing problems including the trading of shares. The bigger exchanges are also waking up to the fact that many companies would prefer to stay private if they could, and in the US the NASDAQ Private Market was launched earlier this year. With so many new alternative ways to finance companies now on offer it is not surprising that hubs for unquoted secondary markets are coming into their own.