Proposed Merger of Crowdcube Limited and Seedrs Limited

Initial Phase 2 Submission by Seedrs Limited

Executive Summary

A. Seedrs welcomes this opportunity to engage with the CMA in connection with our proposed merger with Crowdcube (the "Merger"). We recognise that the CMA's thinking remains at an early stage given that Phase 1 was fast-tracked, and we look forward to working with the inquiry group and the Phase 2 team over the course of their investigation. We hope that the submission we are making today proves helpful in understanding our perspective on the market and the Merger.

B. In this submission, we provide significant detail around a number of the questions and issues that the CMA has raised to date, but there are three fundamental points that we want to emphasise to at the outset:

1. We strongly believe that the Merger will be good for customers and the market. It is a pro-competitive transaction that, first and foremost, is about the survival and sustainability of an innovative method of equity finance in a David vs. Goliath battle against the established providers of SME equity funding. If the Merger is completed, the market in which we operate—and our particular segment of that market—will become more competitive and dynamic, and customers will realise significant direct and indirect benefits.

2. We do not believe that there is logically coherent definition and account of our market that would see the Merger resulting in a substantial lessening of competition. If our market is defined narrowly, then it is capable of sustaining at most one provider, and even then, that provider would struggle to break even. A combination of two providers into one would therefore make the market no less competitive than it would be in the absence of such a transaction. Alternatively, on a broader definition of the market (which is the one we believe to be correct), Seedrs and Crowdcube are small participants, both individually and together. Our combination would not reduce competition within the market in any meaningful way, and instead it is likely (as discussed in point 1 above) to make the market more competitive.

3. ✄, the counterfactual to the completion of the Merger is a set of scenarios that would be highly damaging to customers and the market. ✄. We ✄ set out ✄ general aspects of the counterfactual in section 4 of the submission.

C. We thank the inquiry group and the Phase 2 team for their time in reviewing this submission, and we are available to answer any questions, or elaborate upon any of the points we have made, at any time.

1. Introduction

1.1. In this submission, we respond to the CMA's *Decision on relevant merger situation and substantial lessening of competition*, dated 12 November 2020 (the "Phase 1 Decision") and the *Issues statement*, dated 4 December 2020 (the "Issues Statement"), with respect to the proposed Merger.

1.1.1. Section 2 (Market Definition) explains our view of the appropriate market definition and sets out evidence in support of it. Based on history, substitutability and economics, we think it is clear we are competing within all the established players in the SME equity funding (Goliath) rather than operating within the CMA's proposed narrowly-defined market of equity crowdfunding. We support this analysis with evidence in the form of data and third-party commentary, and we also explain why our internal documents are consistent with the analysis.

1.1.2. Section 3 (Competitive Constraints) then looks at the competitive constraints that apply in our market and segment. We look at both existing firms and new entrants, and on the latter we discuss the barriers to entry, the likely types of new entrants and the circumstances under which entry is likely to occur. We then discuss how the competitors constrain us, both in terms of price and quality.

1.1.3. In section 4 (Counterfactual) we address the counterfactual to the Merger. We discuss the financial position of the parties at a high level, and then we describe the likely scenarios that will unfold if the Merger is not completed. ✂.

1.1.4. Finally, in section 5 (Benefits of the Merger), we round out the picture by summarising some of the direct and indirect benefits that customers and the market would see as a result of the Merger.

1.2. As we indicate in the Executive Summary, there are three overarching points that thread through the entirety of the submission and that are especially important to bear in mind.

1.2.1. First, this Merger is about bringing together the best of the Seedrs and Crowdcube platforms in order to build a sustainable business that can compete more effectively with established providers of SME equity funding. It is a pro-competitive transaction that, first and foremost, is about survival and sustainability within a challenging industry. If the Merger is completed, the market in which we operate, and our particular segment of that market, will become more competitive and dynamic, and customers will realise significant direct and indirect benefits.

1.2.2. Second, there are essentially two possible conclusions that the CMA could reasonably reach after considering the market in which we operate:

1.2.2.1. The CMA's starting point in the Issues Statement (drawing on the Phase 1 Decision) was that Crowdcube and Seedrs operate in a narrow market limited to solely the provision of equity crowdfunding services in the UK. For all the reasons we explain in this submission, this is emphatically not the way that we see the market or what the evidence bears out. Nonetheless, even if the CMA were to take this view, it would then have to conclude that there can only be enough room for a single provider of these services, since even a single provider would—at best—only just be able to break even. The economics underlying that reality are discussed in detail in section 4. On that analysis, the Merger would not reduce competition because at most the market could only sustain one provider of equity crowdfunding services going forward.

1.2.2.2. Alternatively, the CMA could take the view, as we do, that there is scope for equity crowdfunding services in the UK to grow significantly, and potentially expand internationally, to the extent that there would be sufficient demand to sustain multiple platforms over the longer term. However, this would require equity crowdfunding activity to ✂ compared to its levels today. This growth potential would only be conceivable if equity crowdfunding platforms were in fierce competition to win business from other providers of SME equity finance and investment opportunities. This in turn points to a wider market for SME equity finance in general, in which Seedrs and Crowdcube (whether individually or combined) are small players. The Merger would not meaningfully reduce competition for SME equity finance services in this context. On the contrary, it would in our view enhance competition since the combined business post-Merger would be better placed to compete with the large and established competitors in the market.

1.2.2.3. So regardless of which view of the market the CMA accepts, we do not see how this could result in a finding that the Merger would result in a substantial lessening of competition.

1.2.3. Finally, ✂. The Merger is the only realistic option ✂ the combined business ✂ to achieve a sustainable scale, ✂.

2. Market Definition

2.1. In the Phase 1 Decision, the CMA defined the market in which Seedrs and Crowdcube operate as the "supply of equity crowdfunding platforms" in the UK. The CMA has proposed effectively the same definition in the Issues Statement.

2.2. We respectfully but firmly disagree with the CMA's initial market definition. We believe that a full evidentiary analysis of our businesses and the context in which we operate demonstrates that we are each competing against all the players within the market for SME equity funding—by which we mean providers of funding for purposes of SME customers on the one side, and on the other side providers of SME investment opportunities to investor customers. Equity crowdfunding is properly viewed as one segment within that market, representing a different type of distribution mechanism but competing directly with the other firms operating in the market. In this section, we set out how we view the market and the evidence that supports that view.

2.3. **The market for SME equity funding**

There are three sets of reasons why we believe the market in which we operate is the market for SME equity funding: history, substitutability and economics.

2.3.1. <u>History</u>

2.3.1.1. Seedrs' founders set up the business over a decade ago specifically for the purpose of competing in this wider market. When we started working on the business, we looked at the market as it then stood, and we recognised that it was inefficient, expensive, clubby and opaque, and that in many ways it had hardly changed for decades.

2.3.1.2. For SMEs, the problem was cost (in time, effort, deal terms and valuation), combined with a lack of access, consistency and fairness, across a highly fragmented industry. These SMEs had the potential to raise funds through a variety of established types of investors, but accessing these sources of funding was often difficult, and the fundraising process was usually time-consuming, expensive and inconsistent.

2.3.1.3. From an investor perspective, the problem was the significant money and time involved. Investors had a number of alternative products for their preferred risk/return profile. However, those investors who—to achieve a given risk/return profile—preferred to invest directly in SMEs, needed (i) meaningful disposable capital, due to high minimum ticket sizes for offline investments, and (ii) meaningful time availability, due to the laborious and time-consuming process involved in sourcing, reviewing, conducting due diligence on, negotiating, executing, monitoring and managing the exit of such investments. The need for such significant capital and time is especially pronounced given the fact that, in this "returns-skewed" asset class, it is generally seen as important to build a broad portfolio rather than making a small number of investments. These types of investments were therefore largely limited to ultra-high-net-worth, time-rich individuals and highly specialised institutions. For all other investors, investing in SMEs would be possible primarily through indirect investments in funds raised by certain types of fund managers (e.g. EIS and VCT funds), who then deploy that capital into a range of SMEs selected by the firms. While these funds provide asset class exposure for many investors, they were (and continue to be) very expensive, with a combination of high upfront fees, annual management fees, and carry of 20% or more.

2.3.1.4. Seedrs (and, we believe, Crowdcube) saw an opportunity to solve these problems by creating an online platform that would bring much greater transparency, accessibility and consistency to SME equity funding. And by resolving many of the inefficiencies of the existing market, this sort of a platform could bring down costs for SMEs and investors alike. We believed that by effectively using technology to create a platform where businesses from all sectors and at all stages of growth could raise capital from a deeper pool of investors, we could provide effective competition against existing players and make this important part of the capital markets better, fairer and more efficient for all of its participants.

2.3.1.5. Over time, the terms “crowdfunding” and “equity crowdfunding” came to be used to describe our platforms. These were terms that the press and the public largely assigned to us, drawing on the growing popularity of political and non-financial crowdfunding in the late 2000s. Notwithstanding that these terms were a useful shorthand to describe this new distribution mechanism, we never considered equity crowdfunding to be a market in itself; instead, we always viewed what we did as being an innovative method to compete within the SME equity funding market.

2.3.1.6. So when we think about our customers, and when we pursue commercial strategies and invest in product developments to serve those customers, we recognise, and must act on the basis, that the market in which we are competing includes the wide range of industry players who serve SMEs and investors.

2.3.2. Substitutability

In the Phase 1 Decision, the CMA expressed the view that the product offerings of equity crowdfunding platforms “differ significantly” from, and therefore are not substitutable with, those of the established firms in the market. We believe this view is based on a misunderstanding of the hierarchy of needs (customer requirements) that SMEs and investors have and, therefore, what they are looking for when they engage with a fundraising or investment service.

2.3.2.1. *SMEs*

2.3.2.1.1. When an SME considers equity fundraising, it has one fundamental, overarching objective: raising capital. That is the (usually existential) need that the SME faces, and it will only engage with, and consider using, the subset of SME equity funding providers whom it believes will be able to provide it with the capital that it needs.

2.3.2.1.2. Once the SME has defined that subset of firms that it believes can provide capital to it, it will then compare those firms on the basis of a number of balancing factors, including things like prestige, marketing value (i.e. the potential of the fundraising process to also raise the SME's profile or popularity with customers), fees, valuations, personal relationships with investors, post-investment support, the efficiency of the fundraising process and the non-financial terms of a potential investment. Different SMEs will prioritise different combinations of these balancing factors at different times: an SME that feels that prestige and post-investment support is particularly important will likely prefer to raise its capital from a high-profile venture capital firm; an SME that prioritises looser non-financial terms or personal relationships with investors may prefer certain types of angel investor; and one that prioritises process efficiency or marketing value may prefer an equity crowdfunding platform. And an SME may have an overlapping mix of priorities, just as it may have different priorities at the time of different funding rounds.

2.3.2.1.3. It is these types of balancing factors on which providers of SME equity funding compete with each other. Venture capital firms tend to emphasise the importance of prestige and post-investment support, because if they can get an SME to prioritise those things, they are more likely to win the SME's business. Angels emphasise the importance of a personal relationship and the benefits of non-institutional terms, because SMEs who prioritise those things will go to them. And equity crowdfunding platforms talk about the marketing value of fundraising campaigns and the efficiency of online processes because that's what we have to offer against the other types of providers. None of these things mean that the equity funding providers are offering fundamentally different products: all of us are offering the same thing—equity capital—but we're competing with each other on the details of how we provide it.

2.3.2.1.4. If an SME thinks that, based on its balance of priorities, equity crowdfunding may be an attractive option, then it is quite likely that (assuming the SME is UK-based) it will look at both Seedrs and Crowdcube, because we are currently responsible for the substantial majority of equity crowdfunding activity in the UK. And it therefore makes sense that, when an SME that ultimately used an equity crowdfunding platform is asked about the decision it made, it will highlight its immediate decision between our two platforms (see further discussion on this in section 2.4.1.6). But that is very different from saying that we are each other's only substitutes: the SME has already been through the substitution, and elimination, process in seeking the product—equity capital—that it needs, and then only after having focused its choice on equity crowdfunding does it make a decision between Seedrs and Crowdcube. And even at that point, as the data we set out in sections 2.4.1.2 to 2.4.1.5 shows, the SME is not committed to equity crowdfunding and is still very likely to change its mind up to the point of actually launch a crowdfunding campaign.

2.3.2.2. *Investors*

The calculus for investors is a parallel one.

2.3.2.2.1. Portfolio investors

2.3.2.2.1.1. The fundamental need that any active (or "portfolio") investor is looking to satisfy when investing is return on investment. Investors want to make investments whose expected return profile is attractive in light of the expected risk: some investors prefer higher-risk investments because of their potential to generate higher returns; some prefer lower-risk, lower-return investments; and many investors want to include a mix in their portfolios. But whatever the risk appetite, the reason that any investor invests is to generate attractive risk-adjusted returns.

2.3.2.2.1.2. So just as SMEs need equity capital and then choose providers based on their different offerings, investors who need attractive risk-adjusted returns choose how to achieve those returns based on a number of balancing factors. Among the things an investor whose risk/return preference includes SME equity may look at are the availability of professional advice or selection, ease of investment, fees, valuations, portfolio management tools or secondary liquidity. An investor who wants a professional to be involved in the selection of investments may choose to invest in a managed fund (such as an EIS fund or VCT, in the case of smaller investors, or a venture capital fund, in the case of larger investors); an investor who wants to be able to negotiate valuations downward may want to be part of a syndicate led by an angel investor who negotiates price with the SME; and an investor who is keen to be able to invest quickly with a few clicks of a button is likely to prefer an equity crowdfunding platform.

2.3.2.2.1.3. Given all of this, it should come as no surprise that, once a portfolio investor has decided to invest through an equity crowdfunding platform, he or she will likely look at both Seedrs and Crowdcube as the largest such platforms in the UK. And while some investors use both platforms, it makes absolute sense that an investor who uses one platform would likely say that his or her immediate alternative choice was the other platform (see further discussion on this in section 2.4.1.7). But just as an SME will have arrived at equity crowdfunding after selecting among the various types of equity funding provider, so the investor will have chosen to invest through equity crowdfunding after concluding that, based on his or her mix of priorities, it offered the best way to seek attractive risk-weighted returns.

2.3.2.2.2. Community investors

2.3.2.2.2.1. Importantly, the primary need for return on investment is as strong for "community" investors as it is for more portfolio investors. In many equity crowdfunding campaigns, the investors are customers of the fundraising SME, and they learn about the investment opportunity from the SME rather than because they were seeking out investments in general (as a portfolio investor would). But even in these cases, the "brand loyalty" element of the investor's investment decision is fundamentally a component of his or her assessment of the opportunity: the investor has seen the value of that particular SME's products or services as a customer, and in combination with other available information, that sense of customer satisfaction leads the investor to believe that the company is likely to be successful and therefore worth investing in.

2.3.2.2.2.2. The balancing factors in choosing how to invest therefore apply just as much to community investors as to portfolio investors. If the SME that the community investor wants to invest in is only raising capital through one channel, then the investor will invest through that channel, because he or she wants the expected returns from that SME; but if the SME is raising through multiple channels (which is often the case), then the investor will weigh up the balancing factors discussed above in deciding through which channel he or she wishes to invest.

2.3.2.2.2.3. Even where an SME chooses to raise capital through only one channel—which is the one situation in which we are not in direct competition with other investment providers—competition for that SME's community investors takes place in the form of competition to attract the relevant SME to the provider's channel in the first place. There is no basis on which an equity crowdfunding platform can seek to attract these community investors to the platform other than by attracting the relevant SME. So the impact of the Merger on community investors must be seen in the light of competition on the SME side of the market, and as we make clear in a number of places in this submission, we do not believe that the Merger will reduce the intensity with which the combined business must compete for SMEs.

2.3.3. Economics

2.3.3.1. Finally, the economics of equity crowdfunding are important to the question of market definition. As we set out in section 4.3.2, for an equity crowdfunding platform to reach minimum efficient scale, it would need to fund substantially more deals each year than are currently funded by all UK equity crowdfunding platforms combined. Even achieving sub-scale profitability would, at a minimum, require funding nearly all of the deals that are currently funded through equity crowdfunding.

2.3.3.2. Given this, one of two things must be true about equity crowdfunding in the UK. On one (in our view, implausible) interpretation, it is a market unto itself, in which case it is permanently doomed to operating at a sub-scale level, with at most a single provider having any hope of breaking even. On the other view, equity crowdfunding has the potential to become a scaled, sustainable segment of the wider market because the firms in it can fight for and win deals and investors from other types of firms in the market.

2.3.3.3. In order to believe that the former of these—that equity crowdfunding is itself a market—one has to believe that equity crowdfunding platforms are competing for an essentially worthless prize. One could make marginal arguments about how ultra-long-term growth across the entirety of the equity crowdfunding landscape, combined with unexpected technological and legal innovations, could ultimately lift equity crowdfunding beyond minimum efficient scale, but even if that is possible, it would take decades. The unavoidable reality is that if UK equity crowdfunding is the relevant market, it is an inherently unsuccessful one.

2.3.3.4. Clearly we think that the other view—that equity crowdfunding is a segment that can reach scale through competing with other segments in the SME equity funding market—is the correct one. We would not have been pursuing our business all these years if we thought otherwise, and a core driver of the Merger is to make us more effective at winning deals and investors from other types of firms in the market. And when viewed in combination with the historical context and the substitutability dynamics described above, we think it should be apparent to any observer that this view is the accurate one.

2.4. Evidence for market definition

The arguments we have set out in section 2.3 are not simply theoretical. They are supported by key data and third-party commentary, which we set out in sections 2.4.1 and 2.4.2, respectively. They are also entirely consistent with Seedrs' internal documents, which we are conscious formed a part of the basis of the Phase 1 Decision, as we explain in section 2.4.3.

2.4.1. Data

2.4.1.1. The SME equity funding market is not known for its abundance of available data. Many transactions go unreported, investor activity is tough to track across multiple channels, and research reports tend to focus on broad trends rather than consistent quantitative analysis.

2.4.1.2. Nevertheless, we have looked closely at the data we hold, and at least on the SME side, we can see clearly that the behaviour of our customers and would-be customers is entirely consistent with the market definition we have laid out in section 2.3. Examining every one of the ✂ SMEs that we had made a serious attempt to attract to the Seedrs platform but had failed to win across all of 2019 and through mid-Q4 of 2020 (which represents significantly more than the number of SMEs that we actually did fund during that period), we found the following:

2.4.1.3. *SMEs lost pre-signing*

There were ✂ SMEs during the period that we had classified as "campaign qualified leads"—meaning that these were businesses we qualified as attractive targets based on an initial lead and whom we would engage in an active sales process in order to recruit them to the Seedrs platform—who did not sign an engagement letter with us. We have examined what happened to each of these SMEs and found the following:

- ✂% raised capital instead from venture capital firms, angel investors or other types of providers of SME equity finance.
- ✂% chose not to raise capital.
- ✂% raised capital instead through another equity crowdfunding platform.

✂:

✂

2.4.1.4. *SMEs lost post-signing*

There were a further ✂ SMEs during the period who signed engagement letters with us but whom we lost before they ever launched a campaign on the Seedrs platform. The destination of these SMEs was as follows:

- ✂% raised capital instead from venture capital firms, angel investors or other types of providers of SME equity finance.
- ✂% chose not to raise capital.
- ✂% left for unknown reasons (although it is worth clarifying that, given that equity crowdfunding raises are publicly disclosed, we are

confident that none of these SMEs raised through other equity crowdfunding platforms).

- ✂% were qualified out by us during our due diligence process.
- ✂raised capital instead through another equity crowdfunding platform.

✂:

✂

2.4.1.5. *Aggregate picture*

2.4.1.5.1. Across all ✂ lost SMEs therefore, ✂% were lost to another equity crowdfunding platform. The substantial majority either chose to raise capital through other types of funding providers or decided not to raise capital at all. ✂:

✂

2.4.1.5.2. This data puts clear numbers behind the point we make in section 2.3.2.1: SMEs look across the market of equity funding providers when raising capital, and they select the provider—be it venture capital, angel investors, an equity crowdfunding platform or others—that best aligns with their priorities at that time.

2.4.1.5.3. And of course, the data above only includes those SMEs that considered equity crowdfunding closely enough that they at least became campaign-qualified leads. There is then a much wider set of SMEs that dismissed equity crowdfunding as an option at a sufficiently early stage in their analysis that they never even came into our funnel, and these SMEs should be considered as part of any analysis.

2.4.1.6. *Surveys*

The Phase 1 Decision noted that the SMEs that had previously used Seedrs or Crowdcube had been surveyed, and that they indicated that had the platform they used not been available, their preferred platform would have been the other of us. That is unsurprising, because the surveys only looked at SMEs that had chosen equity crowdfunding in the first place. The data we have discussed above shows that this was far too narrow of a sample. The appropriate sample would include SMEs who looked at raising equity capital, and the responses would undoubtedly show that while some considered equity crowdfunding—and in turn evaluated both Seedrs and Crowdcube—many rejected equity crowdfunding altogether in favour of other providers. We feel strongly that, if the CMA has any question about this, it is essential to run just such a survey: we can provide the contact details for all of our lost deals described above, and we can also help identify a number of SMEs that never even engaged with us.

2.4.1.7. *Investors*

We do not hold data on "lost investors" the way we do on lost deals: whereas information about a substantial proportion of SME equity fundraises is in the public domain, investment is generally a private matter, and we have no way to identify investors who considered investing through Seedrs but chose to invest elsewhere, or indeed those who never considered Seedrs at all. Nevertheless, we are confident based on the extensive conversations we have had with investors over the past decade that it would show a very similar picture to the SME data. There would be a set of investors who chose to use Seedrs or Crowdcube (or invested through both of us) at some stage; there would then be a significantly larger set of investors who considered equity crowdfunding but chose to make their investments elsewhere; and then there would be a still wider set that never even considered equity crowdfunding in the first place. As with the SME survey, we would strongly encourage the CMA to consider running a broad-based survey of these investors, and we would be happy to help with defining the parameters of the target audience.

2.4.2. <u>Third-party commentary</u>

2.4.2.1. There has been ample press coverage of equity crowdfunding over the past decade, and while much of it has been focused on individual campaigns or platforms, there have been a number of articles that have discussed the context in which equity crowdfunding exists. Some of these articles have been favourable toward the segment, others much less so, but uniformly they have made clear that the services that platforms like Seedrs and Crowdcube offer are competitive alternatives to, rather than a distinct market from, other SME equity funding firms.

2.4.2.2. There are far too many of these articles for it to be practicable to include a comprehensive list here, but we think it may be helpful to provide a few excerpts, from across a range of publications over a number of years, as examples of how equity crowdfunding is viewed by the press and other independent third parties, as well as by some of the competing firms whom they interview:

> "A year or so ago we thought crowdfunding was for losers, and there is still a kudos to a round with a brand name VC. But the landscape is changing. In our case we turned away several VC offers, and I know from other VCs and founders that I've spoken to that this choice is becoming more common…All of the hard work of crowdfunding is also building your brand – where the work with lawyers and pitching to partners in board rooms to do a VC round may be less so. The questions you get are actually pretty similar – market, team, idea, traction – but VCs will probe deeper. A crowd

campaign has a fixed timeline but that can be a rope to hang yourself on to."

- *Crowdfunding vs VC Money – an entrepreneur's perspective*, The Next Web, 31 July 2015

"'I am an active angel investor and last year the trail went cold at the point of closing a deal with a couple of companies,' said Mr Heath. "I would find the entrepreneur on a Crowdfunding platform a week later with a valuation two or three times the amount we agreed sensible. There would be a charismatic video and the campaign would overfund in two to three days."

- *Crowdfunding charlatans to be named and shamed by new rating start-up*, Daily Telegraph, 17 September 2015. (For context, this article was about the launch of a ratings site for crowdfunding campaigns, and the paragraph above refers to the site's founder, Alex Heath, having found that equity crowdfunding platforms were luring SMEs away from angel investors by offering higher valuations. See sections 2.3.2.1 and 3.3.1.1 for discussions of how competition on valuation is a form of competition on price).

"'Crowdfunding investments won't replace expertly managed investments funds any time soon,' said Daniel Pianko, Managing Partner of University Ventures, which has approximately $300 million under management. 'But it will be an exciting part of a new investing dynamic.'"

- *The Future of Crowdfunding*, Inc., 25 January 2016

"Over the last few years there has been a striking shift in the UK's cultural appetite towards risk-taking, a move which has created a more sustainable ecosystem within an expanding investment community with many new constituents. Alongside the more traditional venture capital houses, there has been a sharp rise in new crowdfunding and peer-to-peer lending platforms, such as Crowdcube and Seedrs, and seed funds like Seedcamp and Entrepreneur First."

- *Britain will retain its golden spirit of enterprise if we keep backing entrepreneurs*, City A.M., 5 July 2016

"Until very recently, anyone running a private company in the UK would have automatically turned to the private equity or venture capital sectors when looking for their first slice of equity capital. But…online crowdfunding platforms are now more likely to provide the financing such companies are looking for."

- *How Crowdfunding Took On Private Equity and Won,* Forbes, 10 February 2017

“While [private equity] is a difficult asset class to master, there are still ways to get access to it without using crowdfunding platforms”

- *Crowdfunding: is private equity better accessed through other channels*, IG, 26 June 2019. Elsewhere in the article, it is made clear that “private equity” for these purposes includes venture capital and other types of SME equity.

“There are myriad modern financing options, and company owners advise exploring every option available to you…[KPOP Foods founder Theo] Lee has explored a number of nontraditional financing options. ‘We've turned toward crowdfunding and Kickstarter, a convertible note from angel investors, equity crowdfunding…and a SAFE [Simple Agreement for Future Equity] from a venture-capital fund.”

- *Small business owners say these 4 things are key to growth*, Business Insider, 6 November 2019

“You’ve got some inspirational market insight and created the killer idea for a business. You can see where the revenue will come from, and with a healthy margin. But what about the investment you’ll need to get it up and running?...there are various different sources…#5 Angel investors…#6 Equity crowdfunding…#7 Investment funds”

- *7 funding choices when it comes to financing your start-up*, Smallbusiness.co.uk, 22 July 2020“

“Angel investors play an important role in the success of startups, entrepreneurs, and small businesses alike. But angel investors aren't the only type of individuals investing in startups…Becoming an angel investor or other type of startup investor may be a lucrative endeavor, but before you start, it's important to familiarize yourself with different ways to invest: Angel investors; Peer-to-peer lenders; Venture capitalists; Personal investors; Crowdfunding.”

- *5 Types of Startup Investors to Know*, Money Morning, Undated (apparently 2020)

“However, while founders no longer have an obvious alternative for equity crowdfunding in particular, there are still traditional private equity channels of HNWIs, Angel syndicates, venture capital, family offices, funds and private equity firms, and in terms of competing platforms, rewards crowdfunding, P2P lending and companies like Envestry that will provide regulatory sign-off on your own equity crowdfunding campaign…it’s worth remembering that Seedrs and Crowdcube do have competition from others like Envestry, Invesdor and Funderbeam, and companies and investors will still have other options in both traditional and alternative finance. Such factors should ensure that all equity crowdfunding platforms keep themselves in check."

- *As Crowdcube and Seedrs merge – what does it mean for equity crowdfunding?*, Startups Magazine, Undated (post 5 October 2020)

2.4.3. <u>Internal documents</u>

The final set of evidence we would address is our internal documents. The Phase 1 Decision noted that each party's internal documents showed significant greater focus on the competitive threat posed by the other party than by anyone else, and that many of the references to other providers of SME equity funding appeared to be in the context of collaboration and partnership rather than competition. While we cannot speak to Crowdcube's documents, we do not view the contents of Seedrs' documents as in any way inconsistent with a market definition that includes all types of SME equity funding providers, and in this section we explain why.

2.4.3.1. *Discussions of Crowdcube*

2.4.3.1.1. We focus on Crowdcube in many of our internal documents ✂.

2.4.3.1.2. We are a small, loss-making business. Much as we would love to produce market-wide strategic analyses or spend time discussing the full scope of our business opportunities and threats, we do not have the resource to do so. ✂.

2.4.3.1.3. As we discuss in section 2.3.2.1, SMEs choose their equity funding provider based on how their particular priorities align with what that provider can offer. If an SME prioritises, for example, the prestige of the investor, there is very little we can do in the short-term to make ourselves more prestigious than a top-tier venture capital firm; likewise, for an SME that prioritises a close personal relationship with the investor, our online model cannot adapt overnight to satisfy that preference better than an angel investor can. In the medium and long run, these are things that we can and do try to address, largely by trying ✂. But as we cannot impact the immediate success of our business in this way, we do not devote significant time in our senior-level meetings to discussing it.

2.4.3.1.4. Where we can increase short-term revenue, however, is by convincing more SMEs who have already expressed a preference for equity crowdfunding to run their campaigns on Seedrs rather than on Crowdcube. These are businesses that have already decided (or are heavily inclined to decide) that equity crowdfunding represents the best balance of their particular sets of priorities. In order to win their business, ✂ to change anything that is difficult to change; instead, we need to do things like identifying the SME ✂. As a result, these are the kinds of things we talk about—alongside many other short-term initiatives for improving our services or reducing our cost bases—when our Board or Executive Committee meet.

2.4.3.1.5. Notwithstanding the above, we do occasionally discuss longer-term strategic ambitions in these types of documents. The Phase 1 Decision notes that both parties' internal documents estimate the size of venture capital investment as an "addressable market". The Phase 1 Decision says that the purpose of these estimations was unclear, but we can confirm that, at least in the case of Seedrs, these references are very much about our ambition to take a greater share of investment currently provided by venture capital firms.

2.4.3.1.6. Perhaps more importantly, it should be noted that our pitch decks include a very different set of content. These presentations, which we have used when raising or attempting to raise capital for ourselves, are the one set of documents where we do talk about our medium- and long-term strategy. ✂, prospective investors want to see where we are trying to bring the business over a longer time horizon. And in these pitch decks, ✂ we devote the bulk of our attention to our efforts to compete with firms across the SME equity funding market. Recent examples of these pitch decks have been shared with the CMA, including among others the document labelled "Annex S065 – Seedrs Final Convertible Campaign Pitch Deck".

2.4.3.2. *Discussions of other SME equity funding providers*

There are three reasons why we characterise venture capital firms, angel investors and other established funding providers as prospective collaborators rather than competitors.

2.4.3.2.1. Ability to create short-term impact

The first is the converse of what we discuss in section 2.4.3.1: there is little we can do to change our basis of competition with them in the short term, so we generally do not focus on that competition in what are inherently short-term documents (although, as noted above, we do focus on it in our pitch decks).

2.4.3.2.2. Market characterised by coopetition

The second reason relates to the nature of this market in general. SME equity funding is a market that is inherently characterised by "coopetition": putting aside the equity crowdfunding segment for a moment, every other type of provider in this market is in a regular mix of competition and collaboration with other providers (both of the same type and of different types).

2.4.3.2.2.1. Venture capital firms will fight each other for the opportunity to invest in an SME on one day, and the next day they will syndicate investment in a different SME among themselves. Angels will work together as part of a network to source and invest in deals, but then one of those angels will keep secret a deal that he or she finds particularly attractive so that that angel can take up the entirety of an allocation. And across provider type, an angel or an EIS/VCT fund manager will introduce a portfolio company to a larger venture capital firm to provide later-stage funding but will compete against that same firm for a smaller deal. This is, and always has been, the dynamic within the SME equity funding market.

2.4.3.2.2.2. So it should come as no surprise that, when equity crowdfunding emerged as a new competitor within the market, firms like Seedrs and Crowdcube found ourselves needing to both compete and collaborate with the established players. Indeed, if we weren't sharing deals and forming collaborative arrangements with these firms, that might point to the idea that equity crowdfunding is of a qualitatively different nature to other forms of SME equity funding. But because it is not, we have to operate the way the market operates, and collaboration from time to time is part of that.

2.4.3.2.3. Need established firms' support

The final reason for our collaboration with established firms is because, as a new entrant, we have needed the support of these firms in order to get a seat at the table.

2.4.3.2.3.1. This is particularly the case for venture capital firms and other institutional investors who can invest significant sums in later-stage companies: an SME that comes to us for an early round of funding will want to ensure that raising money through equity crowdfunding will not damage its chances of subsequently raising institutional capital; we therefore need to be able to demonstrate, as a sort-of seal of approval, that we work closely with prominent venture capital firms ✂.

2.4.3.2.3.2. The support of—or, more precisely, the of lack strong opposition by—these firms, as well as angels and others in the market, is also critical for direct deal acquisition. Given our size, there will inevitably be certain deals for which we are simply too small to provide the entirely of the funding in a round. In those cases, we must work alongside other funding providers if we are to gain a share of the funding opportunity, and we then compete to persuade the SME (which might otherwise rely entirely on those venture capital or angel investors) to allocate us a share of the round. This is true especially in the case of what we call "marquee" deals, which are campaigns by relatively large and well-known SMEs that have a strong base of customers and supporters who want to invest in them. These deals are important not just because of their revenue-generating potential but also on account of their positive reputational effect when recruiting other SMEs to each party's platform. They will only be able to use us, however, if their anchor investor sanctions it, which means at the very least that investor must believe that raising capital through us does no harm, and often it means persuading the investor that we bring sufficient value that it is worth the time and effort (and possibly even scale-back of the investor's planned commitment) required for an equity crowdfunding campaign.

2.4.3.2.3.3. It is therefore essential that, in order for us to compete effectively to win SME customers, both small and large, we have to demonstrate to the SMEs that we can build a smooth and effective working relationship with our competing investors.

3. Competitive Constraints

While the discussion of market definition in section 2 is an essential part of any analysis of the Merger—and it demonstrates, we think, a number of misunderstandings that will have impacted the Phase 1 Decision—we are conscious that what is ultimately relevant here is the extent to which, following completion of the Merger, the combined company would face sufficient competitive constraints without the other party as its competitor. There is no doubt in our minds that it will, and that between the constraints imposed by existing types of SME equity funding providers and those created by new entrants to the equity crowdfunding segment, the market will in fact become more competitive and thereby produce even better outcomes for SMEs and investors.

3.1. Constraints from existing types of firms

We have discussed the interaction and competition between equity crowdfunding platforms and other types of SME equity funding providers at length in the context of the market definition discussion in section 2, and we will not repeat it here. We would simply take this opportunity to emphasise that there are well over 300 venture capital firms, EIS/VCT managers and other types of institutional investors actively competing in the UK market, and there are nearly 20,000 identified angel investors. Over the past decade, alongside the growth of the equity crowdfunding segment, the numbers of these other providers has grown as well, and we have every reason to believe it will continue to do so.

3.2. Constraints from new entrants

While the constraints imposed by the many other SME equity funding providers in the market are themselves significant, it is important to remember that this is not a static market, and there is almost certain to be significant entry into the market generally and—if the Merger completes—the equity crowdfunding segment specifically. In this section we set out our perspective on the barriers to entry in the equity crowdfunding segment, the likely types of entrants, and the different prospects for entry depending on whether or not the Merger is completed.

3.2.1. Barriers to entry

While the Phase 1 Decision is correct that the equity crowdfunding segment is not without some barriers to entry, including the impact of network effects, we believe the assessment it sets out of their operation and magnitude is flawed. We would therefore take this opportunity to share our view of barriers to entry into this segment (some of which we have already communicated in response to the CMA's requests for information) and why we do not consider these to be significant hurdles for new entrants.

3.2.1.1. *Types of barrier*

There are four potential barriers to entry and expansion in the equity crowdfunding segment:

3.2.1.1.1. Regulatory approval

A number of the activities conducted by a UK-based equity crowdfunding platform are regulated under Financial Services and Markets Act 2000 (FSMA). A firm wishing to engage in these activities would therefore generally require authorisation by the Financial Conduct Authority (FCA) under Part IV of FSMA.

3.2.1.1.2. Technological development

Equity crowdfunding platforms offer fundraising and investing services through an online facility. In the case of Seedrs, we built this facility ourselves. Anyone wishing similarly to operate an equity crowdfunding platform would also need to build, or else licence, the technology required to handle the various aspects of transactional activity inherent raising capital for, and investing in, the equity of SMEs.

3.2.1.1.3. Attracting SMEs

As a two-sided marketplace, an equity crowdfunding platform needs to have meaningful "inventory" of each type of customer in order to attract the other type of customer. To attract investors from a standing start, this means having a number of SMEs raising money or prepared to raise money through the platform. Acquiring these SMEs is largely a sales activity, involving one-on-one interaction with businesses that may be looking for funding.

3.2.1.1.4. Attracting investors

Finally, attracting SMEs is dependent in part on their belief that there is sufficient capital on the platform to help them achieve their funding needs—although in the case of the types of "marquee" deals described in section 2.4.3.2.3.2, which tend largely to bring their own funding bases, this will be less the case. It is therefore important, at least for the purpose of acquiring non-marquee deals, to have an investor base that is ready to invest (or consider investing) in fundraising campaigns when they go live. Unlike SMEs, acquiring investors is primarily a marketing activity, involving digital and offline forms of advertising, PR and other brand awareness strategies.

3.2.1.2. *Overcoming the barriers*

Of the four barriers to entry described in section 3.2.1.1, the first two are reasonably straightforward to overcome. The second two barriers are the ones where network effects become relevant, but there are a number of paths to overcoming then as well.

3.2.1.2.1. Regulation and technology

3.2.1.2.1.1. Seedrs' co-founders began working on our business full-time in November 2009, and we launched to the market in July 2012. During that time, we incurred roughly £350k in startup costs in order to obtain regulatory approval (from the Financial Services Authority, as predecessor to the FCA) and build a working technology platform; a portion of that capital also went toward recruiting our first SMEs.

3.2.1.2.1.2. That is not a tremendous amount of time or money to launch a regulated business, and it would be well within the reach of many new entrants to follow the same path that we did. Moreover, a new entrant today would almost certainly have a faster, and potentially a cheaper, experience in getting to market. The time it took us from starting work until launch was largely down to two things, both of which would be very different today.

3.2.1.2.1.3. One was that many aspects of what we were doing, including especially the legal issues and platform structure/design choices, were novel, and we devoted a lot of time to figuring them out from first principles. These issues are no longer novel: the legal bases of online fundraising and investing in our asset class are now well established, and a new entrant could easily copy or adapt most aspects of platform structure/design by observing the platforms of existing firms.

3.2.1.2.1.4. The second issue we faced was that the Financial Services Authority had very little experience with startup fintech firms at the time, and therefore our authorisation process lasted much longer than it would have on a normal timetable. In the years since, the FCA has gained a huge amount of experience with (and indeed has become a world-leading regulator in) authorising fintech firms, and today startups with innovative financial services models are routinely authorised much faster than we were.

3.2.1.2.1.5. Given that much of the cost we incurred during our pre-launch period was in the form of salaries, establishment costs and so forth, a shorter timescale would in turn most likely mean a less expensive process. So as a rough estimate, a new entrant coming to the space from scratch would likely be looking at roughly a year to 18 months from inception to launch, with costs probably under £250k. For entrants already established in related investment activities (as discussed in section 3.2.2 below), this pre-launch phase would be quicker and easier still.

3.2.1.2.2. Customer acquisition

3.2.1.2.2.1. Acquiring both SME and investor customers has the potential to be a higher barrier for some new entrants. But for an entrant that had either an existing base of investors or a strong set of connections with SMEs (in particular those likely to constitute marquee deals), the process for acquiring the other type of customer would be much faster and cheaper. And for such entrants, the competitive constraint that they would exert would exist from the outset, as they would offer credibility and network advantages from the start (even before they had accumulated a portfolio of raises.

3.2.1.2.2.2. An existing base of investors would be particularly powerful. SMEs who may be looking for equity funding are relatively easy for a salesperson to identify through press coverage and online resources, and they are also relatively easy to reach (both through the many networks to which they tend to belong and due to the general lack of secrecy around their management team's contact details). The hard part is convincing them to attempt to raise capital through a platform that does not already have an investor base, as the SME will be concerned that its efforts will be unsuccessful. But if a firm already had a meaningful base of investors in place, persuading a significant number of SMEs to seek capital from those investors would not be a difficult sell.

3.2.1.2.2.3. A strong set of connections with the right SMEs would also make it much easier to surmount this barrier. While in general SMEs would want to see an existing base of investors in place (as discussed above), for certain of the larger and more high-profile ones—the ones that represent the sort of marquee deals described in section 2.4.3.2.3.2—the investor base is less of a concern. These SMEs are in a position where they can raise capital entirely from their own community, and they simply need a platform to handle the regulatory and technological elements of this type of fundraising. The bigger challenge with recruiting marquee deals is ✄. So an entrant who, for whatever reason, already had a strong network among these sorts of SMEs would be in a powerful position to recruit them. Then, as that entrant platform runs several marquee deals, it will both be attracting investors (who come via those deals or the publicity around them) and raising its profile and attractiveness with other SMEs.

3.2.1.2.2.4. In the following sections, we discuss several types of entrant who have such strong networks in place on the SME or investor side.

3.2.2. Types of entrants

With surmountable barriers to entry, the equity crowdfunding segment is very much open to new entrants, and several recent external developments have made it even more likely that these new entrants are well positioned to arrive in the relatively near future. Broadly speaking, we think there are three types of potential entrants to this segment: foreign equity crowdfunding platforms, investment platforms in adjacent spaces, and established SME equity funding providers.

3.2.2.1. *Foreign equity crowdfunding platforms*

3.2.2.1.1. One of the main groups of new entrants will be foreign equity crowdfunding platforms, especially in light of recent EU and U.S. regulatory changes.

3.2.2.1.2. So far foreign platforms have not attempted to build a meaningful presence in the UK, largely because their domestic markets have been too underdeveloped to support international expansion. In particular, the unfavourable regulatory environment in most European countries, as well as in the United States, has made it exceptionally difficult for the equity crowdfunding platforms in those countries to achieve the kind of scale needed to expand abroad.

3.2.2.1.3. All this is about to change. The new European Crowdfunding Service Providers (ECSP) for Business Regulation (Regulation (EU) 2020/1503), which was adopted by the European Union on 5 October 2020 and comes into force on 10 November 2021, creates a world-class equity crowdfunding regime for the entirety of the EU. Significant cross-border platforms are going to emerge under that Regulation, and it is only a matter of time before they achieve sufficient scale in order to acquire the resources to tackle the UK market. Likewise, on 3 November 2020 the U.S. adopted a major set of reforms to its equity crowdfunding rules, making their regime similarly favourable to that of the UK and the new EU regime (SEC Release Nos. 33-10884; 34-90300; IC-34082). American platforms are therefore poised for significant growth, and they too are likely to have the capital and operational heft to expand into the UK sooner rather than later.

3.2.2.1.4. Any of these EU-based or U.S.-based platforms is likely to be in a strong position to overcome the barriers to entering the UK market. They will already have the technology platforms in place, and while they will need to seek regulation under UK law, much of the work in doing so—building the core regulatory and compliance infrastructure—will already have been done for purposes of home country regulation. And, most importantly, these platforms will already have a substantial base of SMEs and investors from their existing markets, meaning that acquisition of UK SMEs and investors is likely to happen quickly and at no greater cost than what Seedrs or Crowdcube incurs to acquire new customers.

3.2.2.2. *Investment platforms in adjacent spaces*

3.2.2.2.1. Another group of likely entrants are firms that provide fundraising and/or investing services online in other asset classes. This includes online share dealing platforms, peer-to-peer lending platforms and other "adjacent" platforms who do something similar to what we do but for a different type of investment.

3.2.2.2.2. Unlike foreign equity crowdfunding platforms, who still need to reach scale at home, many of these adjacent investment platforms are already many-fold larger than Seedrs and Crowdcube combined. They include substantial firms like online share dealing platform Hargreaves Lansdown (which is listed on the LSE Main Market and included in the FTSE 100) and peer-to-peer lending platform Funding Circle (which is also listed on the LSE Main Market), and they even include mega-firms like Goldman Sachs, whose Marcus lending platform quickly became a major player in the online lending space and could relatively easily expand to equity if it so chose. Alongside these large firms are a number of somewhat smaller firms—like AJ Bell, Interactive Investor, Zopa and many others—that are nonetheless significantly larger than Seedrs and Crowdcube together.

3.2.2.2.3. In addition to being large and well-resourced businesses, these adjacent platforms are particularly well positioned to overcome the barriers to entry to expand into our market. For the most part they are already FCA authorised and so would need (at most) only limited variations of their permissions, and they already have advanced technology platforms which would require only a certain amount of adaptation to work for SME equity. Critically, they also already have strong investor bases—in many cases much larger than those of Seedrs and Crowdcube together—so they would be immensely attractive to SMEs seeking to raise capital.

3.2.2.3. *Established SME equity funding providers*

3.2.2.3.1. The final group of potential entrants are existing SME equity funding providers—including venture capital firms, EIS/VCT fund managers, angel groups and others—who may adapt their models to include an equity crowdfunding element. (For the reasons discussed in section 2, we already consider these providers to be our direct competitors within the SME equity funding market. However, if the CMA were to take a narrower view of the market as solely "equity crowdfunding", such players would be "new entrants" under such a definition.) Just as we look to create features and services that make us more effective competitors against these established firms, so they may look to compete against us by matching our approaches.

3.2.2.3.2. The ease with which one of these firms could overcome barriers to entry will depend entirely on how it operates today. It would probably already be regulated, so like the adjacent investment platforms, it would at most need a variation of permissions from the FCA. It may have the base of a technological platform, and while presumably a material amount of further development would be required, as discussed in section 3.2.1.2, the burden of that development would not be substantial. And then there is the question of customer acquisition: depending on the nature of the firm, it could well have a strong set of relationships with the types of SMEs who would run marquee deals, and those relationships could be leveraged to build up the investor and wider SME customer base; alternatively, certain established firms, including especially EIS/VCT fund managers, may have a strong base of active retail investors whom they could convert to online investing, and customer acquisition could proceed from there.

3.2.3. Motivation to enter

3.2.3.1. While there are many potential entrants into the equity crowdfunding segment, no one has made a significant attempt to enter it in the last few years. The fact that the opportunity for foreign equity crowdfunding platforms is a forthcoming one is discussed in section 3.2.2.1, but adjacent investment platforms and established SME equity funding providers could have entered the segment in recent years, and they have not done so.

3.2.3.2. The reason for this lack of entry is the apparent unattractiveness of equity crowdfunding from a financial perspective. As discussed in substantially greater detail in section 4, neither Seedrs nor Crowdcube, as the two largest firms in the segment, have yet been able to turn a profit, and we both remaining meaningfully sub-scale. While in early days there was significant optimism in the wider market about the growth potential of equity crowdfunding, our understanding from conversations with a range of other market players is that, in recent years, most knowledgeable observers doubt that there would ever be the potential to make meaningful returns on investment by doing what we do.

3.2.3.3. In that context it is easy to understand why we have not seen entry into this segment, and indeed it would be difficult to comprehend why any firm would enter it under current circumstances, no matter how easy it may be to surmount the barriers. But at the same time, if the Merger produces its intended outcome—the creation of a scaled platform that is able to operate sustainably—the segment will inherently become substantially more attractive to entrants. And at that point, given everything discussed above about barriers to entry and the scope to overcome them, we would expect significant levels of entry to begin.

3.3. **Impact of constraints**

The constraints that are imposed on us—and that would be imposed on a combined firm following completion of the Merger—by existing SME equity funding providers and potential new entrants play exactly the role that they should do in a competitive market: they heavily restrict our ability to raise our prices; and they strongly disincentivise us from degrading the quality of our service.

3.3.1. <u>Prices</u>

We appreciate that, in the absence of sufficient competitive constraints, one may be concerned that, following the Merger, the combined company would seek to raise the prices charged to SMEs, investors or both. It is clear to us—and we have agreed to, and are preparing for, the Merger on the basis—that this will not happen, as the constraints we have described in sections 3.1 and 3.2 would make attempted price increases counterproductive and value-destructive.

3.3.1.1. *SME pricing*

3.3.1.1.1. The fees that we charge to SMEs vary based on a number of factors, including ✂ and often the SME's own preferences (for example, between a fixed fee and a percentage-based fee). Valuation and third-party costs also play a role: some SME equity funding providers, such as venture capital firms, tend to charge no direct fees at all, but the SME instead bears costs in the form of lawyers' fees (often the SME will be required to pay for the venture capital firm's lawyers as well as its own), and it may find that the valuation it attracts is lower than what other, fee-charging funding providers can offer. As a result, there is not one single market price for SME equity fundraising services, and there will always be some degree of dynamism to prices no matter what the market structure.

3.3.1.1.2. Nevertheless, there are clear and long-established practices around fundraising commission levels, set through years of practice by venture capital firms and other established players, and in our experience SMEs are generally very conscious of whether a fee proposal is outside the accepted norms for the relevant types of deal. Given that the loss data described in section 2.4.1 shows significant levels of diversion even at current prices, it is clear to us that any unfavourable change in prices would simply amplify that diversion and lead more SMEs to choose a different source of funding rather than equity crowdfunding. And as new entrants come into the equity crowdfunding segment, as discussed in section 3.2, the ease of this diversion from the SME's perspective—and therefore the impact of it on us—will become all the greater.

3.3.1.2. *Investor pricing*

The dynamic for investors is similar. As with SMEs, pricing for investors in this market is not entirely simple, with different providers charging different combinations of upfront fees, ongoing management fees and carry. And here, too, valuation plays a role: a higher fee may be worthwhile if that allows for an investment at a relatively lower valuation. But no matter what the structure, the fees and valuation all form part of the returns calculus: as we discuss in section 2.3.2.2, an investor's ultimate objective is achieving attractive risk-weighted returns, and in practice this means returns net of fees. So any increase in fees will decrease returns, and that will lead to investors diverting to other providers.

3.3.2. <u>Quality</u>

3.3.2.1. We are conscious that the other main risk to customers from a lack of sufficient constraints would be a degradation in the quality of the combined company's service compared to what each company provides today. Here, too, we are confident that the constraints we face from existing players and new entrants, combined with certain of the realities around how our service has developed and can be improved over time, effectively eliminates this risk.

3.3.2.2. One of the biggest competitive advantages we have against traditional (especially offline) providers of SME equity funding is the quality of the service that we can provide through use of technology. As discussed in section 2.3.1, the basis of our entry into the market in the first place was the opportunity we saw to create a simpler and more efficient way of raising capital and making investments in this asset class. We are at an inherent disadvantage to established players in some regards—we are long way from having, for example, the prestige of a prominent venture capital firm or the personal engagement of certain angels—but a big part of why we win business from them is because we offer a faster, more transparent and overall better experience than they do. Any sacrifice of the quality of this service would therefore undermine one our biggest attractions for SMEs and investors alike, and just like with a price increase, we would see increased diversion. At the same, new entrants to the equity crowdfunding segment will undoubtedly arrive with robust technology platforms that match or exceed our current levels of service, and so any degradation would put us behind them.

3.3.2.3. The other point on quality of service relates closely to parts of the discussion in section 4. One of the consequences of the current competitive dynamic in the UK equity crowdfunding segment is that ✂. We are both at our core innovative businesses that set out to build platforms that would constantly develop and improve, but due to resource constraints we are now very limited in our ability to invest in this sort of development. The key objective of the Merger is to put the combined company on sounder financial footing than either of us are on today, and doing so will not only allow to us to operate sustainably but will also, in time, give us the freedom to invest meaningfully in making the experience better for customers. So quite the opposite of degrading our service, the

Merger is very much about allowing us to drive innovation and improve service going forward.

4. **Counterfactual**

4.1. The CMA set out in the Phase 1 Decision a contention that the appropriate counterfactual against which to assess the Merger is the prevailing conditions of competition, and the Issues Statement similarly indicates this to be the starting point of the analysis. We respectfully but firmly disagree with this contention, and we would emphasise as strongly as we possibly can that the prevailing conditions of competition are not sustainable and will not last beyond the very short term.

4.2. ✂.

4.3. **Financial position**

One of the apparent drivers of the CMA's view on the counterfactual in the Phase 1 Decision was its understanding of the economic picture and health of our businesses. This analysis was based on a significant misunderstanding of our accounts (and, we believe, Crowdcube's, although we cannot comment on those in detail), and we wish to correct it here.

4.3.1. Gross profit

4.3.1.1. The cornerstone of the CMA's evaluation of the business' economics, as set out in the Phase 1 Decision, was that both businesses have "healthy gross profit margins", and that their lack of net profit was "due to reinvesting gross profit back into their platforms". This a highly inaccurate description of our financial position.

4.3.1.2. Under FRS 102, which is the accounting standard pursuant to which we are required to prepare our accounts, only a very limited subset of our variable costs can be classified as cost of goods sold (COGS). As COGS is the only deduction from revenue when calculating gross profit, it is therefore unsurprising that our technical gross profit margins appear significant. But what is not included in that measure is (1) the other variable costs we incur as part of revenue generation (including, without limitation, our cost to serve and our cost of acquisition) and (2) both the variable and fixed components of our overheads that are necessary in order to conduct our business. When these costs, alongside COGS, are deducted from revenue, ✂ deep into negative territory.

4.3.1.3. Meanwhile, only a ✂ limited proportion (less than ✂) of our costs at this stage are actually growth costs, meaning that they reflect investment in future opportunities rather than current revenue generation. So the implication that we are incurring losses voluntarily, and that we could become profitable if we simply decided not to invest in growth, is profoundly inaccurate.

4.3.2. Profitability and minimum efficient scale

4.3.2.1. In response to one of the CMA's requests for information, we prepared and submitted a detailed analysis of the microeconomics of the Seedrs business, labelled "Annex S080 – Seedrs Micro-Economic Analysis". This document includes the levels at which we would reach, respectively, minimum efficient scale and sub-scale profitability. While we believe it is important to read that analysis in whole, we would summarise the two key conclusions here.

4.3.2.2. The first is that, for Seedrs to reach minimum efficient scale, we would need to be funding ✂, per year. This would represent ✂ growth in our deal volumes, and it would constitute over ✂ the number of deals funded by the entire UK equity crowdfunding segment today. This number would come down a bit with an increase in average deal size, but it is nonetheless very far away from where we are now.

4.3.2.3. The second is that, while profitability could be reached at a sub-scale level, even that requires ✂ growth over where our business is today. We estimate that the absolute minimum number of funded deals on which we could be profitable is ✂ of our current deal volume, and it includes assumptions about a material increase in average deal size (with no such increase, the required number of deals is ✂).

4.3.3. <u>Cash</u>

The final, and most critical, component of our financial position is the interaction of our cash position with the amount of time it would take to reach even sub-scale profitability. ✂one point we would note here is that, as a regulated financial services business, we maintain a certain level of regulated capital at all times. So whatever the apparent level of cash at hand our financial shows, there is a proportion of that which cannot be touched. And a breach of regulatory capital would (if not quickly cured) lead to the loss of our regulatory authorisation, and therefore our ability to conduct our business. We are therefore working within a cash envelope that is materially narrower than it may appear in our accounts, or indeed than it would be for a non-regulated firm.

4.4. Scenarios for the future

In light of the financial position described above in this section 4.3, there is no plausible path to continued competition between Seedrs and Crowdcube beyond the very short term. One of the two of us will run out of cash before profitability can be achieved, and that will be the end of that firm's business. From there, we see one of two possible scenarios emerging:

4.4.1. <u>One surviving firm</u>

4.4.1.1. One scenario is that enough customers and would-be customers of the failed firm move over to the surviving firm, and it is to operate as the sole equity crowdfunding platform in the UK. At one level this is a similar outcome to the Merger, and if the surviving firm can then establish the financial attractiveness of the equity crowdfunding segments, then just as in the case of a post-Merger combined firm, new entrants would come into the market as described in section 3.2.

4.4.1.2. However, unlike in the sort of orderly combination contemplated by the Merger, a disorderly exit would have a number of disadvantages. First, the surviving firm would not get the benefit of the failed firm's technology, expertise and relationships, and therefore it would be significantly less well positioned to innovate and improve its product than if the Merger had taken place. The exit of either firm would therefore set back the development programme of the surviving firm by years as compared to the Merger. In turn, this would significantly delay the surviving firm's ability to drive forward initiatives to allow it to better compete with established SME equity funding providers.

4.4.1.3. The other big disadvantage of a disorderly exit stems from the fact that both firms have thousands of their own investor customers as shareholders (as a result of having raised multiple rounds of finance through their own platforms). While we recognise that the impact on a business's owners is not typically a factor in a competition analysis, Seedrs and Crowdcube represent a somewhat unusual case (although one that is similar to that of many of our SME customers) in that our investor customers are our shareholders, and they would suffer real harm—through complete eradication of the value of their equity—if the firm in which they had invested fails. No such harm would arise in the case of the Merger, which was agreed on terms that are favourable to both sets of shareholders.

4.4.2. <u>No surviving firms</u>

4.4.2.1. The scenario described in section 4.4.1 is problematic, especially given the alternative offered by the Merger, but it is the less bad of the two possible outcomes from the failure of one firm. The other possible outcome is that the failure of one firm causes sufficient reputational damage to the developing equity crowdfunding segment in general that SMEs and investors abandon this type of fundraising and investing for a period of time or even altogether, and eventually the firm that initially survived fails as well.

4.4.2.2. A failure of one firm would undoubtedly raise questions by SMEs, investors and the press regarding the credibility or legitimacy of equity crowdfunding platforms. Meanwhile, there is currently no incentive for the established SME equity funding firms to stop the failure of a platform that, as we explain in detail elsewhere in this submission, poses a competitive threat to them. If these forces result in the surviving platform then failing, there will be zero equity crowdfunding platforms in the market; and given the circumstances, it seems unlikely that new entrants would find the market an attractive one to step into at this stage either.

4.4.2.3. The end result would therefore be that all of the benefits that the equity crowdfunding segment has brought to SMEs and investors over the past decade would evaporate. To an extent we might leave a legacy of having helped push other sources of SME equity funding to improve their propositions over the period, but for the most part the market will return to the position we found it in when we first set out to build our businesses.

5. <u>Benefits of the Merger</u>

5.1. The combination of Seedrs and Crowdcube will provide substantial and lasting benefits to both our SME and investor customers. Many of these benefits will be felt directly by customers, but there will also be indirect benefits resulting from the Merger's wider impact on the market. We think it may help provide a complete picture of how we view the Merger if we briefly summarise these benefits here.

5.2. **Direct benefits**

The Merger will allow the combined platform to offer a better service, with more choice and richer features, for SMEs and investors either of the parties can provide today.

5.2.1. <u>Liquidity and dealflow</u>

5.2.1.1. SMEs will have access to the substantially deeper pool of liquidity that comes from having Seedrs' and Crowdcube's investor bases all sitting on one platform. As discussed in section 2.3.2.1, the main reason that an SME uses one of our platforms is for access to our investors and the capital they provide. While there are some investors who are registered with both platforms, there are many who currently invest only through one of the two, and therefore an SME who uses the other platform will not benefit from their potential investment. A combined platform will substantially increase the number of investors viewing, and therefore the amount capital available to, each SME customer.

5.2.1.2. Investors, meanwhile, will have access to a significantly wider range of investment opportunities all in one place. As discussed in section 2.3.2.2, investors want attractive risk-adjusted returns. When they choose to seek those returns by investing in SMEs directly, they benefit from having a greater choice of potential investments. And while investors are able to invest through both platforms today, monitoring new deals and administering holdings through multiple platforms is inconvenient (especially given that these investors are also likely to have online share dealing accounts for public market securities, peer-to-peer lending accounts for private debt or other types of investment facilities to manage).

5.2.2. <u>Combined existing features</u>

Seedrs and Crowdcube have each developed a number of distinctive service features that benefit our respective SME customers. For example, Seedrs' secondary market helps provided early exit opportunities to investors, and it helps reduce the pressure on SMEs to seek a company-level exit. Likewise, Seedrs' Anchor Investor Service helps SMEs find cornerstone investors for their campaigns. Meanwhile, Crowdcube's mobile app makes it easy for SMEs and investors to engage with each other while on the move, and they have substantial experience and capability in handling certain types of large, community-driven campaigns. Through a combined platform, which is committed to adopting the best of what Seedrs and Crowdcube offer today, SMEs and investors alike will be able to take advantage of these and many similar features all in one place. In the absence of the Merger, neither party is likely to have the resources to develop the other's features on its own.

5.2.3. Development of new features

As we discuss in section 3.3.2.3, the current dynamic of the market, including in particular the financial positions of each the parties, has meant that neither Crowdcube nor we are able to invest meaningfully in the development of new and innovative features today. We entered the market as an innovative firm with a strong desire to build ever-improving products and services, and in the past we have pioneered a number of exciting initiatives—including, among others, our secondary market, our AutoInvest feature, our algorithmic fund products and our Anchor Investors Service—that have added significant value for our customers. We can no longer do that as a standalone platform given our need to preserve cash and focus solely on activities that generate short-term revenue. However, as a combined company on sounder financial footing, we will be able to begin investing again in new and innovative features.

5.3. **Indirect benefits**

Beyond the sort of the direct benefits summarised in section 5.2, customers will also gain from the impact that the Merger as on the SME equity funding market.

5.3.1. Pressure on existing competitors

A more robust, more innovative equity crowdfunding platform will be a more effective competitor against other SME equity funding providers in all senses. In addition to being better at winning deals and investors, and thereby achieving the scale needed for long-term sustainability, our position will force other providers to improve their products and services in order to compete against us. This means that even where we are not winning new business, SMEs and investors will benefit from better offerings elsewhere in the market.

5.3.2. Attractiveness to new entrants

As we discuss in section 3.2.3, the equity crowdfunding segment of the SME equity funding market is not particularly attractive to potential new entrants today, as the two largest firms in it are unprofitable ✂. Following the Merger, we believe the combined company will demonstrate that equity crowdfunding is a segment in which there is opportunity for both profit and further growth. We would expect that will be the key turning point for the types of entrants we discuss in section 3.2.2 to beginning taking a serious look at entering the segment, and when they do so, that will provide further choice and opportunity for SMEs and investors.

5.3.3. Confidence in long-term sustainability

✂, SMEs and investors alike are aware that both Crowdcube and we remain unprofitable, sub-scale businesses, and they know that the equity crowdfunding segment is still a relatively new part of the SME equity funding market. ✂. The Merger will help create that confidence, and in so doing make equity crowdfunding an increasingly attractive option for those customers who would otherwise be worried about the segment's sustainability.

6. Conclusion

6.1. Equity crowdfunding is an exciting and valuable form of funding and investing in the equity of SMEs. We are proud of the role that Seedrs has played in developing this segment in the UK over the past decade and giving so many businesses and investors a simple, efficient and cost-effective way to access capital and make investments.

6.2. We are now at a crossroads. Over the next few years, equity crowdfunding in the UK could thrive as an increasingly effective competitor against venture capital firms, angel investors, corporates and other established (Goliath) firms, providing more benefits to more SMEs and investors across the country. We have chosen to pursue the Merger because we believe that doing so is the best way of making that future a reality.

6.3. But equity crowdfunding could just as easily go the other direction. Stymied by the need to drive for materially greater scale and the disaffection of the capital providers who have run out of patience for supporting that drive, one or both major firms in the segment will exit, and the opportunities for SMEs and investors will at best be far reduced from what they could have been, and at worst they will evaporate entirely. In the absence of the Merger, this is the future that will materialise.

6.4. We therefore very much hope that the inquiry group and Phase 2 team, having now had the opportunity to review significantly more information—and more detailed perspectives—on how the SME equity funding market works, the role of equity crowdfunding within it, and the current position and prospects of the parties, will allow the Merger to proceed.