This Alternative Marketplace Gives Shareholders More Control

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Crowdfunding is a big theme for us at *Exponential Investor* – and rightly so. It's a relatively new investment class – one which enables even the smallest investors to get undreamed-of returns, by investing in early-stage firms.

Liquidity is, of course, a big concern for most investors – and it has traditionally been a challenge for private company backers, especially. One of the most common questions people ask is, "How do I sell my shares?" Normally, you'd have to wait for a flotation, or trade sale – which can take years, if they happen at all. Today, we'll be giving you one useful alternative answer to this tricky question.

There's a little-known way to turn your private shares into cash

We'll hear from a man with a solution to this problem. Rohit Nanda is chief operating officer of Asset Match. This is a share trading platform for unquoted shares. He'll be talking about how you can easily liquidate your private-company portfolio – something that could be very hard, without the assistance of his firm.

Rohit has over 17 years of financial markets experience, and he has made a number of private company investments himself – so he's certainly no newbie. Now, I'll hand you over.

AL: Let's start with the basics. What makes it difficult to sell shares in private firms?

RN: The most obvious difficulty is finding someone willing to buy them. Private company shares are typically illiquid – ie, hard to turn into cash. While companies are required by law to publish annual accounts etc, it can still be difficult to find anyone who might be interested in buying your shares – at least, at a price that you'd be happy with.

In addition, private companies may have put in place certain provisions in their articles of association, or shareholder agreement, which govern the transfer of shares. This may include pre-emption clauses. These mean that shares must be first offered to other shareholders, before being offered to an external investor. In addition, these may come along with guidelines on the timetable, valuation and any arbitration that may be required.

AL: Why should investors in private businesses put pressure on companies when it comes to exit plans?

RN: Investors in private businesses – such as angels, high-net-worth individuals, institutions or even sophisticated retail investors – are always, ultimately, looking towards the potential payout that an exit can deliver.

The number of private investors has grown significantly in recent years. This has been driven by the rise of crowdfunding platforms, and a new-found excitement about small, innovative British businesses.

For many companies, smaller sophisticated investors now sit alongside angels and institutions. However, the terms and share classes are often different, and investors need to be aware of this. That's why investors should put pressure on firms, to make sure they're getting fair terms.

AL: What sort of terms should investors be looking for?

RN: Ideally they should make sure that they are buying in at the same price and share. They should also check to see if there are any preferential rights or returns given to larger investors. Once they have confirmed this, they need to understand the transferability options those shares have – so that they can sell without undue restrictions.

AL: Why can't investors just wait for a trade sale or an initial public offering (IPO)?

RN: These traditionally cited "exit options" are actually fairly rare occurrences.

While trade sales are the often the most cost-effective and simplest way of providing a total exit for shareholders, there will always be debate about the timing – and whether more value could have been extracted a of a sale.

A very small number of companies actually IPO. Cost and suitability are factors – it can cost between £100,000 and £150,000 a year for a company to manage its AIM admission, for example. Most privately owned British companies are actually too small – in terms of earnings or assets – to make a quotation worthwhile. Meanwhile, some larger firms prefer to remain private for other reasons – but we can still help their investors achieve liquidity.

AIM, the London Stock Exchange's growth-shares market, has suffered badly from the removal of liquidity. This has resulted from the banking crisis and increased regulation. The number of companies admitted has declined consistently since the crisis. Furthermore, buying and selling activity is now heavily concentrated in the largest companies. The bottom third of AIM stocks do not even trade on a daily basis. This then begs the question: why is a company paying so much to access this liquidity, when it's not actually receiving it?

AL: So what are the alternatives?

RN: The alternative finance sector is booming and different parts of the value chain are being disrupted. This has led to the growth of the online secondary marketplace. Online platforms connect buyers and sellers – negating the need to liaise with the business, or employ a broker. Platforms are increasingly becoming FCA-regulated, in order to arrange transactions. Asset Match has been regulated from the beginning – which ensures that the marketplace operates in both a fair and transparent way to all users. This opens up an asset class of unquoted shares, which was previously pretty inaccessible to individual investors.

These marketplaces provide shareholders with more control over when to sell their shares. Crucially, in most cases, it also creates a transparent mechanism that lets investors know the value of their assets – as the prices are open.

AL: Should companies be acting differently, to support investor exits?

RN: In most cases, companies are focusing on the short term. They fail to appreciate that investors' circumstances can change over time. Perhaps, after holding shares for five or more years, shareholders should be asking (or demanding) that boards investigate the provision of liquidity.

If we truly want to support investment into British business, companies should be made to think of their responsibilities. Without their early-stage investors, many firms simply wouldn't exist in their current form.

It was recently commented that an investment without an exit is nothing more than a gift. So, if you're an investor, you should be demanding an exit plan – or you might as well make a charitable donation!

AL: What exactly can firms do, to provide investors with liquidity?

RN: Firstly, firms must change their attitude to early investors – seeing them as partners, not just as a source of funds. Firms then need to make provisions to remove transfer restrictions, and allow shares to be transferred electronically in CREST. Then, they can attract investors – by stating their intention to use a secondary market, to provide liquidity a of a trade sale or IPO. There are plenty of ways to do this – but the firm's attitude to shareholders is key.

Are you concerned about your ability to sell your shares in private firms? Does this hold you back from making investments – such as by crowdfunding? Do let us know: **andrew@southbankresearch.com.**

Best,

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