Louvain School of Management

INDEPENDENCE OF THE SME

What tools and strategies can entrepreneurs use to keep developing their company while maintaining their independence?

Auteur : Juliette Hamer
Promoteur(s) : Pr. Xavier Desclée de Maredsous
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Place des Doyens, 1 bte L2.01.01, 1348 Louvain-la-Neuve, Belgique | **www.uclouvain.be/lsm**

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PART I: INTRODUCTION

Chapter 1: General introduction

In this chapter, I will introduce the main topic that will be further developed in this thesis, the different options available for an entrepreneur to finance their company's growth. Afterwards, the research question will be explained, along with a quick introduction to the structure that will be followed.

1. SMEs and financing

Financing patterns of SMEs

Financing sources for SMEs come in all shapes and sizes. In this thesis, various possibilities will be assessed. Variables of interest include the stage of development at which they are most useful as well as the level of control kept in-house after having contracted such financing. In this section, a quick overview is given on how a typical SME chooses to fund itself. Of course, this will be expanded throughout the literature review and only gives a first, very limited taste of the financial ecosystem surrounding SMEs and start-ups.

The first, maybe most evident, source of financing for any firm arises from its own retained earnings. This is what we call "Internal financing" (Mihaela, 2013). In general, de Andrés, de la Fuente, & San Martin (2018) found that managers rated this form of finance as the most important one. Interestingly, over 50% of high growth Belgian companies declare using retained earnings as a means of development (Manigart & Witmeur, 2009).

The second common financial tool for companies is debt. It seems, in this case, that SMEs and in particular young firms have difficulties accessing formal bank loans due to important information asymmetries (Chavis, Klapper, & Love, 2011). Accordingly, Daskalakis, Eriotis, Thanou, & Vasiliou (2014) found a debt ratio that is negatively related to the firm's size. In 2013, Daskalakis, Jarvis, & Schizas also found that SMEs would generally like to use more long-term debt than they currently do. This phenomenon will be further analysed in the next section on the financial gap.

The third generic means for companies to access finance is by selling additional stock. In general, Daskalakis & al (2013) show that SMEs are reluctant to use outside equity as they fear a loss of control. Various sources of equity funding exist, involved at different stages of development. First, an entrepreneur can rely on relatives and friends to provide initial capital. These investors are commonly known as "Family, Friends and Fools" (FFF). They invest mostly based on sentimental proximity (Weinberg, 2009). Later, Business Angels can provide a follow-up capital, before having to call on professional investors (Mulcahy, 2005; Manigart & Witmeur, 2009). The next step involves Venture Capitalists. These are typically organised in professional organizations and invest higher amounts (OECD, 2015). It is important to note, however, that these last two stakeholders (Business Angels and Venture Capitalists) still represent a very low percentage of total funding obtained by SMEs (Lam, 2010). For even more developed companies, two other funding options exist. First, Private Equity firms can be included in the capital, often leading to a radical change in the business (Arango Vazquez & Durango Gutiérrez, 2014). Finally, the firm can turn to public equity in order to raise significant amounts of funding while maintaining control of the company thanks to a large pool of small contributors (Rosett & Smith, 2014). Unfortunately, this method of financing, although growing, is still of low importance among SMEs (Nassr & Wehinger, 2015).

In this thesis, the use of state aid for start-up and SME development will also be considered. This help generally comes at very early stages of development or to help specific growth projects such as international expansion (Igretec, 2019). Unfortunately, Daskalakis & al (2013) still observe a significant informational gap regarding grant financing in particular, preventing some entrepreneurs from fully taking advantage of these benefits.

Finally, the last chapter will be dedicated to a fast-growing financial alternative, the various forms of crowdfunding (Roma, Messeni Petruzzelli, & Perrone, 2017; Viotto da Cruz, 2018). Crowdfunding refers to a way for an individual or a company to obtain funding, usually through a web platform, from a large crowd of informal investors (OECD, 2015; Wilson & Testoni, 2014). Based on the category, amounts raised on these platforms vary significantly. Donation-based crowdfunding is usually used for small amounts or for philanthropic projects (Mejri, Hamouda, & Trabelsi, 2018). Rewards-based crowdfunding is usually used by project leaders who want to start commercializing a product and need the initial funds to launch production (Belleflamme, Lambert, & Schwienbacher, 2014). The two next categories involve more developed financial tools and are of more interest to this thesis. Entrepreneurs can issue debt – usually lower amounts are raised - or equity on such platforms (Goy, 2019). The first option has largely developed as an alternative to bank finance (Ahern, 2018). The second answers rather to the shortcomings of formal equity investors, which require a lot of information and take large shares of capital (Mejri & al, 2018; Harriet, Abdoune, & Bentebbaa, 2017).

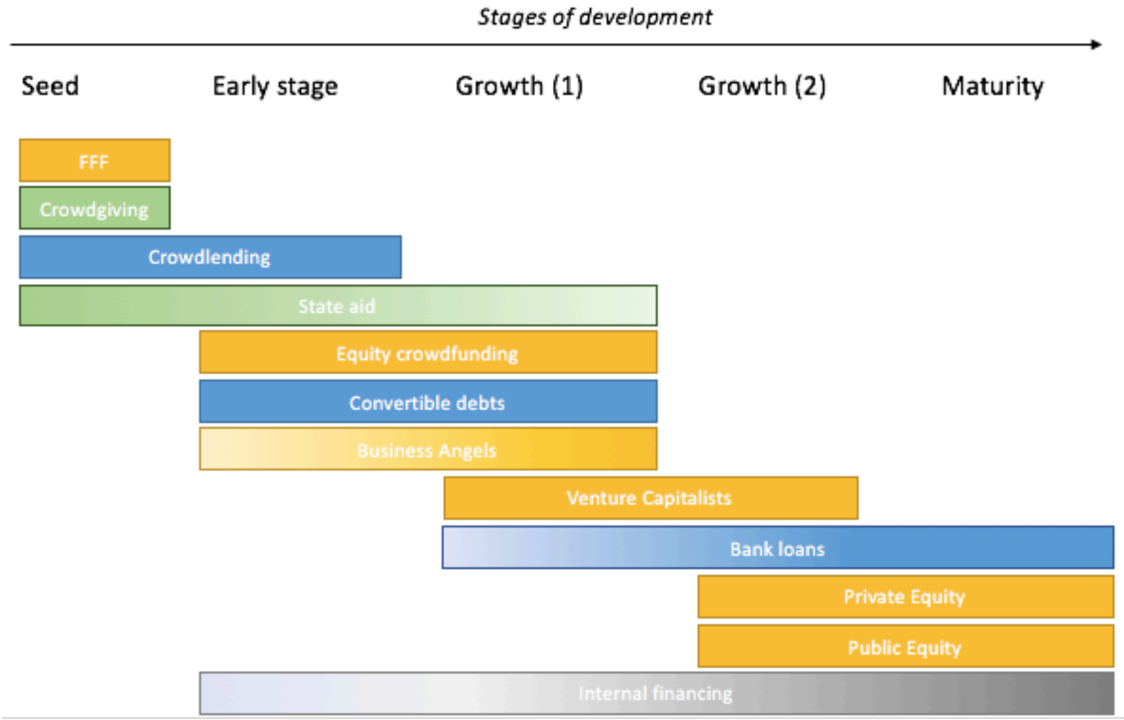

Figure 1: Financial stakeholder by stage of development

The financial gap

The financial gap, also called funding gap or equity gap, refers to a situation in which a company has a capital need which cannot be matched by the funds offered by private investors or lenders (Waniak-Michalak, 2017). This gap exists because of market failures in the financing industry, making it difficult for SMEs to access external finance (Veugelers, 2008). Those failures are considered to be the result of information asymmetries between the banks and the small firms in need of funding. Indeed, due to very limited information on the SME's financials, it is difficult for the lender to assess credit risk and, therefore, provide suitable loan conditions (Brighi, Patuelli, & Torluccio, 2012). Waniak Michalak (2017) found significant evidence for a funding gap at the micro-enterprise level.

Institutions have been taking steps to help SMEs overcome this issue. An OECD report (2015) namely shares a number of initiatives taken by countries to support SME financing, such as tax benefits for investors or innovative debt instruments. Tools that can be developed through direct state funding include credit guarantees, loans or subsidies (Waniak Michalak, 2017).

A final consideration in this section concerns divergent opinions on the existence of a real financial gap. Landstrom & Winborg (1995) argue that academics and governments tend to focus too much on the supply side of the funding, where actors are, indeed, unwilling to fund SMEs. However, by looking at the demand side of the financing equation, they found that only a small percentage of companies wish for additional capital. Similarly, Vos, Yeh, Carter, & Tagg (2007) find that only 1.32% of US SMEs consider they have a shortage of capital concerning something else than simple working capital. These results can be surprising considering the relative low supply of funding for small companies. A few explanations have, however, been developed by academics. It seems not all entrepreneurs have growth as their main objective (Vos & al, 2007). Indeed, some firms – and, in particular, family businesses – will opt for a conservative growth behaviour in order to maintain maximal control over the long term (Hamelin, 2013). This is reflected by a general reluctance to issue further equity to external investors, as observed by Daskalakis & al (2013).

2. Research question

With such a scattered array of possibilities for start-ups and SMEs to obtain financing, it seems interesting to provide entrepreneurs with a detailed understanding of the pros and cons of each. In this thesis, the ability for start-ups to remain independent will be considered the central point from which all those advantages and disadvantages will be analysed. The research question that has been formulated is then the following: ***"What methods should the entrepreneur use in order to finance the development of his enterprise, while maintaining its independence?"***

In order to achieve this, the different ways of obtaining funds introduced in the first section of this chapter will be developed thoroughly in the literature review. Later, qualitative interviews will be carried out with a series of entrepreneurs as well as with representatives of different financial stakeholders. An assessment of the entrepreneur's motivations when accessing one funding source or another will be provided as well as some insights on the resulting performance of the company in later stages of development. Some quantitative aspects will also be used in order to compare the outcomes of two early-stage financial tools, equity crowdfunding and business angels.

Chapter 2: Why is this topic important in today's world?

1. The importance of SMEs and entrepreneurship

When 99.8% of all European companies are SMEs and create together two thirds of the total employment in the union, it is easy to understand their relevance in any research (European Commission, 2011). Unfortunately, it seems young firms have a higher chance of survival in the US than in Europe, which may be the consequence of an unfavourable environment (Schlogl, 2004). In this section, I will discuss the various reasons countries should invest in SME development, such as their impact on country growth, job creation, market competition and innovation.

According to an economic tradition started by Schumpeter in 1934, there is an optimal industry structure that will maximize a region's growth at any point in time (Sledzic, 2013). In the last decades, the rise of globalization and a decentralized market have led to an ideal structure which is also more decentralized, hence giving more importance to small firms (Carree & Thurik, 2010). As a consequence, countries and regions have tried to incentivize new firm creation and financing. In Belgium, for instance, a tax shelter has been installed since 2015 to make it more attractive to invest in young ventures. A similar tax advantage was also put in place for scale ups later on, recognizing their importance in the economic stability of the country (Service Public Fédéral [SPF] Finance, 2018). Thirty-two OECD countries have explicit incentives for investors contributing to entrepreneurial projects (OECD, 2015). The question is then: are we sure these policies are effective? Multiple authors have found an empirical link between entrepreneurial activity and country growth (Carree & Thurik, 2010; Parker, Congregado, & Golpe, 2012). OECD reports also underline the importance SME play in establishing long-term growth (OECD, 2015). Interestingly, Parker & al (2012) found that the relationship between economic growth and entrepreneurship is bilateral. While they find a high level of self-employment will boost growth, they also argue that growth boosts self-employment.

Michael & Pearce (2009) argue there are other reasons than average growth for countries to promote entrepreneurship. Job creation is one of them. Gittell, Sohl, & Tebaldi (2014) show that entrepreneurship will indeed lead to higher employment in a country. Second, Michael & Pearce (2009) explain that countries will tend to favour new venture creation as a means to increase competition and, therefore, lower prices. However, their main point is to show that entrepreneurship should be encouraged because it will lead to higher innovation. Indeed, entrepreneurial firms tend to innovate better and more than larger corporation. An evidence of this is found in the way large corporations tend to innovate. More and more, they are outsourcing their innovative capacity, accessing technologies developed by SMEs (Veugelers, 2008). Innovation is also a factor in growth, job creation and price reduction. Because of these obvious links, many authors tend to consider innovation and entrepreneurship as very similar research fields (Sahut & Peris-Ortiz, 2013).

2. The willingness to stay independent

Motivations

As developed in the previous section, it is highly relevant for a country's economy to have sufficient independent SMEs growing, innovating and creating jobs. In this section, the rationale for independence on the entrepreneur's side will be analysed. It should first be mentioned that there is often a clear dichotomy observed between independence oriented enterprises and those that focus more on growth (Douglas, 2013). This orientation is determined at the very early stages of the firm creation through the personal characteristics of the founding team (Douglas, 2013).

Many reasons for an entrepreneur to be willing to remain independent are found in the literature. For instance, Estay, Durrieu, & Akhter (2013) found that typical entrepreneurial motivations include risk-taking, accomplishment, control and creativity. While the term control seems like the most linked to their independence, all other aspirations can be derived from it. Indeed, if somebody else is managing your start-up, your sense of accomplishment as well as your creativity will be severely diminished. Similarly, when the risks are shared amongst various decision-makers or even completely handled by the corporate headquarters, the "thrill" for the entrepreneur tends to disappear.

In summary, the growth expectations and achievement of a venture will be positively influenced by the importance the entrepreneur puts on financial success. On the other hand, it will be negatively affected by a personal willingness to remain independent (Cassar, 2007). Yet, the same author (2007) found that this independence objective was the main motivation for founders. These results are in line with the findings of Walker and Brown (2004) who state that non-financial, lifestyle criteria are rated higher by business owners when evaluating the success of their venture.

What is independence?

In order to determine whether a firm is independent or not, two factors will be considered. First, the ownership structure of the firm can be used to measure the level of independence of the founders. Different levels include founders and employees owning the whole firm or over 50% percent of the shares. In the latter situation, the remaining shares are either listed on the stock market or owned by private investors. Other situations include one in which the founders own less than 50% of the shares but are still reference shareholders due to the diversity of other investors. Finally, the founders can be in a situation in which they own less than 50% of the shares and are no longer reference shareholders, due to the presence of one large investor in the capital.

The second aspect to be considered is the distribution of the decision-making power within the firm. Here again, a few situations can occur. The founders can have full decision-making power or share it with other shareholders, either keeping the final say or only keeping informal influence. They can also enter in extended partnerships with larger firms which is bound to give away some non-formal decision-making capacity. For instance, having a large company as main client or supplier can limit the smaller firm's ability to move.

In this thesis, I will consider a firm independent either if the founders are the main shareholder or have formal decision-making power over the firm. In the case of a partnership or heavy relationship with another actor in the industry, we observe a continuum of levels of independence from each of Porter's five forces. This can, therefore, be used as a red flag for a takeover or bankruptcy risk but as long as there is no formal control from one firm on the other, I consider them to be independent. Note that this section is based on intuition due to a lack of literature referring to the definition of small firm independence. The qualitative research conducted for this work will attempt to partially fill that gap.

3. The need for financial literacy

Financial literacy, as defined by Mwangi and Kihiu (2012) refers to sufficient knowledge of financial instruments that enables the consumer to appreciate risks and opportunities and, therefore, to make the right choices for their personal as well as professional lives. Delic, Kurtovic, & Oberman Peterka (2016) rather call financial literacy the "knowledge of advantages and disadvantages of individual available sources of financing". While this concept can be applied to individuals, the focus of this section will be on the financial literacy of SMEs.

The potential for growth of a company is naturally influenced and limited by its capital structure (Delic & al, 2016; Mateev & Anastov, 2010). When access to financing is not easy, as is the case for small enterprises, having sufficient knowledge about the sources of funds will then determine the efficiency of the capital structure (Delic & al, 2016). Authors have indeed found a positive relationship between financial literacy of managers and SME access to formal credit, such as bank loans (Korutaro Nkundabanyanga, Kasozi, Nalukenge, & Tauringana, 2013; Mwangi & Kihiu, 2012). These findings are consistent with the resource-based view since financial literacy is a personal skill of the entrepreneur (Abiodun Eniola & Entebang, 2017).

As a summary of the above two sections, figure 2 shows how improving the financial literacy of each individual entrepreneur can lead to an overall better economy at the regional / country level. For this reason, authors argue public investment should be made to improve such financial knowledge among the general population (Abiodun Eniola & Entebang, 2017; Korutaro Nkundabanyanga & al, 2013). While most of the literature reviewed concerns developing economies in Africa, a report from Bruegel, a European think tank (Batsaikhan & Demertzis, 2018), shows that the link between financial literacy and economic development is even stronger for developed economies. Among these economies, the European Union scores relatively low with Belgium being average (Batsaikhan & Demertzis, 2018). Specific policies are therefore implemented to develop those competencies as early as possible in the educational path of European citizens (Batsaikhan & Demertzis, 2018).

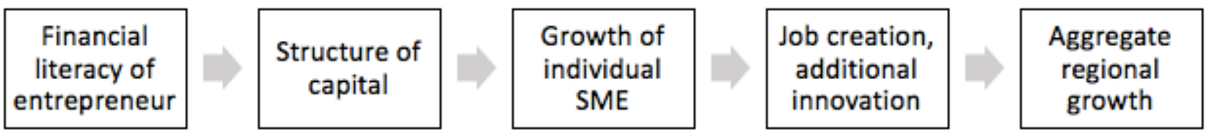

Figure 2: The broad consequences of financial literacy

Chapter 3: Theoretical context

The literature on financing methods for companies is extensive and includes broad theories on ideal capital structures, mainly directed towards large firms (Myers & Maljuf, 1984; Khang, Dolly King, & Nguyen, 2014; de Andrés & al, 2018). Due to the recent realization that entrepreneurship and SME development matter, scholars and policy-makers have turned their attention to the specific ways a small and/or young firm can hope to finance itself (OECD, 2015; Schafer, Werwatz, & Zimmermann, 2004; Erdogan, 2015; Goy, 2019). Some focused on the link between these financing methods and the later performance of the SME (Mikic, Novoselec, & Primorac, 2016; Delic & al, 2016; Puri & Zarutskie, 2012; Cheng, 2009; Macht & Robinson, 2008).

A particular interest has been shown towards new players in the market of small firms' investment. Indeed, observing a difficult access to traditional capital for such companies, especially after the crisis, a variety of actors come into the interest of both authors and policy makers (Block, Colombo, Cumming, 2018; OECD, 2015). Most recently, the practice of crowdfunding has attracted a lot of attention (Hornuf & Schwienbacher, 2014; Goy, 2019; Paschen, 2017; Belleflamme & al, 2014; Bessière & Stephany, 2015). Many advantages of this practice for SMEs are discussed (Viotto da Cruz, 2018; Roma & al, 2017; Younkin & Kashkooli, 2016). Harriet & al (2017), in particular, have reviewed the interest that CEOs see in crowdfunding.

However, these authors focus on the impact of the financing methods on the economic situation of the company. Little research has been carried about the effect on the independence of smaller firms. In this thesis, I want to focus on that aspect as well as how it relates to the various financing options available to SMEs and early-stage entrepreneurs.

PART II: THEORETICAL ASPECTS

The theory gathered in this part is centred around the different ways an entrepreneur can hope to finance its project's development while remaining independent. First, I will discuss the need for development itself as a tool to stay relevant in an industry. Second, I will look at the three means to finance such development: internal financing, debts and equity investments. For each of these options, I will analyse the risk posed to the independence of the company at stake and give literature's view on how to mitigate them. In the last chapter of this part, I will dive into one specific emerging tool: the crowdfunding platforms in Belgium. I will analyse how this way of financing can answer both the small business owner's goals and those of the investors.

Chapter 1: The need for development

1. Grow or die, truth or lie?

Rich (1999) very strongly argues in favour of a continuous growth for all companies. She argues this is valid whether one is active in a growing or mature industry. Many benefits can come from growth. For instance, Rich (1999) points out that talents are mostly attracted to growing firms and will themselves fuel further growth. The same author explains that in a growing industry, not growing would naturally mean losing market share and, as a direct consequence, economies of scale. This is of particular importance for some industries such as pharmaceuticals, telecoms or heavy industries (Rich, 1999). Rich continues by showing that not growing in a mature industry would also lead to financial loss. Indeed, a mature market will always fall into a price competition, leading to decreasing margins. Here again, economies of scale can make the difference. In this situation, the author also advises companies to look for growth in new pockets of the markets or to acquire competition.

On the other hand, Professor Hess (2010) shows that there is no scientific support for this belief. He argues that what entrepreneurs have to do is rather constantly improve the value proposition of their business. This practice can, as a consequence, lead to growth or not. The long-term aim is to keep over-performing competition. A study from McKinsey (Smit, Thompson, & Viguerie, 2005) shows that growth patterns are highly dependent on the industry a company is operating in. In the sample of companies observed, 90% of those showing high growth profiles were concentrated in four sectors: healthcare, high tech, financial services and retail.

2. The concept of sustainable growth

A limit to growth

"Unrestrained growth rate is often inconsistent with sound financial management" (Mayo & Jarvis, 1992). In 1977, Higgins introduced the concept of sustainable growth. He defines it as the maximum growth a firm can afford considering a fixed financial structure. His equation for sustainable growth was reviewed by Mayo & Jarvis (1992) as the following:

g= P (profit margin) x R (retention rate) x A (financial leverage) X T (asset/turnover)*

If this equality is not met, the company will enter into troubles. The same authors find, consistently with McKinsey's survey (Smit & al, 2005), that g* varies from one industry to another, being substantially higher for service companies than those active in manufacturing. While the financial structure is a variable of the equation (and will be extensively discussed in the following section and chapters), Higgins (1977) argues that a firm should not forget that growth rate itself is also a variable. If growth is too high, it needs to be limited. One suggested way to manage the growth rate is by increasing prices or reducing customer services. In addition to reducing sales growth, it will also increase the profit margin and thus tackle the problem from both sides. However, this strategy takes the risk of removing an essential competitive edge. Higgins (1977) then proposes pulling out of a growing business unit consuming too much resources as an alternative strategy. Along these lines, Hess (2010) argues that keeping a strategy of focus is very important for the entrepreneur to 'keep improving' while forgetting about the absolute need for growth myth.

In case a company grows too slow compared to g*, they should invest their available resources in developing their competitive advantage. If it is growing too fast, the company will end up crushed by debts or with low working capital and risk insolvency (Higgins, 1977). Mayo & Jarvis (1992) extend the model developed by Higgins (1977) with an analysis of the non-financial limits to growth. The ability to hire new talent or find new sites for development are examples of such limits. Hess (2010) adds that people themselves need time to adapt. Outgrowing one's own managerial capacity will cause strain on all employees, who will not be able to keep up the pace. Hess (2010) then suggests using a "gas pedal" approach. One needs to pace the growth to make sure employees have time to catch-up.

Conservative growth behaviour - Motivation to reach that limit (or not)

With Higgins and many authors in his wake, we find that a firm cannot grow in sales for as long as it wants with stable financial ratios. The following question is whether, within those limits, a firm is willing to grow to its maximal potential. On that point, Hamelin (2013) finds that family ownership of a firm will often lead to a more conservative growth behaviour. This lower motivation for growth can be explained by three factors: a dislike for risk due to low asset diversification, a willingness to keep the firm away from tax authorities and the pursuit of non-value maximizing goals such as a long-term orientation (Hamelin, 2013). While the first two points are specific to family firms, the last one can also be applied to other business owners.

Consequently, Burlingham (2016) observes a number of companies who have deliberately chosen not to grow. Rather, they are pursuing other business goals such as being great at what they do and having a positive impact on the society. This behaviour - pursuing non-value maximizing goals - seems to be in line with the entrepreneurial mind-set, especially with the mind-set of those who wish to remain independent. Indeed, it is harder to imagine large corporation, accountable to a number of short term-oriented investors, suddenly deciding not to grow anymore in the short run in order to achieve some societal goal.

It seems, then, that long-term orientation of businesses will foster a more conservative growth pattern, avoiding the risks of using too much external finance (Basly, 2007). This is consistent with Hess (2010) who explains one of the main reasons for firms to keep choosing growth is the short tenure of CEOs. With an average stay of 6 years, they will only strive to achieve short-term goals. Since all firms believe blindly in the "grow or die" motto, growth is the objective to be achieved, whether or not this will benefit the company in the long run.

3. When a company wants to grow

In order to increase the sustainable growth rate of a company, the financial manager has four options: decrease dividends pay-outs, increase profits, increase leverage, raise new equity (Higgins, 1977; Mayo & Jarvis, 1992). The first two will increase the capacity for self-financing (Chap. 2.1). The third will be achieved through debt financing (Chap. 2.2). The last can be obtained from a multitude of actors, willing to share the risk of a company (Chap. 2.3)

Chapter 2: The ways of financing a development

1. Internal financing

Internal financing or self-financing refers to the financing of activities or investments through the enterprise's own activities and generated cash flows (Santini & Sopta, 2008; Basly, 2007). This type of funding emerges from sources internal to the company, built from previous net results (Mihaela, 2013). Consequently, the self-financing capacity of a firm is "the potential liquidity generated by the entire activity during the exercise which remains at the disposal of the enterprise" (Radu & Bordeianu, 2017). The net self-financing (or internal financing) is defined by the same authors (Radu & Bordeianu, 2017) as being: Self-Financing Capacity - Distributed Dividends. Therefore, when a company has excess cash, a trade-off exists between internal financing of projects and distributing dividends.

Internal financing is historically the main source for any project's functioning. In 1988, Fazzari, Hubbard, & Petersen reported that self-financing represented on average for all types of firms over 70% of all the funding. Still in 2018, de Andrés & al find that managers rate internal financing as the most important source of funding for their business. Among the high growth Belgian companies, more than 50% use internal financing as a means of development (Manigart & Witmeur, 2009). Though it is generally considered by managers to be the best form of financing (Gaud, Hoesli, & Bender, 2007; Ravid & Sudit, 1994), I will discuss some of the key advantages and disadvantages of this form of financing.

Advantages and Disadvantages

Advantages

To discuss the advantages of internal financing for small and young firms, we first have to take into account their inner limitations. As opposed to well-established companies, access to debt at an interesting rate and access to capital from diverse sources can be limited (Erdogan, 2015; Mateev & Anastov, 2010). Indeed, young firms tend to be unprofitable at the beginning, making it unattractive to investors (Denis, 2004). This fact, coupled with a lack of tangible assets as well as a low level of information available about the firm makes it difficult and costly for banks to assess credit risk and take collateral (Denis, 2004; Erdogan, 2015). It would seem, therefore, that internal financing should be a common choice for small and young business owners, especially in innovative markets. However, let us not forget that the very reason these companies have difficulties accessing external financing is because they do not have sufficient cash reserves. Indeed, this can be seen as a paradox. To the extreme, only those who don't really need to receive external finance will be granted access to it.

Linked to the idea that internal capital is more readily available for small enterprises is the cost of external funding. As argued by Radu & Bordeianu (2017), the reduction of debt through self-financing allows for a lower cost of capital. Interests that would systematically lower future profits are effectively avoided in this way. However, this should be nuanced. Interests are not the only aspects of cost of capital. The opportunity cost for the company to use their available cash should also be taken into account. As developed by Radu & Bordeianu (2017), internal financing comes at the expense of giving dividends to the company's shareholders. Therefore, from their perspective, a debt financing could be more interesting as it can boost long term growth while keeping cash available for distribution. When facing an investment opportunity within the company, shareholders will make a decision based on the same criteria used to invest in the company's stock in the first place. Therefore, they will require a minimum rate of return which satisfies their demand for profitability, which is how Suciu and Barsan-Pipu (2013) define the cost of capital. In order for them to agree to use the retained earnings instead of distributing them, they must be invested in a project which guarantees a rate of return sufficient to account for the risk they are taking (Suciu & Barsan-Pipu, 2013).

Both points - the limited information available to banks and the cost of interests and/or dividends to external parties - are coupled together through the pecking order theory (Myers & Maljuf, 1984). This theory argues that the cost of funding increases with information asymmetries. They conclude that firms will, therefore, tend to use internal funding first, debt second and, finally, equity investment. Since this analysis is based on information asymmetries - which we know to be higher in the case of small and/or younger firms -, it holds especially well when considering these particular cases (Brighi & al, 2012).

Internal financing also appears as a good solution to maintain a high level of control thanks to the lack of accountability to external partners (Mihaela, 2013). The amount of self-financing and the capacity for it are, therefore, good indicators of the level of autonomy of the firm considered (Mihaela, 2013; Radu & Bordeianu, 2017). Managers consider the ability to stay flexible - and, therefore, keep as much control as possible - as a very important aspect of their financing decisions (de Andrés & al, 2018). On the one hand, the absence of collateral allows the firm to use all of its assets when required (Leonard, 2018). On the other hand, in the case of an economic backlash, having the steady constraints of paying interests or pleasing shareholders may be highly damaging. Internal financing is thus a way of funding that does not engage you to pay a third party for an extended period of time which may turn out to be financially constraining. De Andrés & al (2018) analysed this phenomenon after the financial crisis in Spain, where SME's were hit very badly because of their high debt ratio. They found that the share of internal financing increased as a result.

Finally, it is important to note that internal financing and both types of external financing (i.e. debts and equity investment) are not unrelated. As an argument in favour of using some internal financing at least, authors find that it tends to prove the good functioning of the firm through steady cash flows to potential external partners (Brighi & al, 2012). Radu & Bordeianu (2017) also make a point in this sense. Investors will only put money on the table if they believe the managers of the firm are capable of using it in a way that will maximize their return on equity. By investing the firm's own savings first in an efficient way, the managers can prove their ability to do the same with external investment.

Disadvantages

Before getting into the major drawbacks of any strategy of development using internal financing, it should be pointed out that there might be a managerial bias towards using retained earnings for development (Ravid & Sudit, 1994). While this might not mean the decision to do it is wrong per se, it does set a light on an agency problem that might lead to sub-optimal decisions. In the view of these authors, managers enjoy increasing their own power within the firm and will tend to overuse resources instead of distributing dividends. Shinsuke (2014) also argues that there exists a managerial bias that affects the decision to use internal finance. However, in his view, it can either lead to a either a sub-optimal or an excessive level of resources use, depending on the amount of retained earnings. This phenomenon is heightened in the case of overconfident managers.

The main disadvantage of internal funding is the speed of investment. Small firms tend to have, as inner limitations, a low amount of available cash. This can be due to lack of commercialization, for example. One can see the use of external funding as a way of getting access to your future earnings faster. In that sense, a project developed through own self-financing capacity will have to wait for the effective cash to appear while a project funded externally can start straight away, by simply committing future resources. Hamelin (2010) shows that internal resources financing is usually linked to a conservative growth behaviour and, therefore, directly tends to reduce the rate of development of the firm namely through missed opportunities for profitable investment. Carpenter & Petersen (2002) add that a firm's growth that relies almost exclusively on own resources will reach on average a regression of no more than a dollar-for-dollar between internal financing and growth.

As I did in the advantages sub-section, I will conclude this section by the negative consequences the use of internal finance can have on the firm's capacity to attract later external funding. As a reminder, the pecking order theory states that a higher level of information asymmetry will increase the cost of external funding (Myers & Maljuf, 1984). In that sense, authors argue that a development project that is funded entirely by internal funds will reach a high level of confidentiality and, therefore, reduce the possibilities for later external funding (Piga & Atzeni, 2007; Brighi & al, 2012).

Assessment of risk related to independent development and how to mitigate them

The risks that self-financing poses to a firm's independent development are mainly linked to the development aspect as independence is fully guaranteed through a complete absence of external partners. I would argue that a good proxy for entrepreneurs wishing to stay independent are family enterprises. These always have a long-term vision due to the hope to pass on the company to future generations (Basly, 2007). In that sense, Chibani & Henchiri (2016) proved that family enterprises rely more on internal financing than other companies. They also showed that the pecking order theory which we have used extensively to justify internal financing applied particularly well to these types of businesses.

In terms of development risk, a company using only internal resources is exposed to a slower growth rate. This may or may not be an issue based on the level of internal resources, the type of industry the company is evolving in, the level of threat from existing and potential competitors. As explained in the first chapter of this literature review, a conservative growth behaviour aiming towards more independence can be a valid path of development (Hamelin, 2010). However, in a highly competitive environment with fast-paced innovation, internal financing would tend to lead the firm towards a non-competitive position. This position can later drive the independent firm out of business through intense competition. It could also lead to a loss of independence when another player in the market or near market sees an opportunity to increase their own market share by getting ownership of the internally financed firm.

2. Debts and similar financial tools

In the section on internal financing, I started the discussion by some data on the very high historical and current use of such financing in companies. It is, however, important to note that these numbers reflect the use of retained earnings in any funding activity, whether investment-related or working capital-related. Jindrichovska and Korner (2008) found in a survey differentiating both needs that external financing is privileged by managers in the case of investment funding. Particularly, the perceived importance of bank loans is, in this case, the highest out of the external finance instruments. The European commission & the European Investment Bank (2015) describes a loan as an "agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time".

Two main categories of debt exist, based on the type of investor. Companies can access debt from the public bond market. Since my focus in this thesis is on smaller companies, I will, however, focus on private debts. As explained by Myles (2014), some attempts have been made to introduce an SME niche in the bond market but she argues that the successful emergence of such a niche is not in the cards for the next years. Private debt is further divided into bank private debt and non-bank private debt (Khang & al, 2014; Kale & Meneghetti, 2011). Included in the non-bank private investors can be found insurance companies, pension funds and other actors (Knaepen, 2017). Typically, non-bank investors will tend to invest in riskier projects, based on fewer material assets as collateral. The reason for this is the high level of regulation in the banking industry (Kale & Meneghetti, 2011). This is interesting to note as small companies tend to have higher risk profile and, therefore, easier access to non-bank investors. Different subcategories of loans can be obtained through banks and other private investors, depending on the specific needs of the companies. Each form of debt will carry specific challenges for the SME contracting them. However, we will consider all of these options as one single type of financing: debt financing.

Two subcategories of interest to us are the convertible loan as well as crowdlending. Convertible loans represent debt with a maturity date, like any other type of debt. However, at the end of that maturity or if the borrower exercises a call option, the loan can be converted in stocks (OECD, 2015). Crowdlending, on the other hand, is a much less formal form of lending. Popularized through donation platforms, obtaining funding from a massive amount of people has become very popular, especially among small and/or young companies (Goy, 2019). These platforms allow small companies and individuals to borrow from one another without having to work with a financial institution (OECD, 2015). A full chapter is dedicated to crowdlending and other forms of crowdfunding at the end of the literature review.

Advantages and Disadvantages

While Cheng (2009) concludes from a study that debt financing has a significantly negative impact on a firm's operational performance except if that firm has very high cash flow, other authors claim it offers a series of advantages. First, debt financing, along with equity financing, being a form of external financing, it can solve the main disadvantages related to internal finance methods, i.e a lower speed of development. Hereunder, I will only discuss the advantages specific to debt financing.

Advantages

The main advantage of debt financing as stated by authors is the tax deductibility of interests, the so-called tax benefit effect (Tsai, 2005). In Belgium, interests paid on debts are considered as a financial cost under account number 6500 and is therefore tax deductible (IPCF, 2017). By pursuing the same investment opportunity, a debt-financed firm and an all-equity financed firm may have similar results. However, while both will increase their cash flows, the interests paid by the first will be tax deductible and lead to a higher overall payoff (Tsai, 2005).

As in the discussion regarding internal financing, the use of debt should also be analysed in a multi-period situation (Bester & Schepens, 1996). Opting for a bank or financial institution's loan at the beginning of this "game" will have three main effects. First and most simply, it will increase the ability to access loans in the future. It has been shown that having a good relationship with the lenders and potential lenders such as banks and other financial institutions will have a positive effect on the ability to obtain external finance, at better conditions (Slavec & Prodan, 2012; Bester & Schepens, 1996; Hower, 2016). Second, Hower (2016) concludes that firms can and should strengthen their bank relationships, especially when there is a risk of financial distress. Indeed, a bank is able to gather signals of distress from a long-term client much better than from a new one. Hower (2016) then finds as expected that firms with worse bank relationships are more likely both to get into financial issues and going out of business as a result.

Disadvantages

In the case of small companies, the main issue with respect to debt financing is the creditworthiness of the firms. Having little collateral to offer, banks and other institutions will tend to fund those companies with a higher interest rate in order to cover their risk (Carpenter & Petersen, 2002). Delic & al (2016) also describe the use of collateral in debt financing as one of the main obstacles for SMEs. However, they argue that this issue is undermined in more market-oriented systems. Indeed, better access to data regarding the company and its projects will reduce the information asymmetry problem and provide better interest rates as well as lower needs for collaterals. Regardless, even in such markets, small firms are not required to publish detailed financial statements and are most likely not analysed by professional rating agencies and/ or financial press (Slavec & Prodan, 2012). The higher risk premium will, therefore, still be valid – even if to a lesser extent - in those markets.

The debt overhang effect (Tsai, 2005) will often lead to suboptimal decisions by the shareholders of the firm. According to the author, growth opportunities can be missed because of existing debts providing wrong incentives. Schnabel (2015) defines debt overhang or the underinvestment problem as a situation in which a leveraged firm facing a positive Net Present Value investment opportunity will choose not to seize it due to an already high level of debt. By assuming the firm has idle cash available to pursue the investment opportunity and that the alternative to it is paying a dividend to its shareholders, Schnabel (2015) shows the choice of not investing will reduce the value of the firm and result in a value loss for the firm's investors as a group, including both stockholders and debt investors. This situation occurs when the portion of the value increase captured by the debt holders is too high compared to that of the shareholders. Indeed, managers will tend to follow the latter's directions and, therefore, act in favour of dividend distribution.

Assessment of risks and how to mitigate the disadvantages

Technically speaking, a firm using debt financing doesn't give out any control. Indeed, as long as a firm is in good shape, banks act as passive investors. However, a financial constraint is set on the firm's revenues for many years. In the event of a financial issue within the firm leading to a violation of the contract signed with the lender, banks can exert their control rights on the firm. While they do not have the ability to directly make decisions, threats of either terminating the loan or call the full capital early will allow them to influence the firm's activities (Gu, Mao, & Tian, 2017). While this bank control will affect negatively the quantities of innovations produced by the firm, this phenomenon is part of a refocusing strategy that will, in general, improve the value of the violating company (Gu & al, 2017). This risk of loss of decision-making power is real but mostly temporary - i.e. until the borrower gets back to meeting their obligations. In order to make sure this difficult situation ends well, building strong relationships with one's bank is essential, as explained by Hower (2016). A bank that knows a client's business well will make better decisions when trying to save it and, therefore, this particular business will recover its independence both faster and in a better position.

The second risk posed by debt to independent development is found in the debt overhang effect. Here, as in internal finance issues, I link that rather to the development aspect than the independence itself. Having high debt levels can lead a firm to underinvest in its own development, as explained in the previous section. However, this risk might not lead to any long-term issues, depending on the need for development in the company's industry. Furthermore, Schnabel (2015), offers a possible solution to reduce debt overhang problems. Hedging, which he describes as "any activity that decreases the volatility or standard deviation of corporate assets" can lower the incidence of debt overhang. However, this finding does not apply to a company whose assets are more volatile than a certain critical value (Schnabel, 2015).

The main disadvantage of debt financing for SMEs is the lack of trust from banks and financial institutions, leading to unfavourable loan conditions. This can be a threat to independence as the managers will then look for alternative financing options. Often, a lack of internal resources as well as expensive access to debt will lead the company to consider dilutive equity financing, as discussed in the following section. To mitigate this risk, I discuss two options. First, as I have already expansively explained, a good bank relationship management can lower the cost of capital through debt financing (Hower, 2016). Second, as introduced at the beginning of this section, convertible debts can be used. Eisemann & Budd (1982) describe it as a way to access cheaper debt investment and less dilution than what would happen with a typical equity investment. Through a two-way comparison to debt on one side and equity on the other, Sheehan (2014) find convertible securities to be an effective surrogate. However, Eisemann & Budd nuance that with a straight comparison to debt - leaving the comparison to equity financing behind. They argue that high transaction costs, issue under-pricing costs and other penalties as well as the dilution at the end might make this instrument quite costly for most firms. In summary, I would argue this can be a good solution for a small company considering equity finance in later stages of development but willing to avoid an early dilution. In addition, the costly valuation procedure is also pushed back (Liu, 2015).

3. Equity investment

In this section, equity finance obtained from external funds will be discussed. First, the generic advantages and disadvantages of this practice as identified by the literature will be analysed. Afterward, I will provide an overview of the different sources a firm can turn to when looking for equity investors as well as the specific advantages and disadvantages of each one.

Generic Advantages and Disadvantages

Advantages

Using equity financing, a company avoids the obligation for direct payback and interest payments as it would have to if it used debt financing. They also avoid using directly their available cash, leading to an increase in working capital for day-to-day activities. There is, therefore, no particular strain on the treasury. This is particularly important because a lack of cash is one of the main reasons why start-ups and long-standing companies go out of business (Weatherdon, 2017; Quake Capital, 2018). Specifically, in times of economic instability, having sufficient cash is essential. Indeed, Meier & al (2013) show that financial flexibility in times of crisis yields positive impact on firm performance. Glasner (2009) adds that start-ups often choose to give out stock instead of cash in such difficult times, in order to prevent a growing cash burn rate.

Another important aspect of equity financing is the possibilities of further funding it allows. Indeed, rating agencies focus more and more on the liquidity of the firm in need of funds (Knaepen, 2017). Keeping own retained earnings and limiting mandatory payments due to loans will therefore directly improve the company's rating. While SMEs are unlikely to be analysed by large rating agencies (Slavec & Prodan, 2012), banks deciding on granting a loan or not have similar decision-making patterns. Indeed, a stronger balance sheet obtained with larger equity will tend lead to better debt financing options (Nassr & Wehinger, 2015).

Disadvantages

As expected and introduced in previous sections, the dilutive effect of equity funding is a major drawback to this practice (Levine, 2017). Actual dilution occurs when new stocks are issued, convertible debt is converted or stock options are exercised, resulting in a lower share of ownership for existing shareholders. This dilution can be calculated through the primary earnings per share (Clancy & Yeakel, 1981). Potential dilution reflects the entirety of options and convertibles which can be exercised and result in actual dilution. This dilution is calculated through the fully diluted earnings per share (Clancy & Yeakel, 1981). Economically speaking, dilution is not necessarily negative. If the company issues new shares at a higher price than the one offered to first-round investors, then these will see their ownership share diminish but their wealth will be at least equal to what it was before (Bartlett, 2003). In some cases, however, a private company will offer new shares to investors at a lower price than the one the first shareholders paid, therefore diluting their first share of the company. This phenomenon is called down-round financing (Bartlett, 2003). In either case, the political rights of the early investors / founders will be diminished.

To avoid the economic dilution caused by a possible future down-round financing, a first-round investor can require preferred stocks. These shares will have the advantage of being automatically multiplied when new shares are issued at a lower price, to fight the dilutive effect of the new round. Note that this method is mostly used by external investors such as venture capitalists, meaning a down-round financing will severely dilute the ownership rate of the entrepreneurs themselves. This mechanism is called price-based anti-dilution (Bartlett, 2003).

Classification of equity investors

The following classification is based on the average amount of financing received through each of these sources of funds. As a direct consequence, it also follows the stages of development of the start-up/scale-up/SME in need of financing.

Family, Friends, and Fools (FFF)

In this category are included the founders (the fourth F), their families, and friends as well as the so-called fools. In general, these are people who have little knowledge of the project. They decide to invest either because of sentimental proximity to the founders or simply because they enjoy taking risk and hope for some long-term profits or even short-term tax benefits (Weinberg, 2009). Typically, this is the first option an entrepreneur will consider when developing their project (Manigart & Witmeur, 2009) as only “love” can justify trust in such an early stage venture (Moraczewski, 2017). Clearly, the main advantage of such financing is the ease of access. When potential investors such as venture capitalists or even business angels still hesitate, the entrepreneur's own family will likely give some sort of funding when possible (Hennessey, 2003).

Hennessey (2003) argues FFF financing might lead to issues if the firm wants to access venture capital in its future development. Often, an over-optimistic valuation will be later re-adjusted by the professional venture capitalists. This will lead to later funding rounds being down-rounds, meaning high dilution for the early-stage investors - i.e. the friends and family. This will have a negative impact either because they will not be able to do anything about it and founders will take a very big hit or because the FFF received very favourable deals with, for example, a veto right for some transaction. Seeing the large value drop they would endure if venture capitalists come in, one single shareholder can block the whole deal, potentially leading the company to bankruptcy (Hennessey, 2003).

Business Angels

Business Angels provide seed and early-stage financing to start-ups, especially for high-growth, technology-oriented ventures (OECD, 2015). Martel, Cardona, & Mayor (2013) define them as private investor, using their money, knowledge, contacts and time to help a growing venture. Angels are a very common bridge between informal and professional investors (Mulcahy, 2005; Manigart & Witmeur, 2009). They can offer the funds that go above what the entrepreneur's inner circle can provide but do not fly in the million dollars as required by Venture Capitalists. On average, a start-up can hope to raise 25 to 500 K from a Business Angel (OECD, 2015).

Obtaining investment from such a source does not require a proven project or advanced financial plans. This makes it relatively easy for a young venture to enter discussions with potential investors. Indeed, these individuals are not subject to any particular law or supervising power (Martel & al, 2013). Many firms that have received Angel financing confirm they have first tried other sources of finance such as debt or venture capitalists and were turned down (Macht & Robinson, 2009). Still, some information has to be prepared on the company's side in order to convince a Business Angel. Martel & al (2013) identify three factors that will influence the decision to invest: a sound business plan, the required capital and riskiness of the project and, finally, the knowledge of the founding team. However, Mason & Stark (2004) do mention that Business Angels are usually less sensitive to a not-so knowledgeable founding team than other investment entities would be. This can be explained by the expertise they plan on bringing themselves. A lower experience requirement can be a major advantage compared to other sources of equity finance such as venture capitalists for a young founding team.

Business Angels can provide connections as well as industry knowledge (OECD, 2015). Indeed, a typical angel investor is a former successful entrepreneur in a related industry (Martel & al, 2013). Being already wealthy, a potential financial gain is not the only motivation that drives their investment. Angels are often willing to help in an almost benevolent manner, to form the next generation of successful entrepreneurs (Macht & Robinson, 2009). This means that the start-up will benefit from their knowledge and social capital through active involvement in the management but that this involvement will not come at the cost of an independence loss. Indeed, Business Angels mostly do not wish to buy more than 50% of a company in order to leave the entrepreneur in control and with sufficient incentives of success (OECD, 2015).

Having received angel funds at an early stage of growth sends a very positive signal to future investors such as Venture Capitalists. These will likely look for firms having already received one or two rounds of financing from those wealthy and knowledgeable individuals (OECD, 2015). In addition, the Business Angel's contacts in both the rest of the Business Angel and the Venture Capital communities can bring the attention of new investors to the company (Macht & Robinson, 2009). The same authors find that at least a third of the start-ups who had received angel funding received further funding from the same investor later in their development.

One disadvantage of angel investors as opposed to other forms of equity financing is that those individuals prefer to stay anonymous (Martel & al, 2013; OECD, 2015), meaning it is not always easy for a start-up to reach out to them (Deeb, 2014). However, the recent rise of Business Angel Networks (BAN) is improving the visibility of the investors to start-ups (OECD, 2015).

Equity crowdfunding

Crowdfunding is a way for small companies or other initiatives to finance themselves through small contributions of a large group of people - the crowd -, usually through a web platform (OECD, 2015; Wilson & Testoni, 2014). Equity crowdfunding is a sub-category in which the company gives a certain number of shares to each small investor (Paschen, 2017). It is the fastest growing category, though still the smallest due to higher complexity (Wilson & Testoni, 2014). Typically, small firms turn to equity crowdfunding around their early growth stage (Paschen, 2017). This type of funding is considered as a potential bridge for the current gap existing between business angels and venture capitalists (Roy, 2016).

Equity crowdfunding as well as other types of crowdfunding are of particular interest for this thesis as it could be a new answer to meet the need of independent development for small companies. For this reason, I will dive into the details of such a practice in the final section of this literature review. For the purpose of giving a global vision of the equity investment opportunities available to small companies, I will already give some insights through the two following points. As a point of comparison to other equity funding methods, I estimated the average amount of capital raised through equity crowdfunding at 390 000 € (Spreds, 2019). On another note, Equity Crowdfunding has been praised by CEOs as an excellent way to receive funding while keeping the decision-making power completely in-house (Harriet & al, 2017).

Venture Capitalists

Venture capital, as defined by Manigart & Witmeur (2009), is a form of equity financing aiming to develop unlisted SMEs. Typically, they will accompany the growth project of the said company for a period of 3 to 7 years. Companies usually make use of such funds at early-stage development with an average investment of 3 to 5 million $ (OECD, 2015). Venture capital firms can also be found at earlier stages such as seed and start-up phase, going as far down as 50 000 $ investments (StreetofWalls, 2013) but this area is mostly covered by informal investors (OECD, 2015). Moraczewski (2017) adds that recent economic evolutions have led venture capitalists to further forsake the earlier stages of the start-up formation and require actual sales as a proof of concept.

Venture Capitalists are usually a better-known area than business angels who tend to prefer anonymity but it does not mean accessing VC funds is easier. While Business Angels tend to favour a positive feeling between the entrepreneur and themselves, Venture Capitalists have more objective criteria, though gut feeling still counts amongst the decision criteria (Mason & Stark, 2004; OECD, 2015). A criterion that is often mentioned in the literature is the experience and personality of the entrepreneur (Simic, 2015). This means that young and unexperienced founding teams will find it more difficult to convince a Venture Capitalist to work with them. VC funds have a large pool of highly experienced analysts that will study the business' financials, market opportunity, uniqueness of product proposition and growth potential (OECD, 2015; Simic, 2015). This long list of criteria means accessing such financing requires important investments in preparing all the documents (Manigart & Witmeur, 2009). Based on this, the fund will filter all candidates. Out of 100 requests, only 1 or 2 entrepreneurs will receive their financing (Manigart & Witmeur, 2009; Simic, 2015).

Venture capitalists are an important source of funds but can also provide non-monetary benefits to their investee. Indeed, similar to business angels, they have a deep expertise in the industry and/or the start-up development process. They can improve the growth strategy, professionalise management and optimise performance among others (Manigart & Witmeur, 2009). These benefits lead to a higher average growth rate in terms of both sales and employment for VC-backed firms compared to non-VC-backed firms (Puri & Zarutskie, 2012). However, since employment grows proportionally to the increase in sales, this does not reflect a higher profit. As a consequence, failure rate is twice as low when VC financing was obtained and those firms are 800 times more likely to go public (Puri & Zarutskie, 2012).

Unfortunately, benefiting from the Venture Capitalist's knowledge comes at price. Indeed, the entrepreneur has to give up not only partial ownership of the company but also a certain level of control (Arango Vazquez & Durango Gutiérrez, 2014). First, on the partial ownership of the firm, it is important to note that this can have a growing negative impact on founder's share of its own business overtime. Indeed, 95% of Venture Capitalists include an anti-dilution clause, meaning during later rounds of financing, it is the founders' stock that will be diluted (Denis, 2004). Second, the conceded control concerns both the strategic direction of the company during the investment period and the exit mode of the Venture Capitalist. The investor will always plan for its exit from the very start of the investment negotiation, as this is the base of their business model (OECD, 2015). While they typically do not acquire more than 50% of the company's stock, VCs will systematically make sure to have sufficient decision-making power through specific clauses or board members (Arango Vazquez & Durango Gutiérrez, 2014).

Four options encompass the vast majority of the exit modes (Manigart & Witmeur, 2009). Firstly, a trade sale occurs when the investee gets entirely sold to a third-party company. Another option involving the sale of the shares is called the secondary sale, where the buyer is either another VC fund or a more passive financial investor such as a holding. Thirdly, the management has the option to buy its own shares back, through a loan for example. This exit mode is called the management buy-out. Finally, the fund can consider entering the stock market through an Initial Public Offering, IPO (Manigart & Witmeur, 2009; Gordon, 2005). Of course, a last option accounts for the failure of the company. In that case, the Venture Capitalist exits with some cash generated through a liquidation of the company (Gordon, 2005).

The two best options with respect to independence are the management buy-out, which gives full control of the company to the management including the ability to choose their own directors, and the IPO, which allows the VC fund to sell their shares while the entrepreneur keeps his. Additionally, the new shareholders will be extremely scattered through the market, which means very little control will be exercised on the firm's management (Manigart & Witmeur, 2009). However, Gill & Walz (2016) find that a VC-backed IPO is more likely than others to end up being de-listed through a takeover, meaning the whole IPO process may actually be nothing but a delayed trade-sale. In this case, the company's independence is only protected temporarily. It is also worth noting that the IPO process will generate additional sources of funding. This point will be discussed in the sub-section "Public Equity". On the other side of the spectrum, liquidation is clearly not a desirable option. The same goes for a sale to another company, which will likely result in a loss of decision-making power as well as a restructuration of the company. The option involving a secondary sale does not lead to such a clear-cut pro/anti-independence exit. In case the company is sold to another VC fund, the question is simply delayed. In the case of a sale to another financial investor such as a holding, the company's management will most likely keep its decision-making power to a large extent.

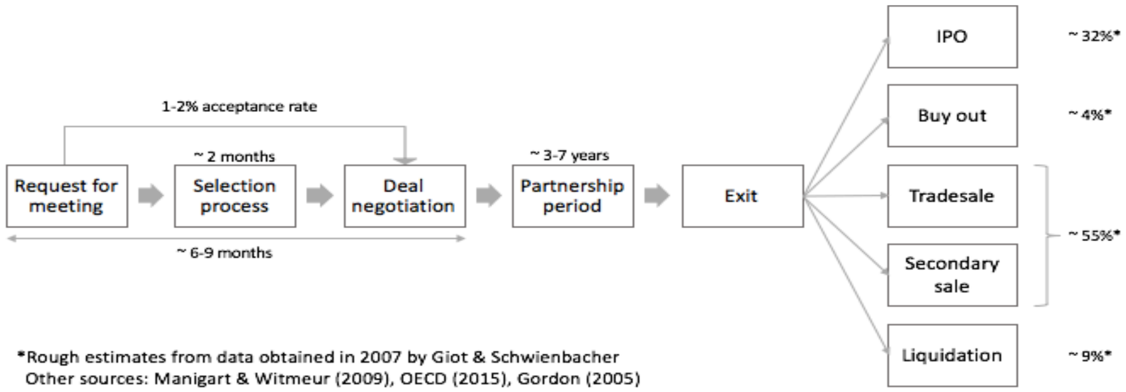

Figure 3: The venture capital investment process

Other Private Equity

The term private equity refers to the equity financing of all non-public companies. Venture capital is thus a sub-category of this (Manigart & Witmeur, 2009). VC funds are usually active at an earlier stage of development and focus primarily on high growth companies, while Private Equity firms will be interested in both high growth companies and underperforming ones (Arango Vazquez & Durango Gutiérrez, 2014; OECD, 2015). Their investment is usually much higher, between 5 and 50 M$ (StreetofWalls, 2013). I will refer to these categories simply as Private Equity. One major difference between Venture Capitalists and Private Equity investors is the target percentage of ownership within the target company. Usually, only a private equity fund will acquire more than half of the shares (Arango Vazquez & Durango Gutiérrez, 2014).

This difference implies a much higher level of control. A typical PE investor will take 3 seats on the board of directors, leaving one or two for management and one or two to independent directors (Gompers, Kaplan, & Mukharlyamov, 2016). With this level of control, the investor can of course guide the strategic decisions of the firm as done by VC funds. In addition, the PE firm will tend to modify the acquired firm in a much deeper way, including driving mergers and acquisitions or a complete restructuring (Arango Vazquez & Durango Gutiérrez, 2014). Gompers & al (2016) find that 58% of all Private Equity deals will at some point involve the PE firm hiring a new senior management team, effectively removing operational control from the original team. The same authors find that their firm's ability to add value to the portfolio company is one of the most important factors when considering an investment, further proving operational engineering truly is part of their core business. These findings have to be nuanced as other authors have found contrasting results. Indeed, Siming (2010) finds that a significant part of PE firms revenues come from so-called quick flips; portfolio companies that are acquired and sold within 18 months to an industrial player or another PE fund. They show that these companies have undergone minor operational improvements. Therefore, the real value provided by the PE firm is to act as a market maker, rather than a corporate restructurer.

Similar to VC investments -though slightly less long-term oriented-, Private Equity firms tend to invest for a period of 3 to 5 years (Siming, 2010). At the end of this period, the firms expect to exit through one of the following methods: trade sale to an industrial buyer in 50% of the cases, secondary sale to a financial investor in 30% of the cases or an IPO in around 20% of the cases (Gompers & al, 2016).

Public Equity (Stock Markets)

Public equity markets are a way to pool resources of a large number of small investors together in order to finance a larger project (Rosett & Smith, 2014). Public capital markets have the advantage of allowing for very large equity investments, very fast. However, this funding comes at the consequence of a major loss of ownership share, a certain accountability towards external shareholders and the need to meet important formalities (Mikic & al, 2016). The latter point is typically seen as the main reason for small companies not to enter the public stock markets. Rosett & Smith (2014) detail many issues such as a potential for bubbles and crashes, insider trading and misleading managers which led to an extended list of rules to be followed.

Entrepreneurs are reluctant to use such financing due to a lack of knowledge of this demanding environment, meaning SME leaders should be educated to stock markets (Mikic & al, 2016; Nassr & Wehinger, 2015). Nassr & Wehinger (2015) identify further factors limiting the possibility for SMEs to enter the public market, including admission fees, listing requirements, broker commission and –at least in Europe – a general dislike by the public for risk equity.

Nonetheless, many advantages can be obtained through a public listing for SMEs. The main aspects being the large financing obtained through an IPO and the potential for secondary capital raisings (Nassr & Wehinger, 2015). By improving the balance sheet structure and providing additional visibility to the firm, a public listing can also increase the availability of debt financing, as well as improving its conditions (OECD, 2015; Nassr & Wehinger, 2015). Going public also allows firms to have a clear valuation of their company, through the combined efforts of all the players on the market. This valuation can be used in other negotiations involving shares. Public firms can use shares as currency for acquisitions or to pay employees (Rosett & Smith, 2014). Finally, while an IPO does involve a major loss of ownership share and some accountability towards external shareholders (Mikic & al, 2016), it is not accompanied by a real loss of control. This is a major advantage compared to other sources of equity such as VC and PE that will transform the business to match their own financial needs.

For these reasons, policy-makers as well as private market participants have been trying to help SMEs access public equity finance (OECD, 2015). In the EU, since 2016, SMEs can raise capital up to 1 million € without any prospectus. For higher equity raises, SMEs and mid-caps can still provide a special growth prospectus, requiring less detailed information but still providing clear insights for the investors (European Parliament, 2019). New adapted platforms have also started to appear with looser requirements in terms of disclosure and financial situation (OECD, 2015). Special multilateral trading platforms with such requirements are called “SME growth markets”, where companies can be listed even if they don’t match usual stock market requirement (Robertson, 2006). In Europe, the Alternative Investment Market (AIM) was launched in 1995 as a way to improve smaller, riskier companies to access capital (Robertson, 2006). Over 2000 companies have already joined, as a way to raise capital with lower requirements or as a step to a full listing (Robertson, 2006). Indeed, the AIM and most other SME-oriented platforms act as “junior markets”, allowing firm to take the step to the ‘real’ trading platform when they meet all the listing requirements (OECD, 2015). In the case of AIM, accessing the London Stock Exchange is the ideal next step (Robertson, 2006).

EnterNext, a subsidiary of Euronext, specifically targets SMEs to help them make an optimal use of the trading platform. In 2014, 740 million euros have been raised by a total of 31 new SMEs on the exchange- 24 M € average-, out of a total of 9 billion (Euronext, 2019). New capital raises in AIM in 2018 involved an average of 24 M £ (28 M €) for 65 new issuers.

Summarizing bubble chart

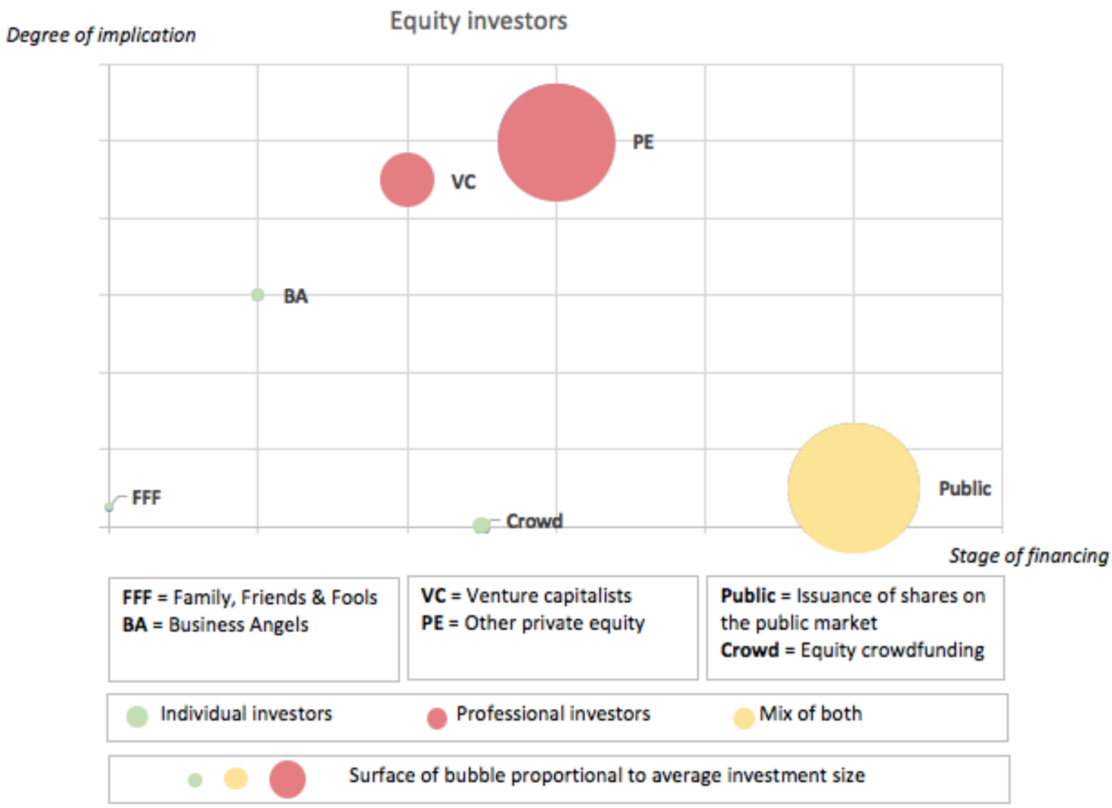

Figure 4: summarizing bubble chart of the different equity funding methods

Assessment of risk related to independence and how to mitigate them

As explained previously, the main concern regarding independent development of the company when using this type of funds relates to the loss of decision-making power. This lower control usually derives from a lower share of ownership. However, as shown in the public equity section, this decreased share does not necessarily lead to a loss of control. This will rather be impacted by the prominence of one specific investor taking on a majority stake (Arango Vazquez & Durango Gutiérrez, 2014) or by term sheets negotiated with an investor (Manigart & Witmeur, 2009; Denis, 2004). To protect themselves, investors such as VC and PE funds will require preferred stock, anti-dilution clauses, board representation and various types of control rights. These have the effect of both allowing someone else to make strategic decisions for the firm, dilute in priority the founders' stock in the case of a secondary financing round and even access a larger share of capital in the case of a down-round financing (Bartlett, 2003; Denis, 2004).

Many of these control rights are required as a sign of good faith from the entrepreneur and make economic sense. For instance, Denis (2004) explains that investors ask for preferred stock to make sure the founders believe in their own project. If they didn't, they would be expecting a drop of value and a necessary down-round financing. They would, therefore, not agree to an automatic multiplication of the investor's shares in that event. However, a few aspects should not be overlooked in order to strike the best deal possible. Thorough negotiation needs to be carried in order to avoid missing an important detail that might squeeze the entrepreneur out of their own business (Manigart & Witmeur, 2009). A few aspects the entrepreneur can work on are listed hereunder.

Firstly, the amount of capital handed over to the investor for a certain price will determine the level of founders' dilution and, in most cases, the loss of control. This is one of the main risk of taking in external equity (Miller, 2008). VC and PE firms will typically come up with a valuation of the company. This does not necessarily stop the discussion on the price paid per share. As discussed by Manigart & Witmeur (2009), many methods of calculations – comparables, NPV, net assets etc.- can be used and give different results. The final valuation of the company will be a mix of these and depend on the negotiation skills of both parties.

Secondly, the founders can work on the clauses of the term sheet to protect themselves. In the case of FFF funding, special rights are often given to the investors as they are taking a lot of risk to help build the company. These rights, sometimes including veto rights, might end up handcuffing the company and driving larger equity investors away (Hennessey, 2003). By avoiding this early mistake, an entrepreneur can increase his control at the start and ensure his business has the highest chance of securing new financing. With more institutional investors, more sophisticated clauses can be used. In order to prevent one shareholder to issue new stocks and dilute the others at will, restrictions to new stock issuance can be made. For example, an extraordinary majority can be required and pre-emptive rights for all existing shareholders should be foreseen (Hand, Lloyd, & Rogow, 1982). However, in case the founder is unable to pay the newly issued shares, these rights provide little protection against dilution (Fryar, 2019). Some additional protection can be put place. Knaepen (2017) explains that by issuing tradeable subscription rights to all existing shareholders, these can either use them to buy shares or sell them on the market, cancelling out the economic part of the dilution of their shares. Miller (2008) provides another alternative to protect founders against dilution. In the event of an acquisition of the company or an entry on the public capital market, the company owes the founder an amount equivalent to a previously agreed, non-dilutable percentage of the company's stock if he remains an employee at that time. If he doesn't, he will receive a vested percentage of this payment, as would happen with sweat equity[1] (Miller, 2008). Note that this protection only works in economic terms and does not guarantee any additional control of the company by its founders.

Examples of anti-dilution clauses

(Based on interview with former Clifford Chance Partner)

- Price-based anti-dilution protection : Mostly financial protection for investors
- Preferential rights : Allow founders to subscribe but might be too expensive
- Voting rights protection: Founders' shares will always be worth a certain amount of political rights, even if there is financial dilution. Many modalities can be imagined, such as veto rights, only a limited political dilution etc.
- Capital increase limit: Can only happen if founders agree, though this might be considered as contrary to the interest of the company.

Both of these points – a good valuation and a controlled dilution – can also be addressed by using another financial tool: the convertible debt. First, a full valuation of the company does not need to be carried through at the time of the issuance (Liu, 2015). However, a valuation cap will still be negotiated in order to limit investor's risk (Farmakis, Kasznica, & Gest, 2019). In terms of dilution, the convertible debt will allow the company to sell less share for the same level of equity. This phenomenon is characterized by a conversion premium of over 20% compared to simply selling common stock (Sheehan, 2014).

On a final note regarding the role of equity funds in the independent development of the firm, I would like to point out that this financing can be used as an anti-takeover defence. A company traded on a public exchange is subject to takeovers if no protections are put in place. By issuing

[1] Sweat equity : As defined by the same author (Miller, 2008), it refers to managers (usually founders) receiving shares of the company as a result of their work, without investing money directly.

further stock and diluting shares, the target company will render an acquisition non-desirable and successfully avoid the takeover (Levine, 2017).

4. State aids

State aids in Wallonia

In Wallonia, a number of supporting measures are available to SMEs, at various stages of development. The following section is based on data gathered on the website “Guides des aides publiques” of Igretec, in collaboration with the EU and the Fédération Wallonie Bruxelles. I will describe different categories of help, starting with the ones involving the least accountability for the company.

The first category involves the “check”, directly granted by the government from public funds. These are offered to nascent or established companies to be used on specific projects. Examples include checks to hire external advice/coaching, cash support for research and innovation projects, export development etc. Other subsidies also target the hiring and training of specific types of employees such as 45+ years old or people with handicaps. With this type of state aid, the company only has the responsibility of using the funds for the task specified in the candidacy.

Next come the support on the investment side. Tax deductibility is granted to the investors in start-ups and scale-ups, to increase their access to external finance while not granting it directly from public funds. Indirectly, the state’s revenue will, however, be reduced. In this case, there is no accountability of the company towards the state but a full accountability towards the investor.

For growing and/or established companies, a specific financing institution has been put in place: the Sowalfin. The main objective of this institution is to provide better access to debt for small companies. They achieve this by providing an external collateral to banks or by offering themselves a subordinated debt. Different subsidiaries of the Sowalfin exist, with specific targets. For instance, Sofinex will tend to boost international activities of SMEs while Novalia will support innovative projects. In the first case – i.e. the state providing a collateral - the SME has the responsibility to re-pay the bank but will not face a loss of asset in the case of failure.

In the second – i.e. the state granting a subordinated debt -, the company has to repay its debt. However, in case of bankruptcy, other debt holders will be repaid first.

The last type of financing I want to mention is not entirely public. Organisations such as Sambrinvest are private firms offering funds, partnering with the government in the search of public interest. Companies can hope to receive significantly more financing, in the shape of debt, convertible debt or even equity. While Sambrinvest is more of a Venture Capital firm than a state entity, it does not have the ambition to control the company. Rather, it will strive to provide the necessary financing to put it on the right track (Sambrinvest, 2018).

State aids as a solution for SME's independence?

Considering the benefits SMEs and entrepreneurship bring for their country's economy, the regional, national and supra-national governments all have developed solutions to help their development (Carree & Thurik, 2010, Veugelers, 2008). This is justified by market failures that make it difficult for SMEs to access finance as well as to appropriate the benefits of their innovation (Veugelers, 2008). In particular after the financial crisis and the development of a larger financial gap for SMEs, governments have been very active in providing alternative financing capacity to boost their country/region out of the crisis (OECD, 2015). Since the goal of such policies is to help small firms develop and getting long term benefits such as job creation or innovation, it can be assumed that there is no ambition of controlling the company.

However, state aids are typically a relatively small amount and have to be used in combination with other financing sources. A good example is the case in which the state provides collateral for a bank loan (Igretec, 2019). Here, the company still accesses normal financing means but receives some advantages in terms of flexibility and, probably, interest rate. The paradox of debt is then avoided. Not only those who don't need it can access it, as the state will make sure to provide the necessary means.

5. Ideal capital structure, mixing options

Now that I have described each method of financing development, I will look at the different possibilities for a company to mix those sources in an optimal way to enable a successful independent development. In this section, I will focus on the determinants of the financial structure of SMEs. First, it is important to note that there cannot be a one size fits all capital structure for small companies. Therefore, having a good knowledge of the available financial instruments available, their advantages and disadvantages combined with a good knowledge of the firm in need of financing is essential. Together, they will determine a company's successful capital structure, enabling her to develop a long-term competitive advantage (Delic & al, 2016). Cheng (2009) also underlines that relying exclusively on either equity financing or debt financing is highly risky and recommends using a mix of all financing available.

As a background theory for SME capital structure, I will use the pecking order theory popularized by Myers and Majluf (1984). As a reminder, this theory states that asymmetries of information will lead managers to prefer internal financing, followed by debt financing and, finally, equity financing. This theory applies very well to the type of business I am interested in. First because young and small firms are affected by information asymmetries more than larger, more transparent firms (Brighi & al, 2012). Second because family firms, which I use as a proxy for entrepreneurs willing to remain independent, tend to have an even more pronounced taste for internal financing (Chibani & Henchiri, 2016). If firms followed strictly that theory, development would be financed exclusively by internal funds when possible. If not, firms would finance the remaining part exclusively by debt, if access was unlimited and only the final residual portion would be financed through a capital increase (Myers & Majluf, 1984).

However, this result seems unlikely and authors have systematically shown that no single theory can explain reasonably well the actual behaviours of firms (de Andrés & al, 2018). For instance, we can find major examples of family firms that decide to increase their capital straight away when an exceptional development opportunity is identified (Solvay, 2015).

What factors will, in such uncertain circumstances, influence the financing choices of SME managers and the subsequent performance of their companies? Different authors observed various decision-making behaviours as well as impacts on performance. In the following paragraphs, I provide an overview of some interesting results.

Generally speaking, an optimal debt amount can be determined on the company's side by balancing the tax benefits it brings and the expected cost of financial distress that comes as a consequence (Gompers & al, 2016). However, Graham & Campbell (2001) show that the tax benefits of using debts is primarily important for larger, dividend-paying companies rather than SMEs. The same authors (2001) find that cost of distress is relatively more important for speculative-grade firms, which usually represents smaller, younger companies. Graham &

Campbell (2001) observe that only 36% of small firms use a target debt ratio derived from such a calculation. This validates the idea that, at least for small firms, there is no ideal capital structure and the structure present at a certain moment in a company reflects a series of historical decisions taken by managers (Myers & Maljuf, 1984). Gaud & al (2006) nuanced that by stating firms typically do have a maximum debt level they would accept in their capital structure. This is consistent with the finding from de Andrés & al (2018) that keeping a certain financial flexibility is typically the most important factor when deciding on the debt level of the company.

Another interesting view on the debt/equity ratio comes from a study by Tsai (2005). He finds that firms with high growth opportunities could have an optimal capital structure involving only equity financing. On the other hand, a firm putting more weight on the value of its assets will tend to use more debt financing. These results were found through an analysis of debt effects, such as the debt overhang. Firms having higher growth opportunities need to limit the risk of underinvesting, which is fostered by higher debt ratios (Tsai, 2005). This result is consistent with other researches. Gaud & al (2006) also find that firms pursuing value-increasing investments will tend to issue equity rather than debt. Similarly, Schafer & al (2004) show that higher risk SMEs as well as R&D intensive companies will tend to rely more on equity finance.

Of course, we should not forget that contracting debt is not purely a one-sided decision from the company in need of financing. A maximum amount is determined by a level of risk the parties involved are willing to accept. On the one hand, we do find a limit to entrepreneurial risk, as estimated by the expected cost of financial distress. This reflects the risk of not being able to pay back and, therefore, getting into bankruptcy (Gompers & al, 2016). On the other hand, debt level is limited externally by banks' willingness to lend.

On the banking side of the equation, the risk assumed is called credit risk. It refers to the financial exposure of one party due to failure of counter party to meet its financial obligation (Corporate Finance Institute, n.d.). For large corporations, this risk can be easily assessed due to the extensive amount of publicly available information. In the case of SMEs, however, asymmetries of information mean a hard to determine credit risk for banks. Debt capacity theoretically refers to the point at which issuing further debt would lead to "too high" costs of financial distress, when the probability of troubles becomes unacceptable (Lemmon & Zender, 2010; Turnbull, 1979). In practical terms, an SME will typically be able to raise a maximum level of debt, calculated as a multiple of their EBITDA. The presence of collateral or indices of significant and steady growth will tend to increase this multiple, otherwise determined by industry standards. Balance sheet measures such as debt to equity ratio can also be used by banks (Corporate Finance Institute, n.d.). Lemmon and Zender (2010) conclude that a firm having a largely sufficient debt capacity will favour borrowing money to issuing additional equity. This finding can help understand why young, innovative firms will often seek equity financing.

In conclusion, I would argue that SMEs trying to achieve value-adding development while remaining independent will tend to prefer internal financing when available, though maintaining sufficient levels of cash to fund working capital and face financial difficulties. When this source of financing reaches its limits, we will observe different behaviours based on the type of SME. A young, risky venture will tend to issue equity while a more stable, family-owned business will tend to use debt financing up to a maximal debt/equity ratio. However, even the venture using equity financing will seek to keep a controlling stake in its business after the multiple rounds of investments. This means two options are available when no further funding from FFF, BAs, VCs and PEs is possible – either because of availability or because of the necessary stock dilution. The company can decide to start leveraging the business and use debt financing to maintain its stake while accessing new funds. Alternatively, it can choose to go public. In this last case, the ownership share will be widely diluted but the control will be kept in-house, while obtaining important capital contributions.

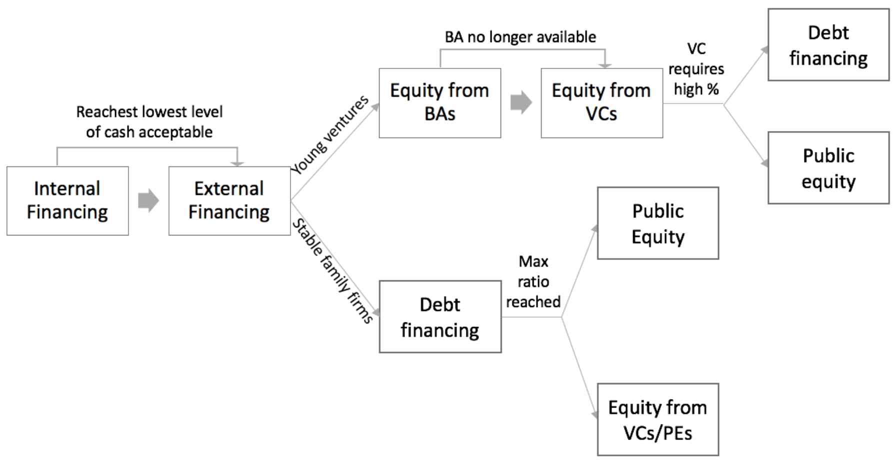

Figure 5: Theoretical use of funding methods, by chronological order

Chapter 3: The emergence of crowdfunding platforms

1. Different crowdfunding platforms, an answer to SMEs' financing needs?

Crowdfunding has recently emerged as an alternative financing tool (Viotto da Cruz, 2018). With over 16 $billions invested in projects on crowdfunding platforms around the world, an impressive growth rate as well as a focus on small firms, it deserves its own chapter in this thesis (Roma & al, 2017). As stated before, I define crowdfunding as a way for small companies or other initiatives to finance themselves through small contributions of a large group of people - the crowd -, usually through a web platform (OECD, 2015; Wilson & Testoni, 2014). In this section, I will look at the different ways this "crowd" can finance a project. Before diving into that, I would like to note that this tool does not only apply for companies in need of funding. Indeed, various personal, artistic, philanthropic projects can call out to the crowd to receive funds (Onnée & Renault, 2013; Goy, 2019). I will, however, focus on the implications of crowdfunding for the entrepreneur.

Donation-based crowdfunding

In this form of crowdfunding, contributors are asked to provide funds with no return, financial or other (OECD, 2015). This sort of financing is the first of the kind, leading the way for all other crowd-based finance, as listed below. Born in 2005 in the United Kingdom and in the United States, it conquered continental Europe in the years that followed (Goy, 2019). The platform will list the projects asking for a donation, collect the received funds and give it to the project-leader when a certain amount is reached (Goy, 2019). Donations are, unsurprisingly, mostly aimed for non-profits or artistic, cultural projects rather than for a regular start-up (Mejri & al, 2018). For this reason, I will leave this category behind in the following analysis.

Reward-based crowdfunding

Some authors categorize reward-based crowdfunding as a form of donation (Goy, 2019). However, based the nature of the reward, very different objectives can be achieved by very different actors. In addition, it is still the most prevalent form of crowdfunding (Mollick & Kuppuswamy, 2014; Roma & al, 2017). Therefore, I choose to divide both categories. Reward-based crowdfunding can take multiple forms. First, the entrepreneur can offer small material or intangible rewards such as a movie ticket, meeting the team, a t-shirt etc. (Mollick &

Kuppuswamy, 2014). This form of funding is very close to donations and will most likely still be oriented towards charitable projects. Another way to reward contributors is by giving them one of your product. This method is called pre-order. By paying advantageous conditions to receive a not yet existing product, the investor is actually paying to launch the first round of production (Belleflamme & al, 2014). One big advantage of this method, aside from the funds raised, is that the entrepreneur can have a first taste of whether there is a market for his offer and appreciate his future customers' willingness to pay for his product (Mollick & Kuppuswamy, 2014; Belleflamme & al, 2014).

Debt-based crowdfunding

Debt-based crowdfunding, also called peer-to-peer lending or crowdlending is a financing method where contributors put a certain capital at disposal of the company for a certain amount of time (OECD, 2015). It can, based on the contract, include the payment of interests before the maturity of the loan or not (Onnée & Renault, 2013). Typically, no-interest loans will be aimed towards social projects (Herzenstein, Sonenshein, & Dholakia, 2011). In such a market, the role of the platform is more complex than for simple, non-monetary incentives. In order to maintain the trust of their investors, the platform has to analyse each project's risk, handle the loans and make sure they are paid back (Goy, 2019). Typically, crowdlending will be used by entrepreneurs in need of small to medium amounts of cash. The projects covered involve working capital, commercial development and recruiting (Mejri & al, 2018).

This type of platform is largely developing as an alternative to bank financing, especially after the banking crisis (Ahern, 2018). Indeed, the newly risk-averse banking sector often rejects high-risk SMEs (Goy, 2019; Ahern, 2018; Younkin & Kashkooli, 2016). Crowdlending then offers the possibility for one individual to lend to another without any financial intermediary (OECD, 2015). Indeed, heavy transaction costs have to be supported by the SME when dealing with a bank (Younkin & Kashkooli, 2016). Apart from removing one expensive intermediary in the lending process, peer-to-peer platforms offer many advantages compared to banks. First, young companies are usually very time sensitive (Mejri & al, 2018). A bank will take 3 to 5 weeks to take a decision to finance an SME and around 3 months to free up the cash (Chappel & al, 2018). On the other hand, P2P lending platform such as BlueBees can give companies the total amount to be raised in a total of one month (Mejri & al, 2018). Another major issue SMEs come across with bank financing is the need for collateral (Denis, 2004). This holds especially well for innovative start-ups who invest mostly in intangible assets (Brighi & al, 2012).

Crowdlending offers the possibility to access interesting amounts of funds without providing any personal or company collateral (Goy, 2019; Mejri & al, 2018). Those highly common immaterial projects are therefore much easier to pursue (Goy, 2019). McKinsey (Smit & al, 2015) estimates that, as a consequence, 35% of banking profits in the SME sectors could be lost to FinTech entrants by 2025.

Unfortunately, Ahern (2018) details the various risks supported by the – mostly not professional – investors and concludes they are under protected. It follows the EU should adopt a regulatory framework to ensure this protection while avoiding cutting off an important source of financing for small enterprises. Indeed, the asymmetry information problem which made banks doubt about investments is not solved (Mejri & al, 2018). The investors on P2P lending platforms often lack experience in finance and will support a high level of risk (Yum, Lee, & Chae, 2012). The way these individual contributors analyse risk and make lending decisions shows large discrepancies with the traditional banking way. Herzenstein & al (2011) find that narratives given by a borrower affect the lender's decision far more than objective information.

Equity crowdfunding

More complex than other forms of crowdfunding, the equity based form follows specific rules and tends to be preferred by more established start-ups and SMEs (Goy, 2019). Equity crowdfunding or crowd-investing is based on entrepreneurs offering a certain percentage of their shares in exchange for a certain amount to a large base of investors. Each of them will receive a percentage of stock as a pro-rata of their investment (Wilson & Testoni, 2014). Platforms active in that area typically do more intense due diligence and have more regulations to follow (Mejri & al, 2018). Due to this higher complexity, this category is still relatively small, though it is the fastest growing (Wilson & Testoni, 2014). Typically, these platforms will be used to finance larger projects, with a focus on intangible assets rather than developing the very first steps of the company creation (Mejri & al, 2018).

Whereas crowdlending appears as an alternative to bank financing, equity crowdfunding tackles the shortcomings of Venture Capitalists. These typically ask for larger investments, above 1 million € (Goy, 2019; Mejri & al, 2018). They are also more restrictive in terms of project selection. More intense analysis will be carried about the company's financials and very strict criteria are applied (Mejri & al, 2018; Mason & Stark, 2004). This will lead to a much longer time between application and funds release (Mejri & al, 2018). On top of that, Venture

Capitalists tend to have a preferred type of industry –defined by both product and market - as well as type of entrepreneur (Simic, 2015). Is it innovative enough? Can it be patented? Is the market growing fast enough? Is the founder 'our' type of people? (Simic, 2015) etc. Younkin & Kashkooli (2016) show that less growing industries as well as social minorities and women typically have less chance of being financed by a Venture Capitalist. Equity crowdfunding then acts as a solution to this by allowing a crowd of people with varied criteria to assess the projects. In summary, between the first investments from the inner circle – potentially with some business angels- and the venture capitalists, SMEs found a new crowd to tap in (Roy, 2016).

Hornuf & Schwienbacher (2014), however, consider equity crowdfunding as a financing solution situated at the business angel level, rather than the more advanced VC level. This holds especially well since VCs have recently moved to more mature segments with the crisis (Wilson & Testoni, 2014). Hornuf & Schwienbacher (2014) name a few advantages that the crowd can have on an angel. First, the large number of small tickets sold lead to the impossibility to have tailor-made contracts, meaning the crowd investors will not require dilution clauses, liquidity preferences or other restraining clauses. Of course, this is only an advantage for the entrepreneur. Crowdinvestors are also usually unprofessional and unable to assess the risk of their securities (Wilson & Testoni, 2014). Second, while not undermining the valuable contributions of one knowledgeable individual, the 'wisdom of crowd' phenomenon should not be forgotten. When looking for valuable advice, an entrepreneur can expect that the large number of advisors will cancel out individual biases. Finally, angel finance cannot offer the very important market assessment advantage. Having a crowd support your product is a much better test for the business sense your idea makes.

Of course, these advantages are counterbalanced by strong benefits business angels can bring such as expert knowledge, potential for IPO, non-disclosure agreements to protect an innovation, etc. (Hornuf & Schwienbacher, 2014). The latter point refers to one important drawback of crowdfunding. If a company wants to develop an innovative product which is easy to imitate, a public display on a platform presents a risk of plagiarism (Onnée & Renault, 2013). Authors then argue that the two forms of financing do not necessarily have to be substitutes (Bessière & Stephany, 2015; Hornuf & Schwienbacher, 2014). Bessière & Stephany (2015) even find that equity crowdfunding platforms tend to follow Business Angels' orientation when evaluating an issued security. This shows a very close relationship between the two actors.

Crowdfunding as a solution for SME financing?

Diversifying the sources of funds

Diversifying their financing resources has become a priority for SMEs (Goy, 2019). For finance below 3 to 5 million, such small companies typically do not have many other choices than turning to banks (Goy, 2019). They consider themselves too young, too small for Venture Capital investment or not adequate for Business Angel search (Mejri & al, 2018). With the emergence of crowdfunding, the options are plenty. Issuing debt, offering material rewards, pre-selling, exchanging equity, committing a part of the profit etc. can all be achieved through the simple use of the web.

In addition to this initial diversity, a further division of funding sources can be achieved in later stages. Mejri & al (2018) explain that crowdfunding can be a first step towards larger, more traditional financing institutions, thanks to an increased visibility and credibility. Consistently with this statement, Mollick & Kuppuswamy (2014) find a positive correlation between a successful campaign and access to further funding. One possible reason for that, which holds particularly well in the case of pre-order crowdfunding, is that by contributing to a project, potential or actual customers show how they value the product (Roma & al, 2017).

Obtaining funds easier, at better conditions

An entrepreneur that has been rejected by the traditional sources of financing can still hope for a good result through crowdfunding. The general public, the crowd, will tend to make less rational decisions than its institutional counterparts (Bessière & Stephany, 2015). Many factors will be taken into account, besides the strictly financial aspects (Yum & al, 2012). I review three factors that the crowd will tend to take into account and that traditional investors would typically disregard. The first point is the very human tendency to follow a trend. Hornuf & Schwienbacher (2014) show the importance of creating the buzz on a crowdfunding platform. Individual contributors tend to believe in the other members of the community, especially if one large investment has been made – probably meaning an experimented investor trusts the project. The ability of the entrepreneur to engage the community early to generate interest is thus very important.

The next two factors will tend to offer better terms to the entrepreneur, financially speaking. First, contributors will be influenced by emotional aspects. Similar to a Business Angel on a smaller scale, they will enjoy being part of an innovation process and helping the economy in general (Mejri & al, 2018). People also enjoy feeling part of something bigger and will have additional utility simply by being a member of a crowd (Belleflamme & al, 2014). Since the contributor will receive something else than pure monetary benefits, he is likely to accept lending/investing his money at better conditions. Secondly, the crowd is highly influenced by the narratives behind a project. An entrepreneur can gain trust and enthusiasm by linking his person to several identities such as trustworthy, hardworking etc. (Herzenstein & al, 2011). Finally, crowdfunding platforms will reduce transaction costs with any type of intermediary. Getting funds from FFF will incur social costs and getting them from professional investors will incur high documentation and agency costs (Younkin & Kashkooli, 2016).

Crowdfunding also allows for accessing funds at better conditions, in terms of company independence. Harriet & al (2017) analysed the reasons CEOs choose to turn to crowdfunding. One of the three main motivations cited by SME managers was the possibility to access new funds while maintaining a high level of independence. For donation and reward-based crowdfunding, this fact is easy to understand. As far as equity crowdfunding is concerned, this is achieved through the same aspects as with the IPO. A large pool of relatively small investors will not constraint the company's decision-making (Harriet & al, 2017). In the case of debt-based crowdfunding, there is still a strain on treasury due to interest payments. However, the absence of collateral means the manager remains in full control of his assets and can use them as he sees fits. In addition, banks have control rights in case the company doesn't respect the contract while crowd lenders can do little to force the company to listen to them and change their operations.

Engaging with a community

The community behind a crowdfunding platform is probably the defining characteristic of this mode of financing. As previously mentioned, the crowd benefits simply from being one. However, those benefits are not only one-sided and the entrepreneur can also take advantage of it. Two categories of interactions can happen between an entrepreneur and that community. On the one hand, he can use the crowd funders to *understand* demand better. On the other, he can use them to *build* demand.

By listening to the crowd, the entrepreneur can adapt a project. Chaney (2019) does not hesitate to talk about a coproduction between the crowd and the entrepreneur. Indeed, since crowd funders find value in supporting a new project, they are likely to get more involved. They can share ideas via social media or the community on the platform itself (Chaney, 2019).

Interestingly, some platforms even offer to aggregate data from crowd behaviour and deliver ready-to-use insights on pricing, most desired product characteristics, market size etc. (Younkin & Kashkooli, 2016). Additionally, feedback and advice from the community does not end after the fundraising period. Once the crowd funders have become actual contributors, they are even more likely to share ideas on the project. Two modes of interactions between crowd and entrepreneur exist. First, each individual investor handles their own shares and communicates directly with the business. Otherwise, the crowd investing platform can create a holding, syndicating all of the contributors and representing them as one in front of the company. In the first mode, investors are very scattered but if the entrepreneur is willing to learn and able to interact, he can access valuable information on the market. On the other hand, the holding method could lead to a more important involvement in the company. The learnings of the company from the crowd will then not only depend on the capabilities of the entrepreneur but also on those of the platform manager (Bessière & Stephany, 2014). Note that this "holding" could take more importance in the decision-making and undermine the independence of the company, which was one of the main reasons for founders to choose crowdfunding. The reality of this will be investigated through interviews.

The entrepreneur can also use the community to build up demand, instead of simply reacting to information. Having access to this vast public of typically interested people is a great opportunity to promote a new product (Mejri & al, 2018). Even if the fundraising does not succeed, benefits can be obtained in terms of marketing due to the high exposition of the company during this period (Harriet & al, 2017). According to Mejri & al (2018), this added promotion comes in second in terms of motivations for entrepreneurs to choose crowdfunding, right after the financing itself.

A large focus on start-ups and innovative projects

Many authors use examples of early-stage ventures in innovative fields to assess the advantages and disadvantages of crowdfunding (Harriet & al, 2017; Hornuf & Schwienbacher, 2017; Onnée & Stephany, 2013). Similarly, the motivations of many funders are based on the hope to fuel innovation (Mejri & al, 2018). It is unclear whether the market is as interesting for more mature SMEs. Most likely, the more regulated the type of funding, the more we will find mature businesses. Indeed, Harriet & al (2017) base their study on equity crowdfunding on five French SMEs, two of which were already established and looking to finance growth. This proportion is quite low and confirms that crowdfunding might be used at the BA stage rather than VC.

No free lunch

As a final note, it is important to underline the work that has to be done by entrepreneurs who are candidates to crowdfunding. While many advantages exist, including an easier procedure, there is of course a necessary investment in time and money by the entrepreneur (Onnée & Renault, 2013). Hui & al (2012) identify some basic types of jobs done by the crowdfunding candidate such as campaign preparation, marketing and follow-up effort as well as their own contributions. Other authors also mention community management, which also take substantial amounts of time (Bessière & Stephany, 2015; Mejri & al, 2018). It is also important not to underestimate the due diligence done by the platform. While they are less demanding than institutional investors, information does have to be prepared (Mejri & al, 2018).

2. Crowdfunding in Belgium

Active platforms and statistics

The five main platforms active in Belgium in the field of financial crowdfunding are Lita.co, Ecco Nova, Look&Fin, Spreds and Bolero crowdfunding (FSMA, 2018). In this section, I will give an overview of statistics that apply to those platforms and, therefore, the Belgian market. Most of the information comes from the FSMA report on equity and debt-based crowdfunding in Europe (2018), providing a thorough analysis of the market from 2012 to 2017.

Crowdfunding in Belgium is growing fast. Out of a total of 40 million € invested, 20 were invested only in 2017. Even so, this remains marginal compared to the yearly 130 000 million euros obtained by companies through bank financing. Out of this – still relatively small – market, 78% of funds were allocated through debt-based crowdfunding. This represents only 57% of campaigns, which means larger amounts are obtained through this form of crowdfunding. This finding is not consistent with the predictions and/or findings of many authors in the literature (Mejri & al, 2018; Belleflamme & al, 2014). On the other hand, literature and Belgian observations match in terms of time-to-money predictions. When banks can take months to deliver the cash, a debt-based crowdfunding platform will obtain its financing in, on average, 13 days. This amount is higher for equity investments, up to 62 days.

On a second note, Belgians are relatively risk-averse and this can be observed in the performance statistics for both founders and investors. The first tend to ask for limited amounts, leading to 85% successful campaigns. The second will contribute on average 2500€, with 50%

of them contributing less than 500€. The projects they invest in are also relatively low-risk, with an average return of 7,42% and only 3,4% default rate in debt-financing. However, in terms of capital investments, investors have taken some additional risk as 9,5% of the companies have gone bankrupt. The FSMA has also witnessed two capital exits. One of them provided a 100% return and one of them led to a 7% loss.

Legislation

The 2016 crowdfunding law

As of the 18th of December 2016, Belgium has adopted a new law recognizing and regulating debt- and equity-based crowdfunding. Among others, it details the rules that have to be followed by both the platform and the company willing to raise funds. For instance, a prospectus has to be put together only in the case of private fundraising – i.e. directed only towards a selected crowd- for a total amount lower than 100 000 euros or directed towards less than 150 people. In the case of a public offering, total amounts below 300 000 euros with individual contributions capped at 5000 euros do not require a prospectus either.

As far as the platform is concerned, they should get approved by the FSMA if they offer financial crowdfunding (debt- or equity-based). The FSMA gives a list of requirement for approval, including commercial form, subscribing to a professional responsibility insurance, having sufficient control and expertise etc. (FSMA, 2017). Furthermore, the platforms are required to check the received information on the various projects on honesty and clarity (Buisseret, 2017).

Tax Shelter

The law of the 10th of august 2015 introduces a favourable treatment towards investing in start-ups. The investor will be granted a tax shelter for their investment in equity for any start-up company, for example through a crowdfunding platform (Loi programme du 10 août 2015). This can lead, if all conditions are met, to a total reduction of 30 to 45% (SPF Finance, 2018). In 2018, an update was published, extending the eligibility to firms that are already in their growth stages, the scale-ups. An investor choosing to buy stock from a growing firm through a crowdfunding platform will be entitled to a tax reduction of 25% (Loi relative au renforcement de la croissance économique, 2018). In both cases – start-ups and scale-ups -, if the investor removes its investment within less than 48 months, the tax reduction will be partly removed. These measures are particularly interesting as they encourage the rise of equity-based crowdfunding in particular. By involving scale-ups in the scheme, the general focus on nascent companies observed in the previous chapter might be reduced. This holds especially well since the Belgian investor is very risk averse and might therefore tend to prefer a company that has already proven its business model.

A focus on Spreds

Spreds, formerly MyMicroInvest, was the first Belgian platform to receive FSMA (Financial services and markets authority) accreditation (Spreds, 2019a). The platform has a strong focus on larger invested amounts, through equity crowdfunding – representing 86% of deals - and crowdlending exclusively (Lauwers, 2018). As advertised on the platform, 132 projects have already been funded and received a total of 50 Million €, that is to say an average of 380 thousand per project funded (Spreds, 2019a). Compared to the literature review presented above, this represents indeed a later stage of development for those companies.

In addition to this focus on larger investments, Spreds has recently partnered with Euronext to promote the development of firms all the way to the IPO (Lauwers, 2019). An alarming observation was made by the two partners-to-be. Most Belgian start-ups lack financing solutions when they reach the scale-up step. They are often bought by larger groups or turn to the international for capital. Very few of them reach the IPO stage, only four did in Brussels in 2018 (Lauwers, 2019). Their objective of the so-called "Jungle Bells" partnership is then to sponsor some start-ups and lead them together to a public offering (Lauwers, 2019). This, however, will not be achieved through the usual crowdfunding platform but with a series of partners in the Venture Capital and Business Angel worlds (Spreds, 2019b).

In summary, Spreds offers a web platform for small companies and established ones to access debt and equity from the crowd, with limited accountability and, therefore, minimal loss of control. The firm then offers to accompany some selected projects and sponsor them in all their later stages of development, aiming to avoid an acquisition or international funds involvement. For all these reasons, the platform Spreds is of particular interest to this thesis. A key focus of the empirical aspects of this work will be to understand whether this new stakeholder in the Belgian financing ecosystem is really the solution to finance independent development of small companies.

PART III: METHODOLOGY

Being in the context of an exploratory study, both qualitative and quantitative research has been carried through.

Chapter 1: Qualitative research

1. The guided interview approach

In order to gather insights on entrepreneurial motivation for independence and the different financial tools used, I first conducted a series of guided interviews with eight entrepreneurs as well as four financial stakeholders. As defined by McIntosh and Morse (2015), a guided interview is one in which the interviewer explains the research domain and lists the main questions in the beginning. Typically, this type of interview starts with a broad question and then goes deeper into some subjects, based on the interviewee's answer and loosely following an interview guide. The analysis is then carried by aggregating the information by categories, rather than comparing responses item by item. For each entrepreneur, I started by a broad question on the company's background, with a focus on its financials and independence. Based on the answers, I insisted on some aspects of their financing, competitive position or motivation for independence. Pre-defined questions were readily available but were mostly adapted throughout the interviews. These loosely followed guides can be found in appendix A.

Using relatively open-ended interviews allows to receive a more concrete, more involved image of the reality (Flick, von Kardoff, & Steinke, 2004). Attitudes, beliefs and deep motives can then be better understood by the researcher (Barribal & While, 1994). The motives for independence are usually partially irrational, making the non-verbals and the attitudes towards this topic more relevant. In addition, this form of interview is open to new, unexpected information through probing, for instance (Hopf, 2004; Barribal & While, 1994). However, the results will be highly subjective on both the entrepreneur's and the interviewer's sides. From the formulation of the questions through to the interpretation of the answers, the researcher's own beliefs are likely to affect the result (Diefenbach, 2009). The second, more obvious, issue is simply the relatively small amount of data gathered, making it impossible to generalize (Diefenbach, 2009). To answer part of those issues, a quantitative analysis was carried after the guided interviews stage.

2. Selecting the interviewees

Entrepreneurs

IBA

IBA is a Louvain-la-neuve based company, developing technologies to fight cancer with, for example, prototherapy and particle accelerators (IBA, 2018). A holding was created through which all of the employees could subscribe to shares of the company, becoming the majority shareholders. I was lucky to interview Pierre Mottet, chairman of the board.

IRIS

The case of IRIS is also that of a 1986 UCL spinoff. Their core business is to develop optical recognition of characters (OCR) and sell it to enterprises. In terms of profile, the main difference with IBA is that the company was, in the end, bought by Canon in 2013. Pierre de Muelenaere, one of the founders, granted me an interview.

EVS

EVS was also analysed through an interview with Pierre de Muelenaere, who came into the capital and management of this company after its founders abandoned the ship. EVS develops live video technology for broadcast and new media productions (EVS, 2018). With a very large percentage of shares on the stock market and very little protections, it is interesting to analyse how the new managers protected it from being acquired.

ContenO

ContenO is a family enterprise, active in the development of bottling plants in containers. The company entered in a bidding war with the giant Karsher and almost went bankrupt because of it. ContenO being a family company, it is interesting to see how this affected the choice of financial tools. In this case, I had a discussion with the CEO, Christophe van Steen.

Upignac

Upignac is a similar case to that of ContenO in the sense that it is a family-owned SME. However, Upignac is still well on its feet and displays a healthy financial situation. It is then interesting to see what differed in the strategy of both companies. I was able to interview a member of the family and majority shareholder, Michel Petit.

Flowell

Flowell builds parts for the nuclear industry since 1969 (Flowell, 2019). The interesting part of its story starts with one employee, Xavier Slabbaert whom I interviewed, and a friend buying back the shares of the company from its former shareholders. The case is of interest to this thesis as Flowell has been highly leveraged in the beginning, namely due to the buyout, and (very) recently signed an agreement for a private investor to step in.

RealDolmen

RealDolmen is the result of a merger between Real Software and Dolmen, forming a one-stop-shop software service for mid-market clients. The company was listed and had different private investors, including the Colruyt group and a financial holding before being bought by Gfi informatics, a larger French competitor. Through an interview with CFO Paul de Schrijver, I tried to understand the reasons behind this sale, which happened at a time the company was performing very well.

Audiovalley

I was able to interview Sébastien Veldeman, CFO of Audiovalley, active in the audio digital industry. The majority of the shares were sold in 2015 to Vivendi, a larger media group. However, the company was later able to buy these back after a successful IPO in 2018. I will then analyse the reasons behind the initial loss of majority and, afterwards, the motivations for an entrance on the public market.

Smovin

Smovin is a Genval-based digital start-up that helps real estate managers to handle their different tenants and leases which received help from regional funds. Michael Phillipart de Foy, founder of Smovin, has granted me an interview to discuss the evolution of their financing and, in particular, the process of accessing state aid.

Financial stakeholders

Spreds

Spreds, as detailed in the last chapter of the literature review, is a crowdfunding platform active in debt and equity crowdfunding. Thanks to a contact with Alex Houtart, head of issuers team, I will analyse the value proposition of the crowdfunding platforms in general as well as the specificities offered by Spreds. The goal is to understand how the platform hopes to answer to the needs of independent growth for the entrepreneurs that trust them.

Euronext

Euronext, the European stock exchange, has recently made some moves in order to boost SME presence on the public market, namely through a partnership with Spreds (Lauwers, 2019). Benoît van den Hove, head of listings, has granted me an interview to discuss the profiles of SMEs entering Euronext as well as the value proposition of the latter in terms of financing independent development for the entrepreneurs.

BeAngels

BeAngels is a Belgian Business Angels network. As their core business is to provide funding for early-stage start-ups, it seems interesting to understand their exact value proposition to entrepreneurs. Through an interview with Gauthier van der Elst, the different profiles of entrepreneurs and how they use the platform will be discussed.

Look&Fin

Look&Fin is the main player in debt-based crowdfunding in Belgium. A contact with Camille Lambillon, business analyst, allowed me to get some insights on the profile of companies that make use of their platform as well as the various advantages for them.

Chapter 2: Quantitative research

1. Public data analysis

The objective of the quantitative part of this thesis is to get some objective data on the different financial means used by SMEs. Because of global data protection rights, it has become difficult to access lists of emails of people I could directly contact. Therefore, my research focuses on publicly available data.

The objective was to understand, based on the type of financing used, whether or not the company remained independent, the level of growth it achieved and the value it created. Different indicators have been used to assess this:

Table 1: Variables used in the quantitative analysis

	Indicators			
Growth	EBITDA growth	Amount invested		
Independence	Percentage of ownership	Percentage of the board	Main decision maker (y/n)	Reference shareholder (y/n)
Value creation	Return on Investment			

EBITDA growth and return on investment were found through the national bank website on the "centrale des bilans". The percentage of the board kept by the founders as well as whether or not they are still the main decision-maker could be obtained on the crossroads Bank for Enterprises website. Finally, the percentage of ownership kept, the amount received as well as whether or not the founders are jointly the reference shareholders were obtained through a careful analysis of documents published on the "Moniteur Belge". Every capital increase is documented to a certain level. A lot of information is kept out of the public transcripts, making it relatively difficult to track and limiting the number of companies eligible for analysis.

Because of such limitations, a small sample of 9 to 10 companies per category only has been selected to conduct this analysis. Obvious issues arise from such a dataset and will be addressed in the limitations section of Part V.

2. Selection of cases

I chose to analyse crowdfunding in particular as this tool is still relatively new. Many authors have been interested in the field at its birth. However, an analysis of the outcomes of such funding is only becoming possible today, with the first equity campaigns having been realized a few years ago already. As literature often qualifies crowdfunding to be an alternative to the business angels, it seems relevant to compare those two means of financing. Business Angels also tend to finance young ventures, taking significant risk. In this case, however, one large investor will most likely take a significant number of shares. How that affects future development compared to the use of a crowdfunding platform can then be assessed through an analysis of the evolution of those entrepreneurs that chose the one or the other.

The companies selected for the analysis are those that match the following criteria. They were financed during the first years of MyMicroInvest (Spreds) or a Business Angel network, as an already existing legal entity. This means I will only consider those companies that were created by a small team of founders, not including external investors from the start. The companies have survived until today, with a relatively similar shape as that of the time of the fund raise. Indeed, when too many changes have been made, it becomes difficult to follow the evolution of the ownership structure.

PART IV: PRACTICAL ASPECTS

Chapter 1: Qualitative research

1. General discussion on independence for SMEs

What is independence?

Pierre de Muelenaere defines an independent company as an organisation in which management has sufficient control and capacity of action and where the power of the shareholders is either predominantly owned by the founders or the family or is sufficiently spread. Indeed, in his view, having the founders as dominant shareholders does not mean independence. Similarly, a company in which they are irrelevant in the capital can very well be independent. The difference lies in the decision-making power.

Of course, a company can have external shareholders sitting at the board and influencing the decisions with their knowledge. This is highly valuable, as explained by Michel Petit, Pierre de Muelenaere, Paul de Schrijver and other entrepreneurs. Full isolation is not desirable for the development of the company. However, if this entanglement of interests becomes too strong, there might be a risk to the independence. Let us imagine, for example, a private investment fund that decides to acquire various companies in a specific field. The entrepreneurs could highly value their knowledge in that field as they have clearly become experts. It is possible, though, that the investor had other synergies in mind than simple knowledge sharing. Through its influence, they can try to foster deals between their portfolio companies, limiting the decision-making abilities of its managers. In that case, even if the company has not sold a predominant share of its stock to a competitor, it can be considered to be tied to others, or not independent.

While most entrepreneurs define the board of directors as the company's top decision-making organ, Michael Philippart de Foy puts some nuance. According to him, most important decisions are made at managerial level. Even if the Venture Capitalist or another financial partner has many seats at the board, they have very few incentives to interfere. The founder of Smovin is, therefore, not worried about losing the control over his company, even after giving away the majority of its board to external investors.

Why remain independent?

Three key points have been raised by different interviewees as to why they wish to remain independent. I will develop each of them in this section, from the most self-oriented benefits to the most community-oriented ones.

First, both Pierre de Muelenaere (IRIS, EVS) and Christophe Van Steen (ContenO) mentioned a certain personal pride related to developing one's own enterprise independently. When starting a new company, there is a clear desire to start something from scratch, without being accountable to an employer (de Muelenaere, 2019). "Why? Simply because it is a lot more fun!". On Mr. Van Steen's side, this pride came from doing something others have never done before. He was also motivated by the direct client interactions, including the US government.

Other aspects of long term independence benefit the families of the entrepreneurs, rather than the latter directly. Here again, Christophe Van Steen (ContenO) explains that passing on the company to his two sons was one of the main reasons he so strongly fought against all external involvement. This phenomenon is also found in Upignac, a good example of the typical family firm. Michel Petit explains that once it became too difficult to organise succession because of a large number of grandchildren, a sale of the company was considered. Then, when he was able to re-acquire most of the shares and envision a succession that involved solely his children, independence became the preferred path again.

Finally, Pierre Mottet (IBA) mentions a certain accountability of the company towards its various stakeholders. IBA was created to help improve people's health. Along the years, it has hired many people for whom the company is now responsible. IBA is anchored in Belgium and affects both its society through direct employment and through its environmentally friendly – or not – actions. All of these stakeholders, in addition to the classic clients and shareholders, deserve to be taken into account. If IBA's management lost the control of the company, it is very likely that at least one of these would suffer.

2. Internal Financing

In this section, the motivations and consequences of internal financing will be analysed through some of the practical cases. Two main behaviours have been observed. In the first case, the entrepreneur decided to only use internal financing as a fuel for development. The second is true for most of the entrepreneurs interviewed and reflects a use of retained earnings to finance development in association with other types of financing.

Exclusive use of internal financing

Among the SMEs interviewed, ContenO had taken a very firm stand against all external forms of financing. The capital structure was clearly that of a family firm. Christophe Van Steen – the interviewee – owned 90% of the company and both his brothers had 5% each. No bank debt was taken over the course of ContenO's life.

Motivations

Not contracting any debt, formal or informal was a very conscious choice made personally by Mr. Van Steen. The fear that accompanied borrowing capital was clear. If the company starts being less performant because of any reason, the entrepreneur is automatically stuck. The main motivation for the complete absence of debt usage or external financing is a willingness to remain independent. In particular, Mr. Van Steen has two sons and sees this company as his legacy for them.

The motivation to avoid issuing new equity was, of course, also related to the independence of the company. Having a next generation to cater for automatically makes dilution even more costly. However, some short term financial considerations also came into play. ContenO had very high hopes of closing deals worth tens of millions of euros, namely with the American and the French army. The goal was to provide the troops with good quality access to water anywhere. Knowing the potential gains from these deals and the - surely arriving - future deals, giving away stock at this time would have resulted in a significant loss. If shares had to be sold, it would be much better to sell after those deals are closed, especially since the company was very confident they would be selected.

Consequences

Mr. Van Steen himself was perfectly aware, when making this choice, that disadvantages would come along. He knows that the company could not evolve as fast as it would probably have otherwise. A practical example of such slow evolution is the development of their brand new "all-in-one" systems. Before explaining what happened in this particular case, I will first give an overview of how ContenO came to develop such system as well as the competitive landscape in which it evolved.

In the bottling industry, the key pain point for customers was the size of the necessary plants. Over the years, ContenO had been able to reduce the size of these from lines measuring hundreds of meters to simple 20 meters-long containers. While attempting to find suppliers to build those revolutionary containers, Mr. Van Steen realised that Karcher was also developing a similar tool. They were, therefore, involved in a competition with a giant. The challenge for ContenO was clear, they had to find a way to beat Karcher, even though they were insignificant compared to them in terms of size. The key focus then became the technique. Karcher was not a bottler, originally. Their containers had plenty of technical issues, meaning ContenO could easily do better.

Then came the idea of developing one single machine, instead of a container subdivided in machines which, all together, could be used for bottling. This all-in-one system is the smallest ever built and truly had an important potential. However, more time and money than ever expected had to be invested in this project. Two consequences arised from this. First, when the American army deal came on the table, the system was not ready and ContenO competed with its second-best product, the container. However, technically speaking, their container was still better performing than that of Karcher and should have won the bid. Many explanations were given by Mr. Van Steen as to why this did not materialize. He explained how Karcher clearly violated their patents and how he believed there was money under the table involved. While these explanations might be valid too, it is important to note that having had additional resources available at this time could have helped contenO fight back. The extensive use of retained earnings to develop a very costly project limited the ability of the company to hire good lawyers, exert influence and resist the financial pressure of Karcher on other aspects.

Use of internal financing in combination with other tools

On the other hand, many entrepreneurs chose to use their retained earnings in combination with other sources of financing. A good example of this can be found in the IRIS group. Founded in 1987, the group has been making positive profits from operations since 1991. It has, therefore, had extensive opportunities to use retained earnings to finance its development (de Muelenaere, 2017). However, significant capital investments have also been obtained.

Motivations

At the time of launch, IRIS needed significant capital to be able to develop and manufacture its high technology products. Financing this large project exclusively through their savings and those of their families and friends would have led to a severe undercapitalization and, simply, the inability to launch any product. For this reason, they accepted 1.5 million euros from the financial holding Ackerman & van Haaren, leaving both founders and the university as minority shareholders.

In 1992, after Ackerman & van Haaren had stepped out as well as the company that replaced them, dr. de Muelenaere and Pierre Rion bought their shares back through a Management Buy Out. This operation was to be financed by future profits of the company, providing a first use of the newly positive operational result. In the years that followed, the company remained profitable and was mostly self-sustained (de Muelenaere, 2017). However, IRIS' management soon realised that simply re-investing earnings was not sufficient. Growth and profits were still modest and the competition remained very intense. In order to stay ahead of competition, IRIS issued new capital by selling shares to 15 Flemish Angels and KredietBank (KBC). Later on, in 1999, growth was further accelerated through an IPO which raised 17 million euros.

Consequences

The fact that IRIS was profitable and able to re-invest its earnings had a significant impact on their success. When the company was launched, there were around fifty competitors for a market which was known to be large enough for only three. By tapping into the more profitable corporate market, IRIS was able to maintain profits and, therefore, invest more in R&D. Along the years, these investments allowed them to reach the top three on the market and maintain a profitable position. However, the market for OCR was moving very quickly and IRIS could not allow competitors to go faster than them. By issuing new capital, the company was finally able to go after Kofax and Readsoft who were previously developing faster on the very profitable corporate market. New investments could be made and the position of market leader ensured.

3. The use of debt

Simple debt

Debt seems to be a relatively commoditised product, which is used by most companies but not highly relevant to their financial strategy. Furthermore, Michael Philippart de Foy from Smovin explains that bank financing should not be the focus for younger enterprises as the main value they build is immaterial, which cannot be collateralized. Interestingly, in the case of IRIS, it seems debt level is quite low and mostly used to finance buildings, which are tangible assets (IRIS, 2007). Since the rest of IRIS' business is more focused on intellectual property and technological advancement, it seems this debt usage is consistent with this logic of collaterals.

One entrepreneur interviewed did put high emphasis on debt financing throughout its development, Xavier Slabbaert from Flowell. For a start, the two owners could access 100% of the capital thanks to a management buyout supported by large banks. In the beginning of their direction, the company reached a leverage of 7. Three main reasons lay behind this surprising decision. First, the debt financing was mainly obtained in the years 2007/2008, when the cost of money was very low. In addition, the company has always had good relationships with banks, leading to even more interesting terms of financing. Second, as Flowell's business is an industrial one, investments are typically affected to material goods such as machinery. With an extensive risk analysis and the existence of collateral, Mr. Slabbaert is always relatively sure to be able to repay the debt and, therefore, avoid a dangerous situation potentially leading to bankruptcy. Finally, Mr. Slabbaert does call Flowell his baby. According to him, taking on debt makes more sense than involving someone else in the capital because he would prefer keeping it shared between the two owners-managers. Of course, this is only reasonable because of the relative certainty of being able to repay debts. Otherwise, this would not only endanger his ownership but also the future of the company itself.

Convertible debt

When asked about the different tools used to finance development, Sébastien Veldeman from AudioValley mentioned the usefulness of convertible debts. Typically, the company would find investors having a similar profile to the equity institutional investors. Offering a tool such as the convertible debt means the company does not have to repay the capital at the end of the period but still pays interest. The interesting aspect of such a tool is that owners can partially share the risk of the company with an external partner. Another advantage of this type of financing is given by Smovin's founder. He explains how early stage funding through business angels or other unformal investors can result in inaccurate valuation of the company. By using convertible debt, this matter is delayed until the next capital increase. At that time, more knowledgeable investors will help determining the value and the lenders from the previous round will enter the capital at a discount.

Crowdlending

As opposed to what had been assumed in earlier chapters of this thesis, it seems crowdlending is generally not used as a seed or early-stage financing method. Indeed, platforms such as Look&Fin typically require a minimal existence of three years as well as 1 million € revenues in order to be listed. The reasons behind this is the protection of the lenders. The debt being heavily subordinated, with very few guarantees, it is necessary that the company has some reimbursement capacity at least.

According to Camille Lambillon, business analyst at Look&Fin, the use of crowdlending is very similar to that of classic debt. Working capital needs, physical investments or even a takeover to increase market share are typically financed on their platform. There are, however, many motivations for an entrepreneur to use crowdlending instead of a classic bank debt. First, by simply diversifying the sources of funding, the company will be less dependent on specific institutions. Second, the time period between a file being completed and the funds being available is only 4 to 5 weeks on Look&Fin, which is highly valuable for entrepreneurs. Also, since the debt is issued with very little guarantees, this can be considered as quasi-equity, reinforcing the balance sheet and allowing the entrepreneur to access even more funding afterwards. The last reason for crowdlending is simply the marketing effect of the platform. Thousands of members are exposed to the project, publically supported by Look&Fin.

4. State aids

According to Michael Philippart de Foy, founder of Smovin, subsidies and other public aids are relatively easy to obtain in Wallonia. Indeed, the region was very industrialised and allocates significant resources to completing the transition out of the industry. Many investors such as NivelInvest or MeuseInvest aim at boosting their local start-up environment and are publicly funded. This is the main reason the two co-founders, originally from Brussels, decided to establish the start-up in Genval, Wallonia. The company also received from the region significant subsidies namely for research & development, consulting services, marketing and hiring expenses. The founder explains that a simple file allows most start-ups to access this finance. He truly believes this is a highly efficient way to access funding as there is no dilution or obligations alongside the contract. The conclusion he gives is that there is money to be obtained at fair conditions if the entrepreneur knows where to look.

5. Issuing equity

Equity financing involves many sub-categories, all of which are meant to strengthen the balance sheet of the company by lowering the debt to equity ratio. Michel Petit claimed it is very important for SMEs to have a strong financial situation so they can face small issues without being forced into a sale immediately. This has been proven by the case of ContenO. For them, when a few concurrent issues came in at the same time, the lack of liquidity forced them to look into a sale to Karcher. While, in the case of Upignac and ContenO, this “strong financial situation” comes exclusively from retained earnings and family investments, the statement can be extended to companies who do not restrict their finances as much.

Of course, another reason for issuing new equity or selling stakes in the company is simply the absence of other options. A good example of this is the case of Real Dolmen. They recently sold a majority stake of their business to Gfi informatics. At the time, two issues were materializing, demanding a fast and powerful answer. The first was linked to Real Dolmen’s customers. They were quickly internationalizing and requiring their software supplier to make the move with them. A second issue was the consolidation of the overall market, with larger players starting to attack the company’s market slice. Real Dolmen then needed to grow fast by making significant acquisitions. However, the total cash and debt availabilities amounted to 70 million euros. This was very little and the company could not have moved fast enough without the financial power of a larger group. The case of Real Dolmen is an extreme as it leads to a loss of independence. However, a significant investment from an industrial investor or a private equity fund without giving a majority stake can be manageable in less demanding situations.

Private investments

The first category of equity investment is financed by private institutions or individuals. Before diving into sub-categories, it is important to note that these investors’ profile matter. It can impact a company’s development in two ways. First, their knowledge and network can be highly valuable in the board of directors. As explained by Michel Petit and Paul de Schrijver, having such valuable people sitting there can be critical for the development of the company. Of course, such directors can also be obtained without an equity investment. However, when accepting significant amounts of money from a private investor, it is important to remember this person will probably be sitting on the board. Therefore, their qualifications matter. Second, the long-term orientation of the investor will determine how much change they will force on the company as well as the type of exit possibilities.

The long-term orientation

As pointed out by Pierre de Muelenaere, having long-term oriented investors can truly make or kill the independence of a company. In his case, he was lucky enough to share ownership with the university from which it originated (Université Catholique de Louvain), a Belgian holding company (Ackerman & van Haren) and a co-founder, Pierre Rion. The two founders had a clear willingness to remain independent, as the motivation behind starting this company was to have their own project. Of course, on the university's side, the objective was to fund research and, hopefully, have successful entrepreneurs emerging from their ranks. This can have both financial benefits – as an important shareholder of the project – and reputational benefits for the university. While the holding sold its shares rapidly because of a switch in their strategy, their goal was not to transform the company within a few years and re-sell to somebody else. A holding has as objective to maintain its stake relatively long and let the enterprise develop. This "luck" in getting such long-term oriented investors resulted in 33 years of independence for IRIS. Mr. de Muelenaere finally sold the company on his own terms, to a company he believed could truly develop his "baby" further and only when he felt like he was starting to be weary of the experience.

Another good example of the difference between having long-term or short-term oriented investors is found within IBA's extensive financial history. IBA started with a financial profile very close to that of IRIS. 60% of the capital was owned by the Université Catholique de Louvain (UCL) and 40% by an industrial partner, Institut des radio-éléments de Fleurus, with only a small proportion left for management. In 1991, the company was about to launch a new line of products and developing the company namely through a partnership with Siemens. Therefore, they needed more financial muscle. The company then accepted funding from a Venture Capitalist. At that time, the most important factor for the entrepreneurs was to see the product flourish. This is also a motivation stated by Pierre de Muelenaere (IRIS). Both him and Pierre Mottet (IBA) declared that, when they realised they needed cash to help their product survive, they took what was available to them, taking significant risks for their independence.

A few years later, the fund wanted to pull out and signalled to the management and the rest of the board that it was probably time for a sale. Anyways, "IBA was too small to compete on its own". Finding no appropriate buyer that would respect the management's will, they decided to buy all the shares of the VC back. With the help of banks, 80% of the employees invested some amount in the company. This way, they were able to go back to owning 51% of the company. Afterwards, IBA became a completely self-managed entity, with the outside help of independent directors sitting at the board. To illustrate how this new capital structure was truly aimed at the long-term independence of the company, the name of the holding created to help employees buy the shares is called "Belgian Anchorage".

The value of the investor at the board

Interestingly, many of the companies interviewed accessed capital through private institutions which do not necessarily qualify as Venture Capitalists or Private Equity funds. Rather, financial holdings were important historical investors for Real Dolmen, IBA and, as previously mentioned, IRIS. Industrial investors also seem to have an impact with, for example, the Colruyt group who was the main shareholder of the "Dolmen" part of Real Dolmen and the Radio-elements institute of Fleurus for IBA. These types of investors are interesting to young businesses as they provide capital and, sometimes, knowledge at the board but often do not aim at modifying it entirely or reselling fast.

In the case of Flowell, for example, the company decided exceptionally to use external capital from a venture capitalist namely because the investor has extensive knowledge of the industry and, according the Mr. Slabbaert, is simply highly intelligent and valuable at the board. Upignac is also a good example of the value that can be brought by larger industrial investors. The example is not perfect as the value was derived from a total temporary sale of the company rather than a cooperation but is still interesting to analyse. The Petit family decided to sell Upignac to a large, experimented family group in 2012. Luckily, they were able to buy the company back three years later. As part of the management kept working within the company during this three years period, they were able to learn a lot from this more professional group. Some of the learnings include new financial reporting methods, more strategic orientation of the board and a collaboration with KPMG for accounting.

While these investors can indeed bring value due to their knowledge, some entrepreneurs do suffer from the excessive control they exert. For instance, AudioValley's founder decided to launch an IPO specifically to buy the shares held by their Venture Capitalist back. Indeed, he thought they would require too many updates and put pressure on the management. However, this is limited to excessive monitoring. It seems Belgian Venture Capitalists and private investors do not typically push for major strategic changes. Rather, they give advice and check that the performance is going up.

Another concern regarding knowledgeable investors is the excessive percentage of shares they require. Smovin accessed early stage capital namely through start-up studios. These organisations aim at entering young companies' capital in exchange for finance and a dedicated team of advisors. Looking back, Mr. Philippart de Foy believes they took too much shares for what they really offered. Generally speaking, he advises entrepreneurs to hire consultants if they need help and pay for it in cash or subsidies rather than shares of the company.

Public equity

Entrepreneurial perspective

Among the companies analysed, five have made use of public equity to finance their development. Audiovalley, IRIS, IBA, EVS and RealDolmen. Different aspects of the use of public equity have been highlighted in each interview.

Pierre de Muelenaere explained the rationale for IRIS to raise public funds. In 1998, the company was still relatively small and, while being successful, its growth rate and profitability did not satisfy management. Indeed, the rise of two international competitors had put them under pressure. Because of low equity position, IRIS was unable to develop sufficiently. The results of this IPO were 17 million raised from a variety of individual investors causing very little risk for the independence of the company.

Both Pierre Mottet and Pierre de Muelenaere touched on poison pills, used to protect the company from an unwanted takeover bid. Having their own project for IBA and IRIS, they did not want anyone to be able to offer their public shareholders a good price and walk away with a majority stake. Typically, explains Mr. de Muelenaere, such "pills" are barriers in the bylaws which make it financially irrational to acquire more than a certain stake in the company. They can also make it impossible for the acquirer to obtain sufficient seats at the board and make decisions for the firm. While both IRIS and IBA used those well to remain untouched, EVS was not so conscientious and faced a situation endangering its autonomy. This company was founded by two entrepreneurs and also went on the stock market to raise capital. Later, the two founders exited the company and left it on the stock market, open to any takeover bid. It resisted relatively long thanks to a high share price. However, that price recently became interesting. In October 2018, a competitor suddenly announced it owned 3% of the company. Following a moment of panic, the managers were able to organise a capital increase, involve new long-term shareholders and stabilize the situation. While the situation was solved for EVS, this example clearly shows the risk a badly managed IPO can cause to the independence of the company.

Finally, Paul de Schrijver explains how using public funds with a small or even micro capital can have some drawbacks. RealDolmen only has a capital of around 100 million € on the stock market, which is considered very small. He describes three factors that make it difficult for such a company to perform well on the public market. First, institutional investors tend to only acquire small portions of a company but still want a minimal investment per transaction. Otherwise, it would require them to manage a very large portfolio. These two conditions often disqualify RealDolmen for such investments and they rely mostly on small, so-called retail investors. Secondly, the market for such small companies is relatively illiquid and large investors do not want to take the risk of being stuck with unwanted assets. Finally, financial analysts have reduced their coverage of small companies, meaning little information is shared and the investment becomes riskier.

These difficulties were also acknowledged by Mr. Veldeman, from AudioValley. However, he argues that by being quoted on the Paris exchange rather than in Brussels has many advantages. Indeed, tax incentives are in place to push institutional investors to acquire shares of SMEs on the public markets. When AudioValley went public, most of its new stockholders were investment funds that specialise in making smaller investments for small caps. He also mentions the issue of illiquidity. Around 1/4000 of the shares of the company are exchanged daily on the market. This means if a large investor wants to get out fast, he risks being stuck. However, Mr. Veldeman mentions the possibility for them to look for acquirers offline rather than offer the shares directly on the market. The exit then looks closer to that of a private investor but the deal is still made through the stock exchange.

In terms of consequences, they seem to be highly positive for all the entrepreneurs interviewed. First, the capitals raised were all very consequent. Second, Mr. Veldeman mentions how being on the stock exchange requires a lot of documentation. This is costly in the beginning but requires relatively little effort on a continuous basis. In addition, having standardized reporting will make the company more credible to other financial stakeholders such as banks or private investors. If there is a need for further funding, this puts the SME in a better situation, reducing information asymmetries. Mr. Veldeman also argues that, whereas a drop in the share price is not a positive signal about the company, there is no major risks left once the IPO is made.

The positioning of Euronext for SME financing

The first point to note when it comes to Euronext's value proposition to small enterprises is that, in Brussels, there is only one recent case, AudioValley. In addition, this case is the result of a double listing as the company chose to become public in Paris initially. The CEO only later listed its shares in Brussels, mostly for visibility purposes.

Benoit van den hove, head of listings at Euronext Brussels, considers this as a major issue for Euronext. He explains this situation in Belgium through a different regulatory framework, which itself originates in a highly risk avoidant culture. Investing, especially in the very uncertain field of SMEs, is considered ruthless in Belgium. In addition, the fiscal environment for savings undergoes changes on a regular basis. Unfortunately, stability is key to push investment. All these factors result in the absence of specialized banks and other institutions that are willing to follow SMEs through the IPO process. Therefore, those small enterprises have to hire the help of expensive banks and consultants, making the whole process too cost intensive compared to the total amount to be raised *in fine*.

However, Mr. van den Hove does argue that there are multiple advantages for an SME to be financed through a public listing. Compared to other competing financial stakeholders such as private equity, family offices and corporates, the stock exchange is more suited to those entrepreneurs that truly believe in their future growth. Indeed, the private funds tend to give a higher value per share but dilute the founders' decision-making power, whereas the public market allows them to keep control. Of course, there is some pressure put on the short-term results but Mr. van den Hove does not see a significant change in the behaviour of managers when entering the stock exchange. In addition, being publicly listed gives a constant objective value of the company, making it easy to use shares for acquisitions or as an incentive for employees. Finally, a certain legitimacy is gained through the publishing of standardized accounts. While Mr. van den Hove does not believe this helps to have better financing conditions with other stakeholders such as banks, he does mention this can help the company access larger clients. As a supplier, credibility is highly relevant to close large deals.

Some initiatives have been taken in order to help SMEs access those advantages. For instance, Euronext is in discussion with different banks to negotiate a better accompaniment of SMEs in the IPO process. Another initiative is specifically directed towards growing high technology companies. The programme “TechShare” currently provides guidance to around 50 selected companies on a potential public listing. Finally, Euronext has entered a collaboration with Spreds in order to follow high potential enterprises and, hopefully, attract them on the stock exchange. However, this initiative seems to simply be part of a general vigilance behaviour of Euronext, which is always on the lookout for new high growth Belgian companies.

Business Angels

Business Angels are another means for small companies to access private equity financing. In order to understand better how this works, I interviewed Gauthier van der Elst, business analyst at the Business Angel network BeAngels. He explains the role of the platform in funding seed and early stage companies by matching private investors and entrepreneurs’ projects.

Motivations to use the BeAngels platform

The first motivation is, of course, to access the resources of those wealthy individuals willing to invest in new projects. Typically, these are relatively hard to find as they are not part of any institution. The platform is then a match-maker which also selects the best projects to be presented to the angels. In 2018, 4.6 million € had been invested in start-ups and scale-ups via BeAngels.

However, the most value added can be found for the entrepreneur in the leverage effect of this initial investment. Indeed, a total of 23 million € where received by enterprises as a result of the angel funds. This phenomenon can be explained by the increased contribution of three actors in financing. First, the regional investors will typically not invest for more than 50% of a fundraise. Therefore, the entrepreneur can double the amount received on BeAngels by adding regional investors to the equation. Still in the public sector, subsidies are also often conditioned by the amount of capital secured by a company. Finally, increasing the equity to debt ratio sends a very positive signal to banks, allowing for debt financing at much better conditions.

Consequences of Business Angel financing

From BeAngels’ perspective, the outcomes are measured by specific metrics, which all send positive signals. First, they observe that 80% of the projects financed on the platform are still alive 5 years after the initial investment. Second, the network also takes into account the number of companies that come back for a second round of financing. Out of the 41 fundraises that occurred last year, 21 were second-round angel financing. It is indeed very easy for start-up to come back as they are fast tracked throughout the process. Business Angels have a preferential right, which they often use, allowing the entrepreneurs to keep receiving more funding from the same investors.

Unfortunately, two main disadvantages should be noted. Firstly, Michael Philippart de Foy from Smovin points out that Business Angels typically are not trained for valuation of small companies. Therefore, the entrepreneurs risk unfair dilution or conflicts later on due to a feeling of uncertainty concerning the accuracy of the initial valuation. Going through a network such as BeAngels would not help in this case as it means a higher number of smaller investors, each having their own opinion on the topic. Secondly, as noted by both Gauthier van der Elst (BeAngels) and Alex Houtart (Spreds), Business Angels typically like to take seats at the board. While the first believes this is a value added for the entrepreneurs, the second is concerned about the control that is lost. When each early stage investor is allowed a seat at the board, it becomes more difficult to organize the second round of financing. Mr. Houtart argues that, often, Angels will not be willing to participate in the next round but also wants to avoid dilution. This can lead to a deadlock, delaying the necessary fundraise.

Crowdfunding

In the case of crowdfunding, an interview with Alex Houtart, head of issuers at Spreds, gave multiple insights on how this tool can be used by entrepreneurs. Active at every stage of development, from seed to public equity through a partnership with Euronext, the platform can truly accompany entrepreneurs through the entire journey.

Motivations to use crowdfunding

Mr. Houtart explains that, statistically, there are three main reasons for early bankruptcy. The first one is under-capitalization. Spreds can help on this aspect by providing finance with a possibility for relatively high amounts. Secondly, a team made out of scientists instead of entrepreneurs is most likely going to fail. Through the profile building and some pitching, Spreds can directly tell whether this will be an issue or not for the team. Finally, a lack of market-fit is a major risk factor. Entrepreneurs can then use the platform to gather information on the needs of the crowds. There are communication tools available and those that use them are very good at it. A good example is found in Acar'Up who used his 150 crowd funders to go all around Belgium in pharmacies and explain the product characteristics, with the hope to sell it. They were out of stock in three months. Unfortunately, only around 20% of entrepreneurs make active use of this communication tool.

Interestingly, though, Spreds never allows for the crowd to invest "alone". A project will only be posted on the platform if there is a lead investor, most often a professional one such as a Business Angel. The crowd will then invest at the same conditions as that particular investor. This is a limitation which removes some of the motivations for crowdfunding as detailed in the literature review. Indeed, the ease of meeting the crowd and the good terms an entrepreneur can hope to achieve are undermined by the necessity to find a professional investor anyway. The main use of the platform is then to double or more the initial investment of the lead investor, while not giving away more percentage of the company to a single person or entity.

Consequences

In terms of control on the company, it is important to note that Spreds offers a pooling vehicle that gathers all the crowd funders, called Spreds Finance. They will be the only representative of the crowd, simplifying the management of these investors for the entrepreneur. However, this does not seem to put the controlling stake of the entrepreneur at risk as the aggregated value of the shares put on the platform are never sufficient for Spreds Finance to have a formal say in the decision making.

In the case of a later stage capital increase, the crowd does have a preferential right, meaning they are always allowed to subscribe to the next stage. This means that most entrepreneurs will be led back to Spreds if they want to further expand. While this might look like a limitation, it has multiple advantages. First, they already know the platform and the process will be made easier. Second, Spreds, understanding that these later rounds needed larger investments, moved to different markets of equity finance. They now deal with institutional investors as well as the public markets, offering a full accompaniment for the successful entrepreneur. Finally, the crowd has a preferential right but strictly no ability to stop dilution if they do not want to subscribe. With, for example, a more limited number of business angel who would sit at the board, it is likely they will attempt to stop a capital increase they do not want to subscribe to.

Chapter 2: Quantitative research

In order to get some quantitative insights on the effects of different forms of financing, I looked into some publicly available data. The data concerned specifically firms that made use of either equity crowdfunding or business angels. The variables analysed can be found in the PART III, methodology. A full display of the results can be found in Appendix B.

Before analysing the detailed consequences of the use of business angels and crowdfunding, it is interesting to note that they both offer, as assumed in the methodology, early-stage finance. Indeed, on average, the companies used crowdfunding only 1.6 years after inception and 1.9 years in the case of business angels. With the small sample used, this difference is insignificant.

The comparison can thus be started on the first criteria; growth. With an average amount raised through crowdfunding standing at 77 091 €, the growth power of these type of platforms seems relatively limited compared to other options. Business Angels jointly invest on average 561 822€, according to this sample, which is significantly higher. The second indicator used to measure growth was simply the evolution of the EBITDA of the funded companies. Here again, a clear advantage can be awarded to business angel financing. With an average growth of 51% over the period of analysis, business angel networks clearly outperform equity crowdfunding, which provides an 18% growth average. These numbers are obtained by removing the extremes from the calculations. The limits of the dataset will be analysed in detail in the fifth part of this thesis but let us point out that this particular outcome (EBITDA growth) is highly flawed. The simple fact that most companies using crowdfunding did so only 3 years ago can, of course, impacts the overall EBITDA growth. By dividing the growth by the number of years between funding and 2018 (latest information on EBITDA), we obtain a clear advantage in favour of crowdfunding, with a yearly growth of 19%. Business angels would only provide 4% of yearly growth. Again, this information is flawed by the number of years of existence. Growth tends to go faster in the first few years and slow down or even crash down after five years, which would explain a very low percentage for the Business Angels networks.

The second parameter that needs to be analysed is the independence level obtained a few years after the financing. Two main indicators can be used. The first one refers simply to ownership. In 2019, 80% of the companies funded on Spreds (crowdfunding) had kept over 50% of ownership. The average percentage of own shares kept for the founders is of 68%. This can be compared to the lower 38% of shares owned by the founders in the case of business angels financing. When using this method, only 44% of the entrepreneurs could maintain a 50% stake in their company. Another important data to keep in mind is the percentage of founders who remained reference shareholders. When using crowdfunding, 90% of them manages to stay jointly the most important shareholder, even if they have lost the 50% majority stake. With business angels, the average percentage is the same as that of the majority ownership, i.e. 44%. This seems to make sense as crowd funders will typically not become significant shareholders, as opposed to business angels. While this can also be impacted by the time passed after the funding, I believe the results still hold as most of the business angel dilution happens during the first round. A second indicator, which is even more representative of the "effective" independence, is the decision-making power kept by the founders. Here again, crowdfunding platforms offer a clear edge. An average of 74% of the board is kept by the entrepreneurs and 80% still hold the main decision-maker office, usually the managing director. This can be compared to only 27% of the board kept when business angels intervene and 50% of the companies having one of their founders as main decision-maker.

The last parameter considered in the dataset is the value creation, for which I used an estimation of the return on investment as a proxy. By calculating the total profits made by the company since the year of the first investment, we can observe that all ROI are negative, for both business angel financing and crowdfunding. The main reason behind this find is probably the young age of these companies and the important initial losses that still have to be offset. No significant difference can be observed between crowdfunding and business angels finance.

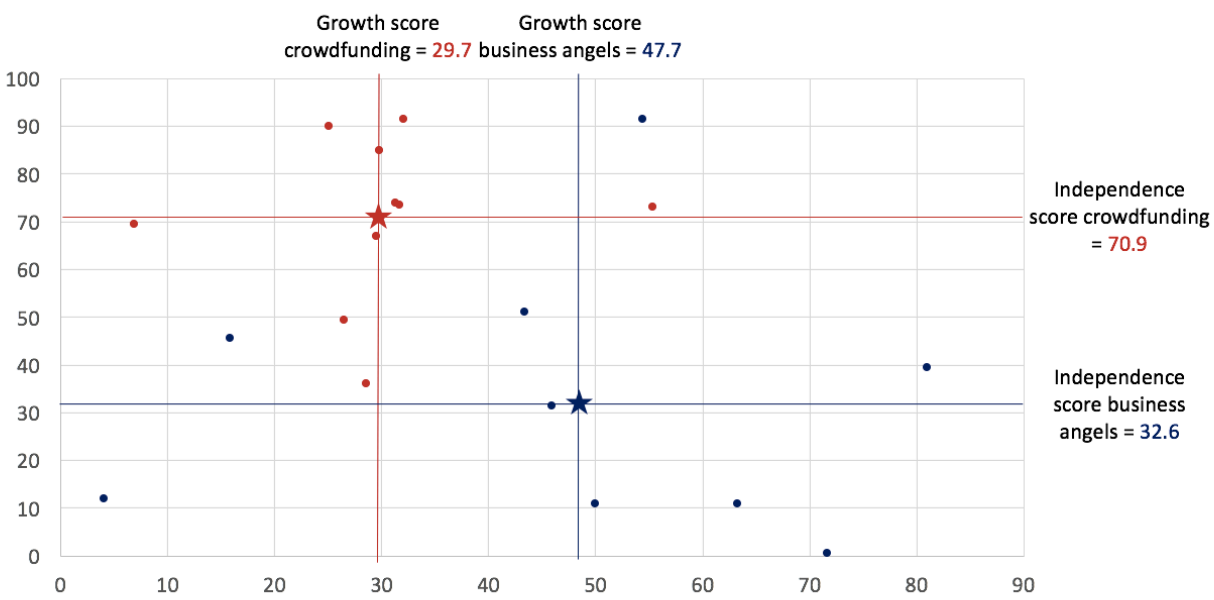

Figure 6: summarizing scores of the two financial tools

PART V: DISCUSSION & CONCLUSION

As I had imagined the dream of every entrepreneur was to develop its baby into a successful company, I decided to look into the means available to help them achieve this goal. More specifically, I wanted to understand how they could hope to finance their project without giving away their independence to competition or outside investors. This topic is interesting not only to me but to society in general. Indeed, entrepreneurship and SMEs are drivers of the economy everywhere in the world (European Commission, 2011). This thesis had as a main goal to help this section of our economy prosper by, hopefully, providing guidance to entrepreneurs on how to access finance. Financial literacy is considered to be a clear determinant of the efficiency of a company's capital structure (Delic & al, 2012).

In this final part, I will first review the main argument brought up by literature (Chapter 2). Then I will give an overview of views gathered on the field and the recommendations I make from that (Chapter 3). After stating a few limitations to this research, I will conclude by opening the topic to further research that can be carried in the next few years (Chapter 5).

Chapter 1: Reminder of the theoretical aspects

Before diving into the different financial tools available for companies to develop themselves, let us not forget that not all firms wish to grow indefinitely. Other, non-financial, goals can be pursued better as a small entity and it is imaginable that a firm wants to limit their growth to remain such an entity. In such a situation, the firm could heavily rely on their own profits to finance the activities of the next year. Such a financing method is called internal finance. However, in many cases, the pressure of the industry will force the company to grow in order to survive. In that case, the entrepreneur has to start looking outside the boundaries of its firm and look for external financing. Two main categories are discussed in the literature.

The first one is debt financing. This can be acquired through banks, private lending institutions or public bonds. However, it was concluded that the lack of creditworthiness of small firms was a major brake to this type of financing as it leads to unfavourable terms. This holds especially well in the case of immaterial developments and innovations. Therefore, a young company should either really invest in bank relationship management to lower these costs or look another way for their financing.

The second, more predominant option in the literature, is the equity financing. Many cases were discussed, from the most early-stage (Family, friends and fools) to the most advanced (public equity). While each option has its own advantages and disadvantages, it can be said in general that equity financing poses a threat to independence. Indeed, dilution occurs automatically, meaning loss of financial autonomy. A good valuation at the beginning and well thought anti-dilution clauses can be effective tools to protect the founding team. In some cases, decision-making power is also limited. For example, when a venture capitalist or a private equity firm enter the capital, they will generally try to influence the strategic direction of the company. In addition, these investors will always be planning their exits, meaning the matter of independence will be at stake again a few years later. Many authors point out the advantages of the public equity markets. It allows to counteract the disadvantages of earlier stage pricate equity providers - small amounts - and later stages - too much control given away - by simply accessing a wide pool of investors. The dilution is, then, only financial.

State aids were also discussed as an alternative way to access finance. In this case, the small company receives very advantageous funding in different shapes, either to promote entrepreneurship, to help the SME sector or to incentivize some behaviours. The main advantages are the maintained decision-making power as well as the conditions of the funding. Unfortunately, authors mention that only small amounts can be accessed this way.

In the last chapter of the literature review, I analysed the specific case of crowdfunding, an emerging financial tool for small companies. The two main categories of interest are crowdlending, where the entrepreneur issues debt to the crowd, and equity crowdfunding, where the entrepreneur receives money in exchange for shares of the company. I have decided to take a special look at these because they have been the focus of many authors in the financial sector these past few years and provide many advantages for entrepreneurs. Financially speaking, crowdfunding allows them to access small to medium amounts at usually good conditions. By using the crowd as an investor, the entrepreneur should not be afraid of losing their decision-making power as each investor is largely insignificant. Also, crowdfunding can be seen as a marketing tool. Indeed, the company and its product are publicly advertised on the platform to a large number of potential customers. They can, therefore, not only use it to sell their product better but also to get feedback and adapt it to the crowd’s needs.

Chapter 2: Main insights from the practical aspects

1. The tools that are in use and how they perform

The “too hard to reach” tools

While public equity has proven its many advantages, it seems it still lies out of reach for most SMEs in Belgium. Only one of them, Audiovalley, did an IPO on the Brussels Stock Exchange last year. This is due to a high risk avoidance culture in Belgium and a changing fiscal environment. Euronext is, fortunately, taking initiatives to make taking this step easier for small enterprises.

Debt financing has also proven to be difficult to obtain for young ventures, especially those with highly immaterial value. As long as the information asymmetry between banks and small borrowers is not solved, the latter will keep considering this option to be out of their scope.

The most common tools

The financial institutions that were mentioned the most during the interviews were industrial and regional investors. While there is little mention of these in the literature of small enterprises financing, they do seem highly predominant in Belgium. In the case of regional investors, this can be explained by a high willingness of the Walloon region to boost economic growth out of the “industrial era”. Industrial investors are those large firms or families active in a specific industry and investing in a large portfolio of firms. An example of this is the involvement of Colruyt group in RealDolmen. Both types are usually long-term oriented. They provide significant amounts of funding, without disturbing the leadership of the company, making them a real option to access growth and independence.

Venture Capitalists or financial holdings were also commonly used at some stage of development among the companies interviewed (IRIS, IBA, Flowell, Audiovalley). While their exit has been a sensitive time for all of them, they did provide necessary funding at a time the company really needed it. Each has found different options to buy their shares back, management buyout, entire personnel buyout or even an IPO.

Finally, it seems the younger ventures (Smovin and companies analysed for the quantitative analysis) often used specialised start-up investors for early stage funding. These organisations provide not only financing but also a full team of counsellors. Unfortunately, it seems they make the start-ups pay a high price, all in shares. Therefore, they might not be the best option to access counsel and/or funding.

The "not-so-used in the end" tools

While crowdfunding is generally recognized as an interesting tool, still very few ventures use equity and/or debt-based crowdfunding. Since the levels of funding are quite low, entrepreneurs mostly regard it as a marketing tool. However, the conditions of this financing are still very interesting and should not be overlooked.

Business Angels are also a hot topic of conversation that does not translate into such a large number of applications. In addition, the involvement of such investors can bring more issues than expected for the entrepreneur. For instance, it is common to end up with too many people at the board, trying to influence the company and its future fundraisings. Another issue is the lack of valuation expertise. Angels typically do not know how to estimate the value of a very young venture, leading to conflicts either from the beginning or later on.

The tools we should use more

The founder of Smovin made a very convincing case about the use of both convertible debt and state aids. The first should be used in early stage financing as it allows the company to delay the valuation until someone capable of doing it comes in. The second is widely available in Wallonia for many different applications. While it can be a pain to understand exactly which aids a company is eligible for, the conditions of the funding and the complete autonomy that is kept is well worth it.

Public equity should also be made more accessible to small companies, as discussed in the "too hard to reach" section. Many enterprises have benefited from the large funding this can provide as well as the ability to keep the control in-house. However, this usually comes at a later stage of development.

Summary of advantages, disadvantages and advice on the different tools

Table 2: Summary of advantages, disadvantages and advice on the different tools

	Advantages	***Disadvantage***	***Constraints***	***Keys to efficient use***
Internal Finance	Control Financial freedom	Speed of development Inability to compete	Being profitable	If no sufficient funds are generated, it is necessary to combine with external funds
Classic debt	No dilution Higher amounts available	Difficult terms for SMEs Long-term constraint on profits	Having collateral Information to show the banks	Good relationship with a bank Use for material and safe projects
Convertible debt	Delayed valuation, avoiding conflicts on the board	Both interests to be paid and later dilution	Deal with private investors, negotiations on exchange rate	As an alternative to business angels
Start-up studios	Early help for young companies Team of counsellors	Dilution too high for service provided	Use the studio's team of counsellors	To be avoided Pay counsel in cash rather than shares
Business Angels	« Benevolent » motivation Personal knowledge & contacts	Early valuation by non-professionals High % of ownership and board taken	Often need to go through a network to find them	Avoid too many people involved Status not allowing blocking of next raise
Venture Capitalists	Professional valuation and knowledge High levels of financing	Exit Some strategic decisions taken Many anti-dilution clauses	Heavy documentation, high requirements	Choose the investor well to maintain effective independence
Industrial investors	Long-term oriented Control kept in-house	No real value at the board Could make an unforeseen exit	*(Not mentioned in interviews)*	As above, the choice of the partner is important
Public equity	Significant amounts Credibility gain Control kept in-house	Some short-term pressure on financials Low liquidity Takeover risk if unprotected	Very heavy initial documentation, though little continuous effort	Take the step! Paris has more options to help SMEs
Regional investors	High funding with low control loss Easily reachable in Wallonia	Do not typically invest for more than half of the fund raise	*(Not mentioned in interviews)*	Often used in combination with other investors at various stages
Other state aids	Excellent terms, sometimes free counsels, collateral or subsidies	Small amounts	Need to match the criteria, as listed on their website	Check the whole list Use a lot and play with the limits
Crowdlending	Heavily subordinated debt Marketing tool Faster than banks	Small amounts for quite a lot of trouble	Less than for banks, need for a 3 years of existence and 1m€ revenues	Working capital or physical investments Use the crowd!
Equity crowdfunding	Higher funding than crowdlending Less documentation than other equity Control kept due to the pool of investors Possibility for later rounds of financing Marketing tool	Still low amounts in most cases Relatively small market compared to other alternatives	Some documentation Need to find one major investor to lead the crowd	Use Spreds Finance as a tool of crowd management Double the money from another investor with little additional constraints

2. The complex topic of independence

What is our main goal: stay independent or prosper?

As can be seen from the data gathered on Business Angels- and crowdfunding- financed firms, growth and independence do not always go hand to hand. Often, getting more capital will lead to more growth but will also be a bigger threat to the company's complete independence. My original assumption was that at an entrepreneur would choose to moderate growth as much as allowed by the market in order to keep the control. This was motivated by a vision of the entrepreneur as a "parent" who wants to keep their "child". However, by looking at successful large corporations, one can see that it is not always the case. For instance, Bill Gates did not value his independence this much (Shah, 2019). It seems a parent can also be willing to let go of some control if it means allowing their child to prosper.

When Pierre de Muelenaere decided he was no longer willing to manage IRIS himself, he had the choice to transfer the control to one of his managers or to sell it to their main client (Canon). In the interest of the company and its future prosperity, he decided that Canon was the best choice. Paul de Schrijver was also faced with a major challenge. The company needed to either specialize a lot or grow very fast. On its own, it didn't have the capacity to grow fast enough to catch up with competitors. Additionally, RealDolmen's core business was to offer fully-integrated services, meaning specializing would go against the company's growing path. Therefore, he chose to let go of its independence in order not to threaten the development of the company. Similarly, when IBA's founding team went looking for funding to develop their new particle accelerators, their main objective was simply being able to develop those accelerators. The independence considerations only came afterwards.

Effective independence

Many entrepreneurs distinguished the idea of decision-making power and financial independence. While Smovin has lost more than 50% of their shares, the founders are still in charge of all the decisions. Investors do sit at the board but they mostly trust the entrepreneurs with their own project. It seems young entrepreneurs (Smovin), family business owners (ContenO) and more mature businesses with non-financial goals (IBA) still aspire to having the daily control over their company. However, from the various cases analysed, it seems keeping a majority stake in the company is not a priority.

The many factors involved in the concept of independence

As mentioned in the above sections, the objectives pursued by the founders at the beginning will influence the ideal development of the company. We cannot assume one company was unsuccessful at maintaining its independence because it was taken over by a larger entity. This might be the result of a strategy to develop the product to its maximal capacity. On the other hand, we cannot judge a smaller company unsuccessful because it did not reach the same level of growth. The founders could have decided to specialize in what they do, for instance, or to voluntarily constrain growth in order to keep control generation after generation.

However, the applications of both these strategies can be assessed. As mentioned by Mr. Petit: “Stay independent, not isolated”. The type of board will vary based on the strategy but should involve more than just the founder. Indeed, a strong desire for independence as shown in the case of ContenO can lead to having only one decision-maker, with no outside vision. Unfortunately, it seems many entrepreneurs find it difficult to leave their position of founder – controlling everything - and switch to a CEO mindset – delegating and taking advice. In this case, we can observe the risks posed by this “full independence strategy”, including the risk of a development which would be too slow to maintain competitiveness, the risk of making blind decisions and, as a consequence, the risk to endanger the unique value the company aimed to offer in the first place. Entrepreneurs should be conscious of these aspects and read the recommendations I provide with this in mind.

Of course, other parameters that do not involve direct choices from the managers also matter. For instance, the industry will also determine the development path and the financing options available. Flowell has an easy access to debt, allowing for large funding with no dilution. IRIS was competing in a “red ocean” and needed heavy, fast funding, turning to an IPO. Smovin has a smaller project, allowing them to make use of the smaller amounts offered through state aids.

To conclude this chapter, it is important to note that the first condition for independence is, of course, the health of the company. When ContenO lost a major contract, they were more vulnerable to the attacks from Karcher. As soon as EVS’ shareprice dropped, competitors made moves to take the company over. On the other hand, healthy IBA was able to finance an all-personnel buyout of the venture capitalist’ stock thanks to the promise of future profits.

Chapter 3: Recommendations

1. Should entrepreneurs stay independent at all costs?

As a general rule, founders should not keep complete independence as their first goal. It is more about giving the company the tools to be able to resist an unfriendly offer. When an appropriate opportunity arises, an intelligent discussion can take place and it might turn out that selling is the best option for both the entrepreneur and the company. Indeed, even if the entrepreneur wishes to remain autonomous in order to achieve non-financial goals, sometimes selling a majority stake to a more capable individual can be the best to reach those objectives. Being able to choose the time, the partner and the modalities should thus be the point of focus.

2. Which tools to use? In which cases?

In general, every tool has its advantages and disadvantages. The company should make the right choice regarding their strategy and, most importantly, diversify its financing.

The importance of the original goal

As shown in the comparison between crowdfunding and business angel financing, different objectives will lead to different optimal decisions. Do we want our company to grow as fast as possible or do we want to keep it in control to achieve non-financial goals? Similar differences occur between other tools. In later stages of development, the manager might have to choose between venture capitalists or other private financial holdings and public equity. The first will most likely allow them to make a profitable exit in the next five years but poses a risk to independence. The second gives a lot of funding and control but requires more attention.

General recommendation when starting up

Regardless of the long-term goal of the entrepreneurs, some general recommendations can be made in order to avoid the most common mistakes.

1. Try and push back the valuation of your company until professionals are willing to step in and do it. Choosing convertible debt over business angels can help you achieve that.
2. Make use of the resources around you! State aids come in all shapes and sizes in Wallonia. Your company is highly likely to be eligible for counsel, R&D funding, employment benefits or other.

3. Equity crowdfunding may not bring a lot of resources but it is a good tool to advertise your company and get feedback. If you go for it, make sure to use the input of the crowd as much as possible.
4. Whenever you can, pay for counsel in cash instead of shares. Start-up investors seem valuable but if your project grows as projected, they will soon have a larger share than they deserve.

Later stage SME financing

For later stage companies as well, different strategies can fit different objectives. Family enterprises will tend to turn to debt more often, for instance. However, the following advice holds for most cases.

1. Regional and industrial investors are highly valuable but choose them well! As long as they trust the management, they will let you do what you want. A long-term focus is interesting in order to avoid an untimely exit.
2. As soon as the company can consider public equity, use it! A lot of funding can be obtained with little threat to the independence, even if it requires a lot of work.
3. Crowdlending also usually becomes available later in the lifecycle of the company. Since the debt is highly subordinated, it does not cause a threat to the survival of the company and can be used as a marketing tool too.
4. Sometimes, when funds are needed, things have to be left to chance but it isn't because you left a venture capitalist enter your board that you will definitely lose the control. Schemes can be put in place to buy the shares back with the help of the banks or the public markets.

Chapter 4: Limitations and further research

1. Qualitative research

The scope of the research was relatively wide, involving the use of many different financial tools, and the number of interviews limited. For this reason, only a few different points of views were gathered for each funding method. Therefore, the results are difficult to generalize. However, all interviewees were asked the same question about their independence and how they believe this goal has affected their financial strategy. The results concerning the desire for independence itself are then more robust.

2. Quantitative research

In the case of the quantitative analysis, some major flaws can be observed. The first one is found in the number of cases. Both methods of financing analysed (crowdfunding and business angels) concern very few enterprises in Belgium. Additionally, because of the data gathering methodology, many did not qualify for the analysis. This could result from a lack of publicly available information, a bankruptcy or a very long history making it difficult to track all capital increases.

Secondly, the date of funding varies between the two samples. Since crowdfunding is relatively young, the cases are very recent. In the case of business angels, the name of enterprises I could access had received funding earlier. This can lead to skewed results concerning their EBITDA growth rate as well as the level of control kept by the entrepreneurs as of last year.

3. Further research

I believe many other researches can be carried in the field. Crowdfunding appears to still be a very young phenomenon. It would be interesting to see the effect it has on the growth and independence of companies using it when the researcher has more distance from the events. If a researcher manages to access a long list of entrepreneurs among many categories of financial tools, primary data can be gathered. The samples should be larger and across more categories in order to understand the key differences between these funding methods. This, however, cannot be achieved in the next few years. Another research that could be carried through sooner would involve a thorough analysis of the different factors blocking the way for SMEs in the Brussels stock market.

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