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CASE STUDY ON CROWDFUNDING

Working Party on SMEs and Entrepreneurship (WPSMEE)

This report contains a case study on crowdfunding as a finance mechanism for SMEs and entrepreneurs. The case study was conducted in 2014, as part of the WPSMEE project on "New approaches to SME and entrepreneurship financing: Broadening the range of instruments".

The report contains information about the functioning of crowdfunding; provides insights about the profile of firms that may be suited for this type of finance; highlights key enabling factors for its development; describes major trends in the market and access by SMEs; and offers some policy examples in this area. The study includes data up to 2012-13 and forecasts for industry trends in 2014-15.

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ABSTRACT

The present report is a case study on crowdfunding as a finance instrument for SMEs and entrepreneurs. The report aims to examine the characteristics, diffusion and uptake by new firms and existing SMEs, assessing its effectiveness in supporting innovative or potentially high-growth firms to overcome financial constraints; to evaluate what contextual factors can improve or hamper SME access to crowdfunding opportunities; to illustrate policy experiences and programme outcomes; and to identify good practices that promote the broader use of this financing technique.

JEL codes: G23, G28, G32, L26
Keywords: SME Finance, Crowdfunding, Regulation, Public Policy

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TABLE OF CONTENTS

Case Study on Crowdfunding **3**

Executive Summary **8**

Objective and methodology 10
1. What is crowdfunding? 10
Benefits of crowdfunding 12
Risks of crowdfunding 14
How crowdfunding platforms work 15
2. Market structure and trends (supply-side) 17
Market trends (quantitative evidence) 17
Selected national experiences 20
Drivers and constraints on the supply side 30
3. Regulatory framework 31
United States 32
European Union 34
Recent regulatory developments for crowd-investing 35
Regulation and capital flow models 36
4. Crowdfunding as a source of finance for SMEs (demand side) 37
Relevance of the instrument for SME financing (current and potential) 37
Types of SMEs for which the instrument is most suitable 37
5. Policies 39
Rationale for policy intervention 39
Policy experiences 40
Evaluation of policy effectiveness 42
Policy considerations 42
6. Conclusions and the way forward 43
References 44

Annex: Selected crowdfunding sites (as of July 2014) **47**

Tables

Table 1. Selected crowdfunding sites in the Czech Republic 21
Table 2. Summary of the regulation of P2P lending 32

Figures

Figure 1. Crowdfunding and the financial cycle of the firm 12
Figure 2. Growth in the number of platforms, by category 17
Figure 3. The Global Crowdfunding Landscape 19
Figure 4. Crowd-investing vs. equity finance in Europe 20
Figure 5. Amounts raised by crowdfunding platforms in France (million EUR) 23
Figure 6. Project categories funded through crowdfunding in France 24
Figure 7. Crowdfunding Platforms in Mexico 25
Figure 8. Amount of crowdfunding in the Netherlands 26
Figure 9. Crowdfunding lending amounts in the United Kingdom 27
Figure 10. Crowdfunding in the United Kingdom (million GBP) 28

Figure 11. Online SME loan market in the United States 29
Figure 12. Crowdfunding Capital Flow Model 36

Boxes

Box 1. Impact of crowdfunding on Job Creation, Company Revenue and Professional Investor Interest 13
Box 2. The JOBS Act Title III 33
Box 3. Crowdfunding and creative industries 38
Box 4. Gender and Crowdfunding 39
Box 5. Crowdfunding in the Netherlands 41
Box 6. A set of good practices developed by the private sector in the United Kingdom 41
Box 7. Recommendations for boosting crowdfunding in Mexico 42

Executive Summary

Crowdfunding is a technique to raise external finance from a large audience, rather than a small group of specialised investors (e.g. banks, business angels, venture capitalists), where each individual provides a small amount of the funding requested.

Since the late 1990s, the diffusion of crowdfunding practices has been especially related to non-profit organisations and the entertainment industry, where non-monetary benefits or an enhanced community experience represent important motivations for donors and investors.

Nevertheless, over time, crowdfunding has become an alternative source of funding across many other sectors and it is increasingly used to support a wide range of for-profit activities. New product-development is an activity for which crowdfunding can provide specific advantages, as the financial dimension is importantly complemented by direct contact and feedback from current and potential customers.

Crowdfunding activities gather money to finance projects, with two main objectives: financial and non-financial. Financial crowdfunding collects money from individual investors through two types of instruments: loans (this is called "peer-to-peer lending" or P2P lending) and equity shares (or mezzanine forms). Investors mostly get engaged in the proposed projects because of the expectation of a financial return. Non-financial crowdfunding collects money in the form of donations or involving rewards for the investors, without a financial return. Financial crowdfunding has grown fast since 2009. As of 2012, crowdfunding manages about USD 2.67 billion globally, and the forecast for 2013 is to surpass USD 5.1 billion in funding volumes (Massolution, 2014).

Crowdfunding typically is done through an online platform, although latest developments show that the use of an intermediary is not essential. Crowdfunding can be useful as an early-stage financial source for new ventures, and can also fulfil other functions, such as aid in building hype/marketing. Community crowdfunding can help gather experience on the instrument, and once demand for products is assessed, financial crowdfunding can help in raising money for the early stages of the firm.

In peer-to-peer lending (lending-based crowdfunding), the platform usually has an advisory board who decides on the interest rate to charge to the borrower, and how much it will pay the investors. In order to decide, the board uses credit records/credit history. This type of crowdfunding might be useful for established firms seeking finance for their projects.

In equity-based crowdfunding, investors get equity shares in the project, and the platform charges a fee that typically varies between 5-10% of the total amount collected, plus sometimes, fixed administration fees. Equity-based crowdfunding might be useful for new entrepreneurs and early stages of the firm, and can help putting a market value to the new idea, although it might have impacts on valuations due to under/over estimations.

By design and regulatory limitations, crowdfunding is suited to start-ups and projects that request relatively small amounts of funding. However, this depends on the extent to which larger investors participate in the process, as there have been some cases where the potential of the model to raise larger amounts has also been shown. Indeed, large

companies have been increasingly investing through crowdfunding platforms, which can offer access to promising start-up ventures. In some cases, crowdfunding challenges have been set up by large firms, offering the most competitive projects to match the funds they raised from smaller investors.[1]

Some business models and sectors may be more suited to raising funding through crowdfunding than others (Collins and Pierrakis, 2012). In particular, consumer–facing businesses may find the instrument more suitable to their needs, as traction with the potential customer base (as shown by the ability to raise fund through the platform), is an integral part of proving to investors the viability of their proposition. Signalling is one of the most important functions of crowdfunding, and a large number of supporters suggest that there exists already a core market for the new product or service, which can be easily mobilised to broaden the market through personal contacts and social networks (Hemer, 2011).

On the other hand, the crowdfunding channel may be less suited for business models that are based on complex intangibles or innovations in very high–tech and cutting edge areas, which require specific knowledge on the side of investors. It may also not be appropriate to fund firms for which business information and financial details are too sensitive to be shared with a large number of potential investors, as it is either impossible or legally very difficult to arrange non-disclosure agreements with all of them. In addition, crowdfunding may not be suited for projects that are particularly capital–intensive in early stages or those that require the types of post–investment support that can only be provided by institutional investors (Collins and Pierrakis, 2012; Hemer, 2011).

An enabling environment for crowdfunding activities requires the same levers as other Small and Medium Enterprises (SMEs) and entrepreneurship activities: clear rules and enforcement of misconduct; clear tax treatment; human capital skills of entrepreneurs; and data to assess impact.

In particular, crowdfunding activities require: a reliable internet connection, access to the banking sector (bank accounts) and/or online payment systems (only for the money transfer). The banking system can have a supporting role in providing the infrastructure for the mechanism, and maintaining credit history records. Crowd investors need a credit card or a bank account to operate. In the case of crowd- lending, the platforms may use the credit history to decide on the interest rate to charge and on whether to accept the project for financing through their site.

To date, the nature of the business has led to great caution by regulators. At the same time, the lack of a clear regulatory framework with regard to a new form of debt or equity issuance has contributed to caution by the investment community, in the light of concerns about how much protection they have against fraud, the public disclosure of sensitive information, and the management of a large number of shareholders (Collins and Pierrakis, 2012). Especially, crowdfunding practices raise questions with respect to corporate governance and investor protection, as crowdfunders are most likely to be offered very little protection. However, the regulatory environment is changing rapidly. As of today, crowdfunding activities do not pose a systemic risk, but continuous evaluation and a dynamic assessment of potential risks and benefits is needed if this source of finance is going to become mainstream.

[1] See "Big companies show they are in with the crowdfunding", *Financial Times*, October 9 2013, www.ft.com/intl/cms/s/0/1234e5f6-30e5-11e3-b478-00144feab7de.html#axzz2hY7mOjON

Objective and methodology

The present report is a case study on crowdfunding as a finance instrument available for SMEs and entrepreneurs. The purpose of this analytical report is to examine the characteristics, diffusion and uptake by new firms and existing SMEs, assessing its effectiveness in supporting innovative or potentially high-growth firms to overcome financial constraints; to evaluate what contextual factors can improve or hamper SME access to crowdfunding opportunities, to illustrate policy experiences and programme outcomes, and to identify good practices that promote the broader use of this financing technique.

The study is based on quantitative and qualitative information, including existing research literature and public reports, exploration on data sources, and on interviews with policymakers, SME representatives, practitioners in relevant public and private institutions, independent experts and other market participants.

The study is part of the OECD Working Party on SMEs and Entrepreneurship's (WPSMEE) project on New approaches to SME and entrepreneurship financing: broadening the range of instruments, which aims to increase awareness and understanding of alternative finance instruments. Through the present case study, the WPSMEE makes a tangible contribution to government efforts to ease finance constraints and promote business growth. This study also contributes to the OECD initiative on New Approaches to Economic Challenges (NAEC).

The structure of the report is as follows: after a brief description of crowdfunding and its modalities, the first section focuses on describing the benefits and risks of crowdfunding. The second section investigates the market structure and dynamics, identifying the drivers and constraints on the supply side. The third section analyses the regulatory framework and describes the recent developments taking place in this area. The fourth section looks at the demand side of SME financing, analysing the relevance of the crowdfunding instrument as a current and potential source of finance for SMEs and entrepreneurs, and the typology of firms to which this instrument is most suitable, with a special focus on the potential source of finance for innovative firms. This section also covers the contextual factors that hamper or improve SME uptake. Section 5 presents a series of policy initiatives and raises some questions for better understanding the potential of crowdfunding for SMEs and the role of policy to enable it. Finally, Section 6 presents conclusions and the way forward.

1. What is crowdfunding?

Crowdfunding is a finance technique that uses the Internet to match investors and borrowers for projects of common interest. The matching is usually done through dedicated operating systems (platforms) and enables participants to invest in one or several projects, pooling resources to support projects initiated by borrowers.

Crowdfunding is used mainly to finance specific projects/ideas (as opposed to firms), and its apparent simplicity draws attention.[2] From the lender's side, crowdfunding allows investors to finance projects of interest that do not, necessarily imply a monetary return; from the borrower's side, crowdfunding enables (potential) entrepreneurs to find non-bank finance opportunities. Crowdfunding first appeared as an instrument to finance philanthropic projects, and then spread to the financing of consumer products and lending.

[2] One of the criticisms of crowdfunding is that it does not finance "entrepreneurs", only "projects" (Schwienbacher and Larralde, 2010).

One of the main drivers of crowdfunding is an emotional engagement with the idea that might be related to local needs, private preferences or brand values that are attached to the project (De Buysere and others, 2012). Crowdfunding generally takes place through social networks, with the potential entrepreneur detailing the project activities and objectives, in some cases in the form of a business plan, and requesting funding under specific terms and conditions. The main innovation of crowdfunding with respect to other forms of finance is that the entrepreneur does not need an intermediary (e.g. a banking institution), to seek funding and can source directly the savings of a large audience.

The type of contributions by the investor – and related rewards - may vary, depending on the internet platforms and the projects. Indeed, as new platforms are created across countries, in a context of low regulation, new features and business models are continuously emerging. The types of funding may range from donations to equity, thus giving rise to processes with different degrees of complexity and different contractual relationships between the firm and the individual investor.

For lenders, there are two main forms of participation:

1. **Non-financial**, sometimes called "community crowdfunding". It involves a small donation, given without financial consideration and sometimes in exchange for a non-financial but tangible compensation (e.g. a free ticket to a show, a pre-order of a product). The idea of raising money from atomised agents has long existed – before the development of internet platforms- to finance community projects (money raised at the church, donations given to charity). The classical example is Pulitzer's campaign in 1885 that collected funds to build the pedestal of Bartholdi's Statue of Liberty in New York City, through a newspaper campaign and small donations of hundreds of residents (BBC, 2013).
2. **Financial**, here the contributor expects some financial return. It comprises lending-based crowdfunding (i.e. crowd-lending, peer-to-peer lending, or P2P) and equity-based crowdfunding (i.e. crowd-investing). The social and intrinsic motivations of investors still remain.

    a **Crowd-lending.** There is an obligation for the borrower to repay the money to the investor, often with a fixed interest rate. Unlike traditional banking, there is no money creation, as only the amounts provided by the investors are lent. Still, in many countries, loans with interest can only be offered by authorised financial institutions, and money collection to be lent afterwards charging an interest rate is explicitly forbidden. For instance, in France, crowd-lending opportunities are allowed only as interest-free loans.[3] On the other hand, in the United States, there exist crowdfunding platforms to provide peer-to-peer lending, where the interest rate to be charged is decided by the platform, based on the characteristics of the borrower.

    b **Crowd-investing.** The remuneration of investors can be through a share of ownership, including the participation in future earnings, or investments into securities issued by the borrower that launched the campaign. Equity crowdfunding is relatively recent. Belgium, France, Italy, the Netherlands and the United Kingdom have active equity-based crowdfunding platforms. In Italy, there are nine authorised platforms (and more pending authorisation, expected to launch campaigns in the Fall of 2014). In the

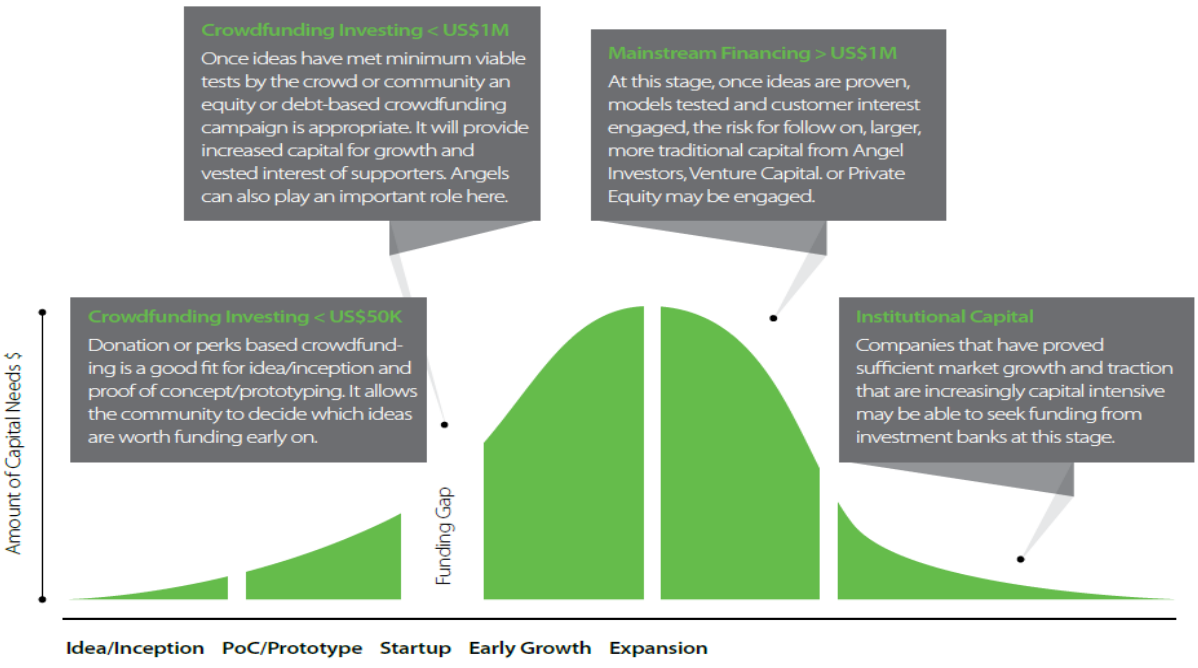
[3] The According to *Ordonnance 2014-559* dated 30 May 2014, the regulation is expected to change after October 2014, where charging an interest rate for crowdfunding loans will be authorised.: http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000029008408&categorieLien=id

Netherlands, there are eight operational platforms (OECD, 2014a), although only one registered with the financial authority (ESMA, 2013). The same is true for Germany (one platform, Bergfürst, is registered).

Equity crowdfunding differs from usual risk capital investment because borrowers do not have to submit reporting standards; projects seeking crowd-investors are of smaller size; and crowd-investing offers direct interaction between investors and borrowers (Collins and Pierrakis, 2012). However, there are some unavoidable legal fees and accounting costs that might make crowdinvesting unprofitable for small projects (Vass, 2014; Nead, 2015).

In the financial cycle for SMEs, community crowdfunding can enable firms to estimate the demand for their products and start production. Community crowdfunding is also a way for firms to gather experience in presenting and delivering projects, which can be useful to raise money through financial crowdfunding later on, after projects have passed the viability tests. Even in the absence of equity crowdfunding, investors can obtain shares of future profits, royalties, IPOs, or shares of real estate investments, among other possibilities (Mollick, 2014). Later on, other traditional sources of finance can be used as well (angel investors, venture capital, IPOs) to promote firms' expansion. According to Wilson and Silva (2013), equity-based crowdfunding is starting to be used in the seed and early stages cycle of the European firms. Figure 1 describes where crowdfunding enters in the financial phase of the firm.

Figure 1. Crowdfunding and the financial cycle of the firm



Source: MIF (2014).

Benefits of crowdfunding

The main benefit of crowdfunding is providing finance to innovative projects, be it from new or existing firms (Schwienbacher and Larralde, 2010; De Buysere and others, 2012). Crowdfunding platforms charge lower interest rates than traditional finance (IOSCO, 2014;

P2PFA, 2013). In addition, crowdfunding platforms might reach entrepreneurs that are marginalised by the financial system, such as women and minorities. Moreover, there is a relatively shorter time lapse between applying for funds and receiving them from the crowd (usually 30 days) that makes the crowdfunding process much quicker than bank loans.

There is also a direct involvement in the project that extends advantages towards non-financial benefits. Crowdfunding allows firms to interact with customers and validate R&D outputs (De Buysere and others, 2012; Massolution, 2014). It also brings in knowledge, networks, strategic planning, and experience from funders, as funders might assist the entrepreneurs in shaping winning strategies and crafting products. Crowdfunding also enables market opportunities, and it serves firms to test the potential demand for their products, based on the monetary contribution in the crowdfunding transaction (De Buysere and others, 2012; CCA Report, 2014). An international survey conducted by crowdfunding advocates in 2014 concluded that the most significant impact of financial crowdfunding campaigns was on marketing planning, along with strategic planning (see Box 1 for more details).

Box 1. Impact of crowdfunding on Job Creation, Company Revenue and Professional Investor Interest

An international survey was undertaken by Crowdfunding Capital Advisors in 2014 to investigate crowdfunding marketing benefits, job creation, follow-on investment and return on investment. The survey was directed at companies that had successfully raised capital via rewards, equity and debt-based crowdfunding (the survey specifically excluded philanthropic causes). The report concluded that the most significant impact of crowdfunding was on marketing planning, followed by strategic planning. More in details:

- Crowdfunded companies increased quarterly revenues by 24% on average, post crowdfunding (not including amounts raised by crowdfunding).
- Equity-based crowdfunded companies increased revenues by 351% (after crowdfunding campaign). None of the companies had received money from capital markets before.
- 39% of companies hired on average 2 new employees per company after crowdfunding.
- Within 3 months of a crowdfunding campaign, 28% of the companies had closed an angel investor or venture capital round.[4]
- Every hour invested in a successful crowdfunding campaign returned USD 813. On average, a company invested 135 hours of staff time during 45 days, estimated at about USD 2100.
- The minimum and maximum amounts raised via crowdfunding ranged from USD 15.600 to USD 936.000.

Source : www.crowdfundcapitaladvisors.com

Crowdfunding spreads risks for both investors and borrowers. Lenders/investors can provide smaller amounts in several ventures (Collins and Pierrakis, 2012), while borrowers can fill up their financing needs from several funders (IOSCO, 2014).

[4] On the other hand, crowdfunding might discourage business angels or venture capitalists from participating, due to the hassle of having to deal with many small investors.

Crowdfunding brings in indirect benefits. Crowdfunding boosts entrepreneurial culture, helps make visible the entrepreneurs, and promotes a more transparent vetting of entrepreneurship ideas.

Among the indirect benefits that crowdfunding brings in, there is entrepreneurship promotion, which leads to economic growth, and might induce job creation, as funders are not only attracted for the financial return, but also for social motives. Although social benefits (e.g. job creation in the local community) is mostly related to non-financial crowdfunding (donations and rewards-based campaigns), some P2P lending might be associated with job creation, as people invest in projects that create jobs in their community or that are locally engaging (De Buysere and others, 2012). As a consequence of the crisis, banks are in the deleveraging process and lending is allocated away from small and young companies, hence the growing importance of alternative financing, including non-bank lending (EIF, 2014:71).

In *crowd-lending*, P2P platforms attract borrowers because they charge lower interest rates than traditional finance (ISCO, 2014; P2PFA, 2013; De Buysere and others, 2012). New lending in 2012 was estimated to be EUR 20 million per month in Europe (De Buysere and others, 2012).

P2P lending can be beneficial for established businesses and/or small-sized projects, while equity-based crowdfunding can help new entrepreneurs or projects in need of larger amounts. Similarly, the involvement of angel investors in crowdfunding projects might send a signal about the quality of the project (EC, 2013).

Data for Europe shows that default rates are on average less than 1% (De Buysere and others, 2012). Until now the default rates of P2P business loans are less than those experienced by traditional banking (Collins, Swart and Zhang, 2013).

Equity-based crowdfunding or crowd-investing can be a complementary source of finance for projects that are unable to find other finance sources. Equity-based crowdfunding attracts investors in a similar fashion to that of business angels (but instead of having one big investor, equity-based crowdfunding brings in several funders investing small amounts each), although crowd-investors might be inexperienced.

Royalty-based crowdfunding is emerging as a new form of equity-based crowdfunding: it is a share in a unit trust, which pays a percentage of a specific revenue stream. It has been developed as a way to prevent initial crowdfunding investments from diluting when other forms or finance are incorporated into the project, as the firm grows.

Risks of crowdfunding

Crowdfunding presents risks for both investors and borrowers. Direct risks for investors comprise project failure, closure of the platform, lack of an exit option, and fraud. Indirect risks are those coming from cyber-attacks, identity and payment data theft, money laundering, and lack of transparency. Although most of the indirect risks mentioned might as well be present in traditional bank finance, crowdfunding activities may be more vulnerable, as they are not as established as traditional bank finance.

Project failure

Lack of financial literacy from the part of investors might make them prone to invest in advertised projects based on the narrative used, and other soft information, rather than on the probability of success of the project and on the expected return rate. To be able to assess risk, data availability, analytical capacity and risk diversification are essential

characteristics. At present, crowdfunding campaigns rely on the ethics of the borrowers about the reliability of the project. Moreover, the small amounts involved imply that investors have weak incentives to perform project due diligence (ESMA, 2014b: 72).

Platform failure

Many crowdfunding platforms tend to be start-ups, with a high concentration of ownership, and therefore limited financial and risk assessment capacity (De Buysere and others, 2012). Douw and Koren (2013) have explicitly identified this problem in the case of the Netherlands. According to ESMA, platforms tend to small firms, and that could imply weaker control and governance frameworks (ESMA, 2014b: 72).

Lack of an exit option

Crowd-investing opportunities take time before yielding returns. At present, there is no secondary market for investors using this instrument.

Fraud

The risk of fraud in crowdfunding platforms might arise because – unlike venture capital or angel investing – investors might not know the borrower beyond what is presented on the platform. In addition, if there is geographical separation, there might not be physical overseeing of the project (De Buysere, and others 2012). However, the use of social media and fraud detection mechanisms by the platform might be useful to prevent deception (De Buysere and others, 2012).

For crowd-investing, a fraud protection measure is embedded in the model. As crowd-investing operates through the "all-or-nothing" modality, a proposal gets funded only if a sufficiently large number of funders consider it worthwhile (this method relies on the wisdom of the crowds). A drawback of this modality is the potential herding behaviour of funders. Another measure for fraud protection could be the staggered release of funds linked to milestones. A drawback is that the measure would increase the burden of procedures and regulations (Collins and Pierrakis, 2012).

Setting valuations in equity-based crowdfunding

For equity-based crowdfunding, the usual practice is that the borrower is the one deciding how much equity to offer for the capital needed, before the start of the crowdfunding campaign. The quantification of the market size and scale might be difficult to estimate in advance, and the borrowers can either under- or over-value the business, with consequences for both investors and borrowers (De Buysere and others, 2012; Collins and Pierrakis, 2012). One possible solution is to allow the borrower to be flexible with the amount of equity offered over the course of the campaign; or to set the amount of equity and the number of shares and make a call for bids on them (De Buysere and others, 2012; Collins and Pierrakis, 2012).

How crowdfunding platforms work

Crowdfunding connects investors and borrowers through an online platform, which can be national or international. Sometime the platform conducts a pre-screening of the viability of the idea (although some platforms automatically publish every project seeking funding). Once the proposal is accepted, the borrower prepares a budget proposal with the required amount needed to accomplish the project, and a timeline. The project owners use social networks to attract lenders/investors, and the platform itself might also publicise the

project. If the project is funded, then borrowers use the platform to keep lenders/investors updated.

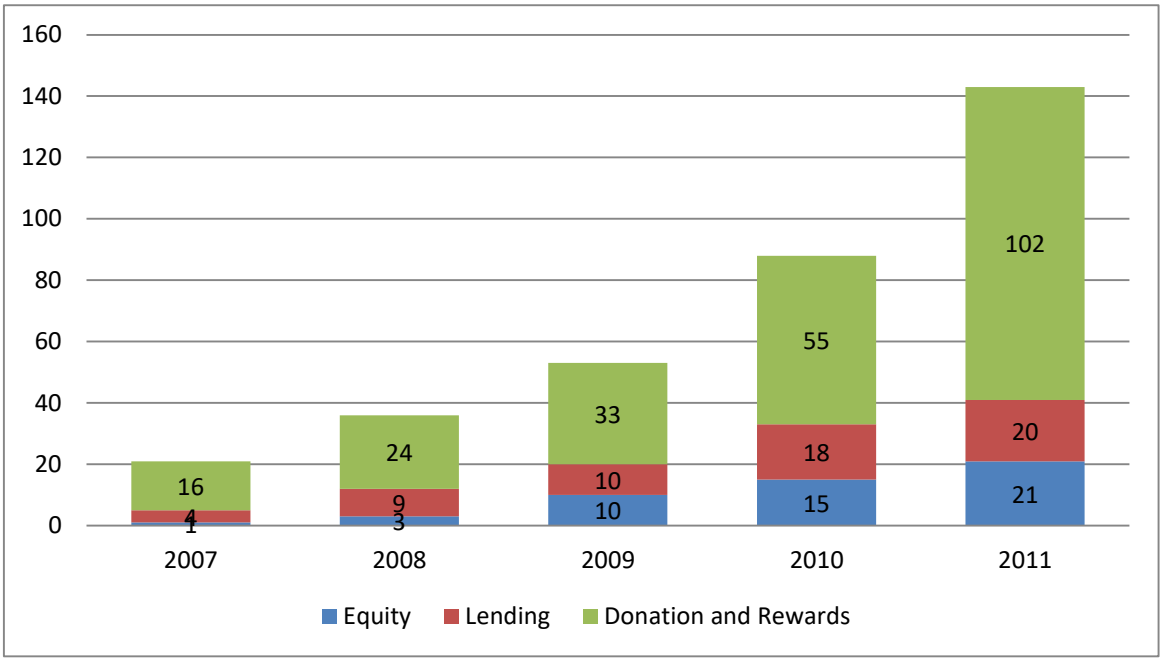
For crowd-lending, the funding modalities can be: “all or nothing” or “everything helps”. Platforms charge different fees for the different modalities (the latter being more expensive). Under the first modality, the project will be undertaken if the entire required amount stated at the beginning was met by the time of the deadline. If the “everything helps” funding modality was chosen, then the creator needs to resubmit a revised proposal on how the amount collected will be used. For crowd-investing, the sole funding modality is “all or nothing” (Collins and Pierrakis, 2012). There might be legal and accounting fees embedded in the crowd-investing model that might render unprofitable projects seeking small amounts. Nead estimates the fees to be about USD 40,000 for crowd-investing projects in the United States (Nead, 2015). In contrast, in Italy and the United Kingdom, projects attempting to raise EUR 5 million or less in a 12-month period are exempted from the Prospectus legislation (Aschenbeck and others, 2013).

An emergent business form of equity crowdfunding platform is the “holding model”, as defined by Hemer (2011), whereby the platform creates a subsidiary company, which operates as an individual holding for each of the crowdfunded ventures. In this case, it is the holding company that owns the company shares and sells them to the crowd, acting as a single investor in the project, alongside other potential investors from the conventional capital market.

The use of an online platform might not be essential for raising money through crowdfunding. Selfstarter (http://selfstarter.us/) is a company that has created a mobile application that enables each firm to directly administer crowdfunding campaigns without the need to go through an online platform. Similarly, the same purpose (raising money from several investors to finance a project) could be achieved without the internet, but at a higher cost (Schwienbacher and Larralde, 2010).

Figure 2 shows the evolution over time on the number of platforms, for different crowdfunding categories (non-financial, aggregating donation and rewards-based crowdfunding) and financial (crowd-investing and crowd-lending). Latest data available are from 2011, and show that the higher increase is observed for non-financial crowdfunding platforms. Platforms are multiplying rapidly, and in the future a Darwinian selection process might take place which could lead to platform consolidation. A small number of platforms trade most of the flows, due in part to customer familiarity with the platform, and the lighter regulatory framework in some countries (ESMA, 2014b:71).

Figure 2. Growth in the number of platforms, by category, 2007-11-



Source: Statista (2014). http://www.statista.com/statistics/251577/growth-in-the-number-of-crowdfunding-platforms-by-category/

Agrawal, Catalini and Goldfarb (2011) find that an online platform reduces frictions related to acquiring information, monitoring progress and providing input, but it does not reduce the privately-held information about the characteristics of the entrepreneur (perseverance, resilience). Their paper examines the role of distance in crowdfunding. The results show that an online platform does not yet eliminate all frictions, and that social networks are more efficient in reducing them. The authors find a role for family and friends investing in the early stages of a project, which might send a signal quality to other investors (further away in terms of distance).

Although crowdfunding platforms can enable international finance, in practice, the projects that are featured tend to be local, and the risk assessment is done by local teams operating the platform. Mollick (2014) supports this assertion using data from the United States. In contrast, some crowd-investing platforms in Mexico target international investors by abiding to the US SEC regulations (MIF, 2014).

2. Market structure and trends (supply-side)

This section identifies the market structure and the dynamics of crowdfunding from the supply side. It provides an overview of international market trends, identifies the main players, and the drivers and constraints.

Market trends (quantitative evidence)

Crowdfunding started as a way to gather funds for non-profit objectives, but has expanded to the for-profit side of the market. The European Securities and Market Association (ESMA) estimates that community crowdfunding and financial crowdfunding have a 50/50 share of the amounts traded. Considering only financial crowdfunding, P2P lending

comprises 90% of activities, and equity-based crowdfunding represents the remaining 10% (thus, 5% of all crowdfunding transactions). Equity-based transactions are securities issuance (bond issuance is virtually null, according to ESMA, 2014a).

Crowdfunding activities, although increasing at a rapid pace since 2009 (first year with records on activities), still represent a marginal share of SME finance. However, based on crowdfunding volumes SME funding is ranked as the second category funded (16.9% of total funding volume), after philanthropic and social ventures, with 27.4% (MIF, 2014:31, using data from Massolution).

According to Massolution[5] (2014) report, in January 2012 a crowdfunding campaign (Elevation Dock) raised USD 1 million for the first time. That milestone was surpassed in April, when another campaign (Pebble Technology) raised USD 10 million in 28 hours. During 2012, there were over 1 million campaigns (Massolution, 2014).

International evidence

The global crowdfunding landscape shows an important expansion worldwide. As of 2012, there were 450 platforms worldwide; 200 of them were located in Europe (De Buysere and others, 2012). In 2012, there were 68 crowdfunding platforms in France, 16 in Italy, one in the Netherlands, one in the United Kingdom -with 2 platforms pending authorisation- (ESMA, 2013).

North America continues to be the location where crowdfunding is most expanded, with USD 1,606 million collected in 2012; followed by Europe with USD 945 million, Oceania with USD 76 million; Asia with USD 33 million, and South America with USD 0.8 million in 2012 (MIF, 2014).

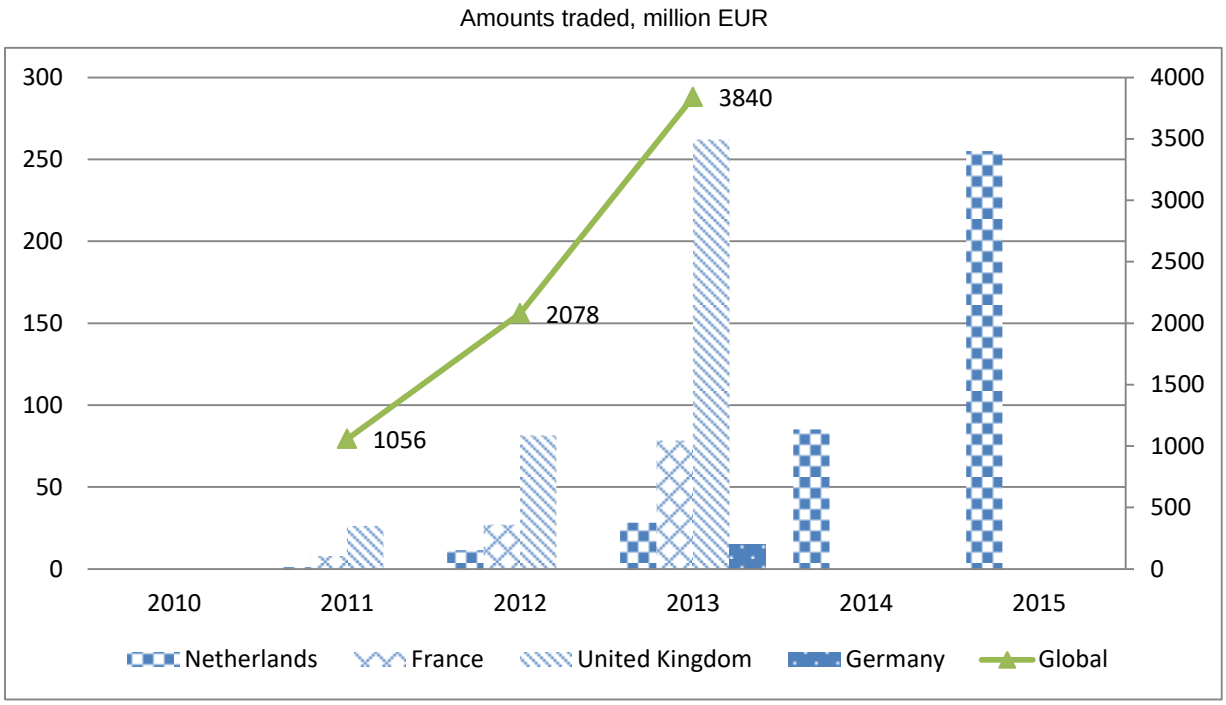
For Europe, the USD 945 million in 2012 (approx. EUR 735 million) can be compared to the amounts provided by business angels (EUR 660 million in 2010); venture capitalists in seed, start-up, later and growth stages (EUR 7 billion in 2012), and EUR 6 trillion from European retail bank lending to non-financial institutions in 2012.[6]

As a finance instrument, crowdfunding has rapidly expanded since 2011. Figure 3 shows the amounts collected through crowdfunding in the years 2011-12 and estimations for 2013-15. Notice that in 2012 the United Kingdom collected through crowdfunding the same amount that France did in 2013 and what Netherlands expect to collect in 2014 (about EUR 80 million). In Germany, crowdfunding activities are estimated to be EUR 15 million in 2013; the small size of the crowdfunding market might be due to customer loyalty (*Hausbanken*, relationship banking -system) and competitive interest rates in the German economy (IOSCO, 2014).

[5] Massolution is a research, advisory and implementation firm that specialises in crowdsourcing solutions for private, public and social enterprises. See www.massolution.com

[6] Extracted from: http://europa.eu/rapid/press-release_MEMO-14-240_en.htm?locale=en

Figure 3. The Global Crowdfunding Landscape, 2010-15

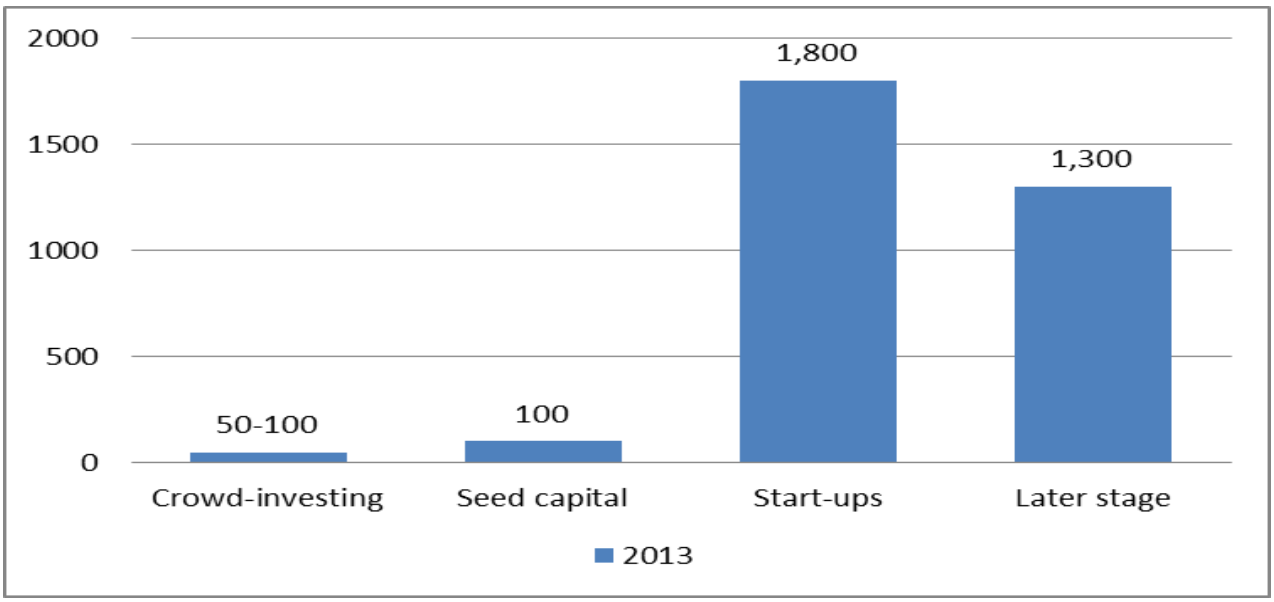


Source: Own construction, several sources. The left-hand-side scale shows the amounts collected for France, Germany, Netherlands and the United Kingdom. The right-hand-side scale shows the global amounts collected.

In 2013, the size of crowd-investment in Europe was estimated to be in the range of EUR 50-100 million, which represents a marginal figure (0.3%) of the overall initial public offering (IPO) market in Europe, estimated at about EUR 26 billion in 2013 (ESMA, 2013). It is also small compared to venture capital investments; market statistics from EVCA show that in 2013 there were EUR 100 million invested in seed capital; EUR 1.8 billion invested in start-ups; and EUR 1.3 billion invested in later-stage ventures (see Figure 4).

Figure 4. Crowd-investing vs. equity finance in Europe, 2013

(in million EUR)



Source: EVCA (2014).

Across countries, the growth of crowdfunding as a finance instrument in recent times is due mainly to donations and lending-based crowdfunding, which amounted respectively to USD 1.4 billion and USD 1.2 billion in 2013. Equity-based crowdfunding amounted to USD 116 million (Massolution, 2014).The growth in lending volumes mainly stemmed from crowd funded micro-loans and community-driven loans to local SMEs.

Selected national experiences

Canada

Securities commissions in Ontario, British Columbia, Quebec, Manitoba, Saskatchewan, New Brunswick and Nova Scotia have developed a set of rules to regulate online crowdfunding for new businesses. Provinces began their investigations into crowdfunding in 2012, and a consultation was held ending in June 2014. While many of the provinces' rules are similar, some provinces have proposed different maximum limits for crowdfunding investments.

A proposal by the Ontario Securities Commission would allow start-ups and small businesses to raise CAD 1.5 million over one year online through a registered crowdfunding platform. The proposal would also limit how much an investor could invest in a single project, with a maximum of CAD 2,500 in a single investment and CAD 10,000 per year. The British Columbia Securities Commission would allow companies to raise just CAD 150,000 per offering, twice a year. Investors would be limited to a maximum of CAD 1,500 in a single offering.[7]

[7] The comment period on both proposals was open until 18 June 2014. See more at: http://www.dentons.com/en/insights/articles/2014/march/24/crowdfunding-alert-ontario-securities-commission-releases-equity-crowdfunding-exemption-proposal and

Similar rules implemented across provinces will transform their exempt securities markets by providing greater access to capital for small businesses. These rules will help small companies' access capital they might not otherwise be able to get, and they are attempting to do so in a manner that is intended to facilitate capital rising while maintaining an appropriate level of investor protection.

To address concerns about fraud, regulators have outlined a set of fundraising restrictions. Crowdfunding websites, for instance, will themselves have to be registered with a securities commission as a "restricted dealer." This requires them to meet minimum capitalization levels and to fulfil certain insurance requirements. They are also required to meet various reporting rules and monitoring requirements. For instance, websites are required to do background checks on companies and their directors or officers who are raising equity on their sites. The Ontario Securities Commission says it will be the responsibility of the website portal to restrict possible issuers that it believes could be fraudulent.

Czech Republic

Crowdfunding in the Czech Republic started in 2011. During the last three years, five crowdfunding platforms have been registered (Hithit www.hithit.com, Startovač www.startovac.cz , KreativciSobě www.kreativcisobe.cz , Nakopni.me www.nakopni.me, Fondomat fondomat.com). Some of these have not been very active, and Fondomat.com does not operate as a crowdfunding platform at present. All platforms were established by private individuals, without any support from public sources.

Table 1. Selected crowdfunding sites in the Czech Republic

Platform	Provider	Period of operation Number of projects	Focus
www.hithit.com	Hithit s.r.o	11/2012 – 06/2014 278 projects, 120 successful	Music, film, technologies, theatre, art, design, food, sport, dance, literature, fashion, games, photography, education
www.startovac.cz	Army of Darkness s.r.o.	04/2013 – 06/2014 success rate 48,5%	Theatre, dance, film, games, apps, music, books, comic, fashion, design, science, technics, art
www.kreativcisobe.cz	kreativcisobě s.r.o.	n.a.	Film, theatre, music, art, society, enterprise, books, games, entertainment, dream, travelling
www.nakopni.me	Nakopni.Mě s.r.o.	n.a.	Art, books, music, charity, sport events, social services, education, enterprise (shops), care for animals
www.fondomat.com www.fondom.at/	Fondomat Ltd.	n.a.	Although it was the first in the Czech Rep., it does not operate as a crowdfunding platform; it now deals mostly with investment and advisory services

http://www.bcsc.bc.ca/News/News_Releases/2014/26_B_C__Securities_Commission_publishes_new_securities_crowdfunding_exemption_for_comment/

Since 2012 the total sum of money collected through all Czech crowdfunding platforms has amounted to around CZK 20 million (around EUR 715 000). Crowdfunding in the Czech Republic usually works on the principle "all or nothing", so if the total funding amount is not raised in full, contributions are returned to the sponsors. The success rate is slightly below 50%. Achievement of required amount is considered as success. The fees for platform services are from 3 to 10%.

In 2013 around CZK 1 million (EUR 36 000) was raised by the two most successful websites (CZK 750 000 by Hithit and CZK 250 000 by Kreativcisobe.cz). In 2014 the China tour of a music group was the most successful project at Startovač (CZK 581 000 within three months) and Music festival United Islands at Hithit (CZK 1.7 million within six weeks).

Czech crowdfunding platforms are focused mostly on the creative industries (music, books, art, theatre). Music projects prevail. Only non-financial benefits are applied (reward-based crowdfunding). The rewards are usually some kind of present. Finance-based projects have not been started yet, so there is no crowd-investing/securities crowdfunding in the Czech Republic.

Hithit.com is currently working with Foundation Vodafone, which promised to double the successful funding for selected projects (it is not public funding, more like co-funding).

There is so far no association of crowdfunding websites. According to unofficial information, there is at the moment a website under development that will be dedicated to crowdfunding of research and science.

Czech people also seek funding in the United States (mostly Indiegogo, for example:
https://www.indiegogo.com/projects/trabant-vs-south-america or
https://www.indiegogo.com/projects/the-prostitutes-new-international-album or
https://www.indiegogo.com/projects/help-us-record-new-album)

The most successful Czech crowdfunding projects are:
https://www.kickstarter.com/projects/1294225970/kingdom-come-deliverance (GBP 1.1 million)
https://www.hithit.com/unitedislands (CZK 1.7 million);
https://www.kickstarter.com/projects/dreadlocks/dex-cyberpunk-2d-rpg?ref=city (GBP 30 000);
https://www.startovac.cz/projekty/mnaga-a-zdorp-made-in-china/ (CZK 581 000);
https://www.hithit.com/cs/project/649/takovej-barevnej-vocas-letici-komety (CZK 480 000);
https://www.startovac.cz/projekty/hydronaut-deeplab/ (CZK 368 000);
https://www.hithit.com/cs/project/2/xavierovo-dawntempo (CZK 303 000);
https://www.startovac.cz/projekty/dokolakolem-bajkal-2014/ (CZK 290 000).

Raising awareness is done through several media (in Czech language) - these articles are published on various websites, so there is no single "promoter of crowdfunding"; however the most active are websites dedicated to internet and computers like Lupa.cz or Tyinternety.cz. There have also been articles in general internet newspapers (as well as in their printed copy) like idnes.cz or E15.cz. The websites dedicated to crowdfunding are also active in promotion.

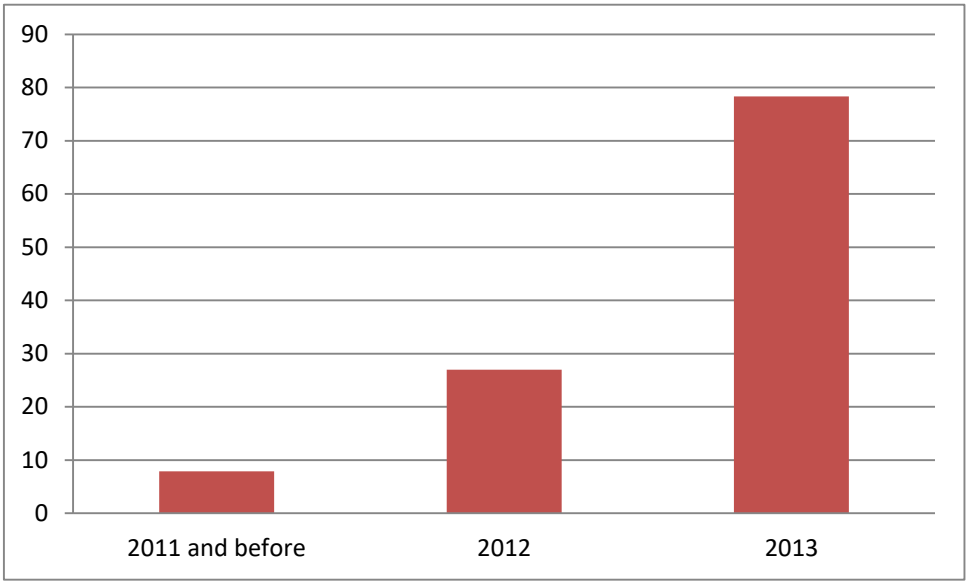
France

SME and entrepreneurs in France obtain most of their financial needs through standard loans, which amounted to EUR 215 billion in 2012 (about 20% of total loans go to SMEs). A relative small share of finance is obtained through equity shares. Equity investments in SMEs comprised EUR 6 billion in 2012 (OECD, forthcoming).

Crowdfunding platforms have increased threefold the amount of money raised with respect to 2011 (for all purposes, not only SME finance), and comprised in 2012 EUR 27 million (Figure 5). The estimates for 2013 are again of a threefold increase with respect to 2012, for a total of EUR 78.3 million (APCE, 2014). Crowdfunding represents a very minor share of SME finance.

Apart from the money raised, the number of projects financed successfully through crowdfunding also increased threefold between 2011 and 2013 (from 10 000 in 2011 to 32 317 in 2013), while the number of contributors increased fivefold (from 130 000 in 2011 to 650 000 in 2013) (APCE, 2013).[8]

Figure 5. Amounts raised by crowdfunding platforms in France (million EUR), 2011-13



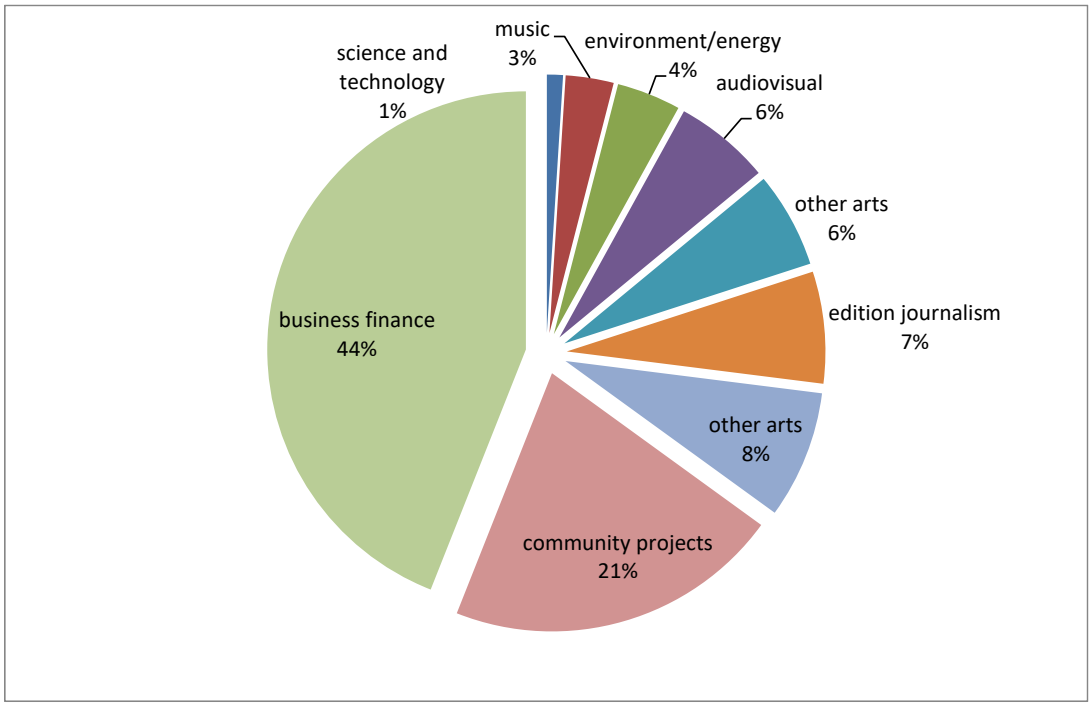
Source: Note: Amounts in million euros. Information in this figure includes crowdfunding amounts raised for non-profit options (donations) by 13 platforms, 9 lending platforms,8 equity platforms and 6 hybrid platforms. http://media.apce.com/file/14/3/barometre2013-v3.68143.pdf
Source: http://www.apce.com/pid14215/crowdfunding.html

Since 2012, crowdfunding loans have overcome the amount raised by donations. In 2013, equity crowdfunding raised EUR 10 million; crowdfunding donations raised EUR 20 million, and crowdfunding loans raised EUR 48 million (APCE, 2013). However, according to the same source, contributors for donation purposes are the overwhelming majority of 328 809 contributors in 2013, equity crowdfunding contributors were 1 881; loan contributors were 12 515; and donation contributors were 314 413.

[8] Note that APCE surveyed 36 platforms, and there were more than double registered, so these numbers are a lower bound estimate.

Finance for SMEs and entrepreneurs is one of the most funded projects in France: it comprises 44% of project categories, followed by community projects with 21%, and creative industries with about 15% (see Figure 6).

Figure 6. Project categories funded through crowdfunding in France, 2013



Source: Baromètre 2013.

As of 2012, there were about 68 crowdfunding platforms operating (ESMA, 2013). However, as of July 2014 the site of Bpifrance lists three registered platforms for loans-based crowdfunding, eight platforms for equity-based crowdfunding, and 10 platforms for community-based crowdfunding.

Mexico

The business environment in Mexico shows that there is a shortage of finance for SMEs and entrepreneurs, due in part to the high interest rates charged, which is close to 10% according to the OECD Scoreboard data, (OECD, forthcoming), and the requirements on collateral provision. Thus, many small firms and entrepreneurs are unable to find finance in the banking sector.

Access to internet is relatively widespread, as is the use of online payment mechanisms. The proximity to the United States market, as well as the close business ties (the Mexican government has a partnership with the United States government to conduct Business Accelerators programmes[9] in key external markets) enable the potential development of

[9] The Business Accelerator programme encourages SME innovation and technological development in niche sectors (aerospace, electronics, automotive, life science, biotechnology related to the food industry). The program places Mexican companies in the centre of physical locations and networks outside Mexico where there are strong markets and knowledge flows in their specific technologies (OECD, 2013a).

Mexico as a regional leader in crowdfunding activities. Mexican investments in the United States amounted to USD 28 billion in 2012 (MIF, 2014).

As of 2014 there are two crowd-investing platforms in Mexico, Vakita Capital and Crowdfunder. Vakita Capital offers domestic equity-based crowdfunding, while Crowdfunder supports domestic borrowers raising money from international investors, under US Securities regulation (MIF, 2014: 61). There are also several crowd-lending platforms (Kiva, from the United States; Kubo Financiero, and Prestadero, both Mexican) and two non-financial crowdfunding platforms: Fondeadora and Idea (See Figure 7 for details on funding volumes and number of campaigns funded).

Figure 7. Crowdfunding Platforms in Mexico

Platform Name	Type of CF	Total Funding Volume in Mexico (USD)	# of Campaigns Funded	Client Base	Country of Origin	Date Launched (in Mexico)
Fondeadora.mx	Donation, Reward	$800,000	121	Artists, Entrepreneurs	Mexico	June 2011
Crowdfunder.mx	Equity	$4,100,000	N/A	Entrepreneurs	Mexico/USA	November 2012
Idea.me	Reward	$300,000	57	Entrepreneurs, Artists, NGOs, Community Projects	Argentina	February 2012
Kiva.org	Lending	$10,500,000	22,000	Entrepreneurs, P2P	USA	October 2006
Prestadero.com	Lending	$840,000	204	P2P, Entrepreneurs	Mexico	June 2012
Kubo Financiero	Lending	$1,100,000	640	P2P, Entrepreneurs	Mexico	November 2012
Vakita Capital	Equity	N/A	N/A	Investors, Entrepreneurs	Mexico	April 2013

Source: MIF (2014).

Italy

Access to finance for SMEs has been deteriorating in the period after the 2008-09 crisis. Total business loans have declined in 2012 and 2013, reflecting a high-risk borrowing environment for SMEs. Venture and growth capital, however, declined in 2008-09 but have recovered afterwards, in part due to tax incentives for investment in seed and early stage innovative firms (OECD, forthcoming).

The government designed a regulatory framework for crowd-investing that was put in practice in 2013. One year after the implementation of crowd-investing regulation, Italy has surpassed EUR 1 million, mainly among the three initial authorised platforms. As of August 2014, nine platforms are authorised and more platforms are pending authorisation, expected to start operating before the end of the year (Lerro, 2014).

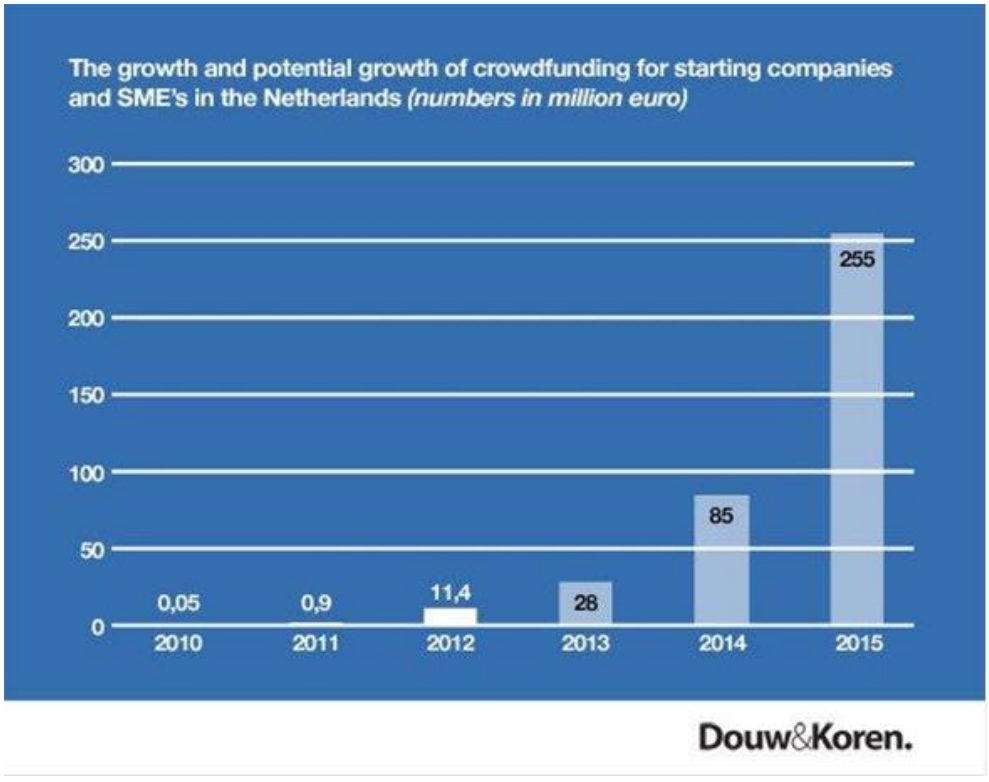
One successfully financed project from the platform StarsUp is Cantiere Savona, which raised EUR 380 000 from 31 individual and 13 institutional investors (Lerro, 2014). Another platform, Assiteca Crowd, raised EUR 520 000 within 8 weeks for the Paulownia Social Project, averaging more than EUR 40 000 per investor. In general, crowd-investing projects in Italy need more time to reach the target funding than reward-based projects. The author hypothesizes that lack of information and awareness is the reason for the extra timing (Lerro, 2014).

Two of the upcoming platforms expected to start operating in 2014 have been created by universities, in order to sustain their own spin offs (Lerro, 2014).

The Netherlands

In the Netherlands, start-ups, high growth and innovative SMEs have difficulties in access to finance. Debt finance is the most widespread financial instrument used, and while venture capital investments have recovered since the financial crisis of 2008-09, have not reached their 2008 levels yet (OECD, 2014b). In order to boost finance opportunities for SMEs and entrepreneurs, the Dutch government commissioned a report on the potential barriers and opportunities that crowdfunding might present (Figure 8) (see the policies subsection for details).

Figure 8. Amount of crowdfunding in the Netherlands, 2010-15



Source: Douw&Koren (2013).

Sellaband is an online platform for creative (musical) projects that exists since 15 August 2006. Originally based in the Netherlands, as of 2014 it has relocated to Germany.

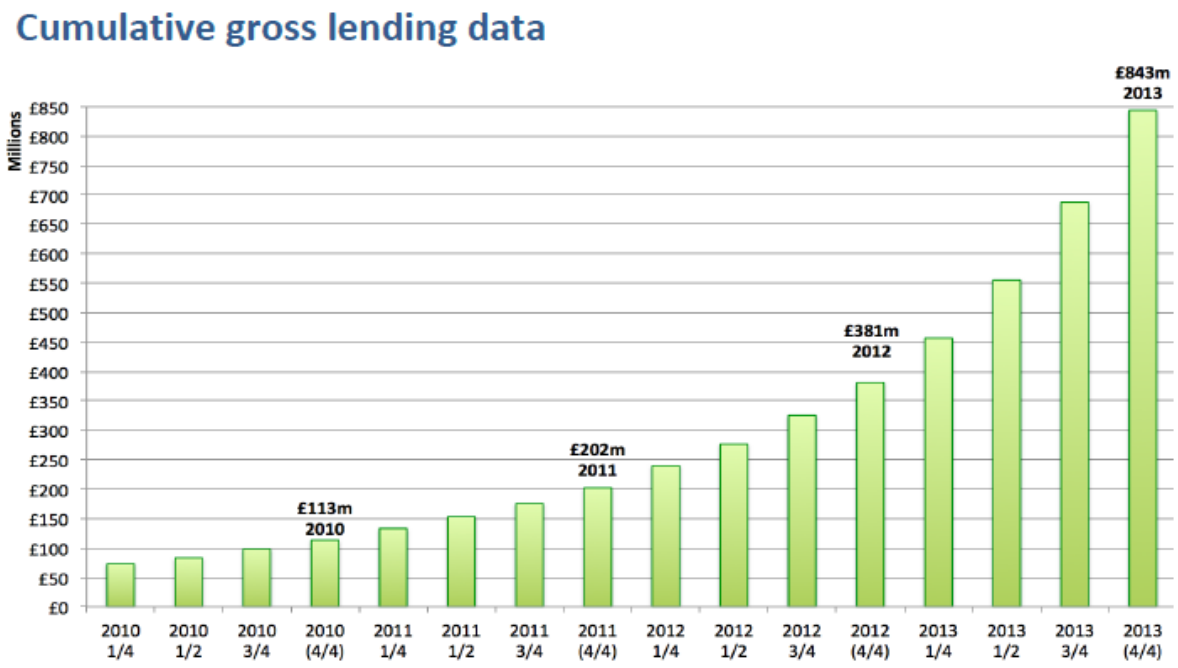
United Kingdom

SMEs in the United Kingdom face a finance gap (the so-called "Macmillan Gap", identified since 1931), a chronic shortage of long-term investment funding for SMEs, particularly for capital needs in the range GBP 250,000 - GBP 1 million (OECD, 2014c). Such a finance gap implies that funding needs for SMEs and entrepreneurs are too large to be considered by micro-finance institutions, but too small to attract standard bank lending.

Data from F*inancing SMES and Entrepreneurs 2015: An OECD Scoreboard* show that the outstanding stock of loans to SMEs has decreased by more than 16% during the period 2008-13 and the pattern persists in early 2014. The number of new loans almost halved over the same period (OECD, forthcoming). This fact might be one of the reasons explaining the diffusion of crowdfunding in the country.

According to ISCO, crowdfunding platforms began in the United Kingdom in 2006, and expanded to the United States in 2007 and to China in 2009 (ISCO, 2014). In the United Kingdom, there is an industry body, the Peer-to-Peer Finance Association (P2PFA) that sets the industry standards, and represents its members to regulators and policy makers (for both financial crowdfunding types). According to their website, during 2013 P2P business lending accounted for GBP 193 million, while equity crowdfunding accounted for GBP 28 million. Overall, the amounts traded through P2P in the country reached GBP 843 million, a 121% increase year-on-year (P2PFA, 2013). The majority of borrowers from P2P lending are individual consumers (about 70 000); business borrowers are about 5% of total borrowers (about 3 700). In 2013, there were 86 000 active lenders. Figure 9 provides more details on the amounts traded and the evolution over time.

Figure 9. Crowdfunding lending amounts in the United Kingdom, 2010-13

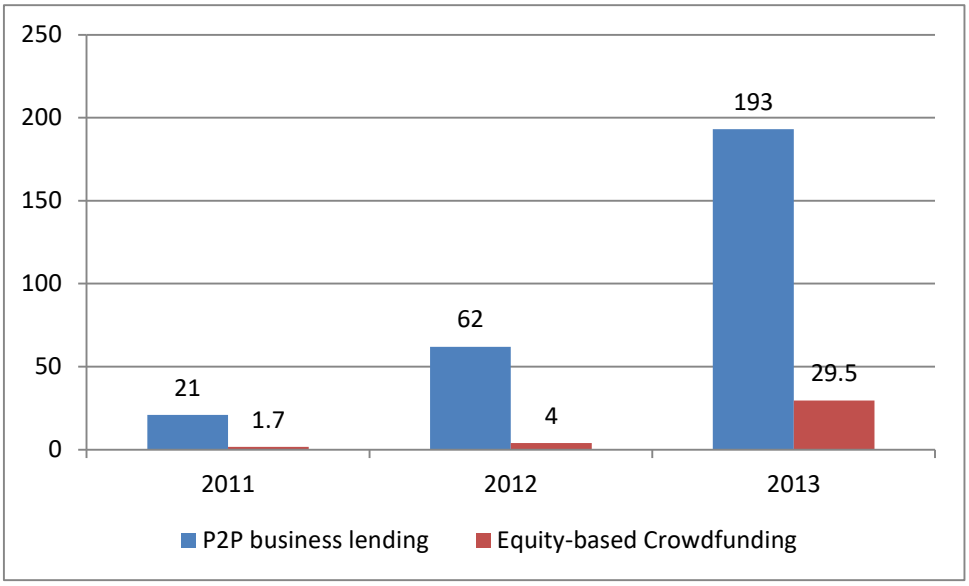


Source: P2P (2013). Amounts relate to financial crowdfunding; they include P2P lending to individuals. Of the GBP 843.4 million in 2013, GBP 156 million corresponded to new lending.

Specifically regarding SMEs and entrepreneurs, during 2013 the alternative finance market in the United Kingdom (which comprises equity crowdfunding for GBP 29.5 million and P2P business lending for GBP 193 million) provided GBP 222.5 million on early-stage and growth capital. It is estimated that more than 5,000 SMEs have used alternative finance mechanisms (Collins, Swart and Zhang, 2013).[10]

Loan-based crowdfunding to businesses has multiplied nine-fold since 2011. Equity-based crowdfunding has grown at double that rate, although the absolute magnitudes are still small (Figure 10).

Figure 10. Crowdfunding in the United Kingdom (million GBP), 2011-13



Source: Own construction based on data from Collins, Swart and Zhang (2013).

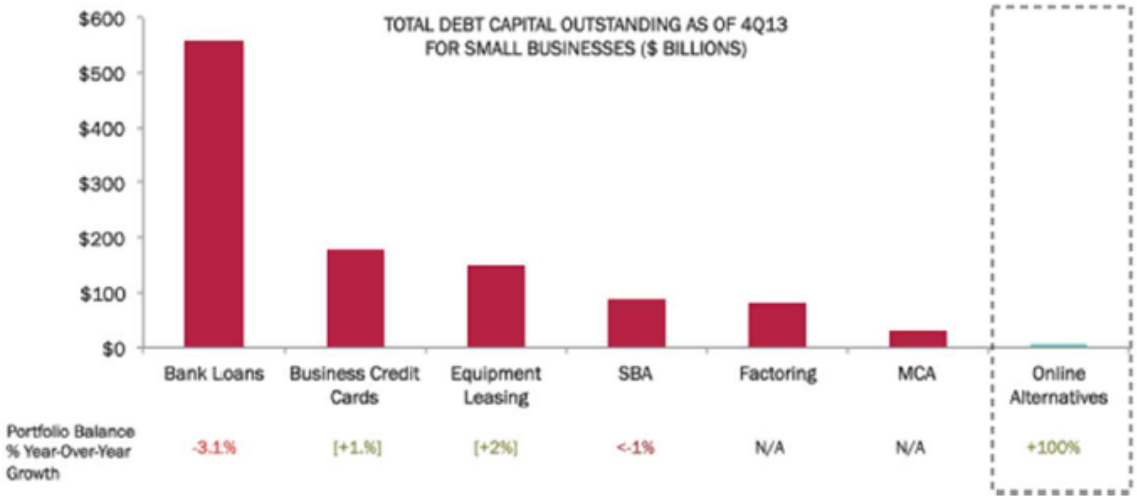
United States

The OECD Scoreboard data show that small loans balances at insured institutions keep declining since the second quarter of 2008 (OECD, forthcoming). The role of the Small Business Administration (SBA) is to link and leverage government and private assets, by taking the role of matchmaker. Thanks to an enabling environment (internet access, diffusion of online payment systems and e-commerce), crowdfunding activities (most of them with non-financial objectives) spread earlier in the United States than in other countries. Figure 11 shows that the online SME loan market in the United States for crowd-lending, despite a 100% increase as of 4q2013 remains small.

[10] These figures are based on a survey to more than 50 alternative finance intermediaries in the United Kingdom, which comprises over 95% of the market (Collins, Swart and Zhang, 2013).

Figure 11. Online SME loan market in the United States, 2013

Total Debt Capital Outstanding as of 4Q2013



Source: Bank loans data taken from FDIC Call Reports; SBA data sourced from SBA publicly available information; Credit card data sourced from creditcards.com; remainder sourced from interviews with industry experts, and authors' analysis.

Source: Mills and McCarthy (2014).

One of the most well-known platforms comes from the United States: Kickstarter (www.kickstarter.com), which started as a funding platform for *creative* projects, for US residents. Its business model is "all or nothing", and charges a 5% fee. It was launched on 28 April 2009, and up to date has financed USD 1 billion, from more than 6.5 million contributors, towards over 65 000 projects. According to their website, there have been about 84 700 unsuccessful projects started on the platform, which did not reach the 100% desired amount. The period for money collection was initially 90 days, it has been reduced to 60 days, and the platform encourages a funding period of 30 days (Mollick, 2014:6).

Mollick has conducted one of the most cited studies on non-financial crowdfunding (the author addresses only rewards-based and patron-based campaigns). Data are from Kickstarter for the period 2009-12 for projects in the range USD 100 – 1 million.[11] He addresses three questions: (i) whether crowdfunding investments are driven by the same dynamics than other projects; (ii) what role does geography play; and (iii) whether crowdfunding projects actually deliver. For the year 2012, 45 of the 50th highest funded projects on Kickstarter have become entrepreneurial firms (Mollick, 2014:3). The author finds that the quality signals of the project can predict success in raising funds, suggesting a rational assessment from investors, more than the effect of social networks. (ii) Mollick finds that geographical location is an important predictor of success for borrowers, and that crowdfunding projects deliver the promised product/idea, but 75% of products are delivered with a delay on average of 2.4 months.

Lending Club (www.lendingclub.com) is the first ranked (as of traded volumes) P2P lending platform in the United States, used mainly to refinance loans (61%). About 2% of

[11] Incidentally, all 25 projects with goals over USD 1 million failed (Mollick, 2014:4).

their loans (number of loans) go to finance businesses. Lending Club has funded over USD 5 billion. Prosper (www.prosper.com) is the first platform for P2P lending in the United States. As of August 2014, Prosper has more than 2 million members and has funded loans for a total volume of USD 1 billion. Prosper lends amounts in the range of USD 2 000-USD 35 000. Lenders can contribute with volumes starting at USD 25 in each loan listing. Both Lending Club and Prosper charge an interest rate for their loans, providing almost the same services than banks (credit rating, scoring, but there is no money creation).

Some problems with the implementation of regulation have slowed down the expansion of equity-based crowdfunding; community crowdfunding activities dominate (De Buysere and others, 2012). At the moment, several States have implemented their own regulation regarding equity-based crowdfunding activities, which increases complexity in the use of the instrument. Due to these legal constraints, equity-based crowdfunding trades minimal amounts (De Buysere and others, 2012).

Drivers and constraints on the supply side

Crowdfunding is attractive because of the low transaction costs involved, and the absence, apart from the platforms, of intermediaries between investors and entrepreneurs. Crowdfunding relies on a suitable technological infrastructure, since the availability of internet and the diffusion of an online payments system are essential for this instrument to work.

The capacity of business owners to disseminate the information that investors need is a key determinant of successful crowdfunding. The coverage of social networks is an important predictor of the success of a crowdfunding campaign (Agrawal, Catalini and Goldfarb, 2010 for European data; Collins, Swart and Zhang, 2013 for the United Kingdom; Mollick, 2014 for the United States). Collins, Swart and Zhang (2013) define this effect as "monetisation of social media", which can be accomplished because of the expansion of digital transactions. The diffusion of e-commerce, mobile technology, and innovative entrepreneurship has fostered the use of this alternative finance instrument. Agrawal, Catalini and Goldfarb (2010) cite Parker (2009) claiming that 31% of start-ups funds come from family and friends, and that despite of the recurrent references to that source of funds for SMEs, data are lacking.

The engagement of the crowd is essential to ensure the success of crowdfunding. Trust (in institutions, as well as in other people) plays an important role. The uptake of crowdfunding might be hampered if there is apprehension towards online business transactions and the provision of personal information. Policies aiming to increasing trust in the crowdfunding instrument should focus only on increasing trust on the trustworthy.

The main contextual factors driving crowdfunding (from the supply side) are:

1. **The economic and financial ecosystem**. The expansion of crowdfunding as a finance instrument occurred in the aftermath of the financial crisis of 2008-09. Some researchers claim that the crisis was in fact one of the main factors contributing to the expansion of crowdfunding (ISCO, 2014; Collins, Swart and Zhang, 2013). It is certainly true that the financial crisis lowered the availability and willingness of banks to lend (OECD, 2014c).
2. **The increased regulatory requirements on bank lending**, in particular Basel III, which has contributed to decreasing the supply of finance for SMEs and entrepreneurs (OECD, 2014c).
3. **The cultural context and the diffusion of e-commerce and online payment systems** are important drivers. Crowdfunding platforms can be national or

international. In many cases, the platforms themselves are SMEs, and sometimes they need finance in order to boost their activities.

4. **Low interest rates for deposits** – search by investors for higher returns.

The main constraints to the development of equity-based crowdfunding are (Collins and Pierrakis, 2012):

1. Regulation
2. Lack of investor protection against fraud
3. Concerns about making sensitive information public
4. How to manage a large number of shareholders

In countries with a strong stigma related to business failure, crowdfunding might be less likely to expand. Another constraint for crowdfunding diffusion is the fragmentation of regulation, laws, legal procedures, and language barriers that might restrict transactions at the national level.

While a specific regulatory framework might not be an essential requisite for the development of crowdfunding, guidelines on entry and exit of this financial instrument can help support uptake and further expansion.

3. Regulatory framework

The legal and regulatory frameworks of a country provide rules for participation and compliance standards. Regulation is an important tool to guide the development of new financing instruments. In the case of crowdfunding, regulation might regard: the platform, the campaigns, and/or the investors. At present, the existence and scope of regulation varies within and across countries and regions. This section describes the regulations governing crowdfunding activities across the OECD.

Table 2 presents some examples of regulatory regimes for loan-based crowdfunding across several geographical regions. In many countries, crowdfunding is unregulated because of the small size of the market. In Israel and Japan, crowdfunding is explicitly forbidden (IOSCO, 2014). In the United Kingdom there is no tax deductibility for reward-based crowdfunding, and there is a 20% VAT on the transactions. In Brazil, regulation depends on the platform size (unregulated for small platforms, regulated after a threshold depending on the number/size of loans). Reward-based platforms do not need special authorisation (EC, 2013).

According to IOSCO (2014), some platforms can be regulated as intermediaries; as banks; or as collective investment schemes (although the study notices that this is a theoretical possibility, but that no regulatory regime follows under that classification.

Table 2. Summary of the regulation of P2P lending

Regulatory regime	Description	Countries using the regime
Exempt/Unregulated	Either the regulation has classified P2P as exempt, or there is a lack of definition in the legislation	Brazil, China, Ecuador, Egypt, South Korea, Tunisia, United Kingdom
Intermediary regulation	P2P lending is regulated as an intermediary; requires registration and other requirements that depend on the jurisdiction	Australia, Argentina, Brasil, Canada (Ontario), New Zealand
Banking regulation	Regulates P2P platforms as Banks	France, Italy
United States Model	2-tier system. Requires platform registration with the SEC, and applying for a license to conduct business on a state-by state basis	United States
Prohibited	P2P and equity-crowdfunding are banned under legislation	Israel, Japan

Source: IOSCO (2014). In Brazil, regulation depends on the size of the platform. Small platforms are unregulated; after a threshold either in the size of the loan or in the number of loans, platforms need to obtain a financial certification.

United States

In the United States, the Securities Act of 1933 states that entities cannot offer or sell securities to the public unless (a) the offering is registered with the SEC, or (b) there is an available exemption from registration, for firms raising less than USD 1 million (with individual investments limited to USD 10 000 OR 10% of investors' annual income) and raising the cap on "mini-offerings" (Regulation A) from USD 5 million to USD 50 million.[12]

Among the recent modifications/amendments, the Jumpstart Our Business Start-up (JOBS Act) of 2012 liberalises small equity issuance by allowing SMEs to raise capital via the internet with minimal regulation (crowdfunding); increases the minimum issuance that requires SEC oversight from USD 5 million/500 investors to USD 50 million/2000 investors; introduces emerging growth companies; and allows marketing of issuance via the internet.

The JOBS Act promotes equity crowdfunding at the Federal level; on October 2013 the Securities and Exchange Commission (SEC) published a set of proposed rules for crowdfunding available for public comments within 90 days (see Box 2 for the SEC publication). By the proposed rules, there are requirements for the platforms, the borrowers and the investors.

Each platform is required to be registered with the SEC, and is required to fully disclose its finances, loan origination and practices. The JOBS Act title III allows investors to participate in transactions, subject to certain limits (individual investments during a year cannot be larger than 5% or 10% of annual income, depending on whether annual income is smaller or larger than USD 100 000; transactions must be conducted through a registered broker or a registered portal; and amounts raised by the issuer cannot be larger than USD 1 million during a 12-month period.

[12] http://www.whitehouse.gov/the-press-office/2011/09/08/fact-sheet-and-overview

Box 2. The JOBS Act Title III

Proposed Rules

Consistent with the JOBS Act, the proposed rules would among other things permit individuals to invest subject to certain thresholds, limit the amount of money a company can raise, require companies to disclose certain information about their offers, and create a regulatory framework for the intermediaries that would facilitate the crowdfunding transactions.

Under the proposed rules:

A company would be able to raise a maximum aggregate amount of USD 1 million through crowdfunding offerings in a 12-month period.

Investors, over the course of a 12-month period, would be permitted to invest up to:

USD 2,000 or 5 percent of their annual income or net worth, whichever is greater, if both their annual income and net worth are less than USD 100,000.

10 percent of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than USD 100,000. During the 12-month period, these investors would not be able to purchase more than $100,000 of securities through crowdfunding.

Certain companies would not be eligible to use the crowdfunding exemption. Ineligible companies include non-U.S. companies, companies that already are SEC reporting companies, certain investment companies, companies that are disqualified under the proposed disqualification rules, companies that have failed to comply with the annual reporting requirements in the proposed rules, and companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

As mandated by Title III of the JOBS Act, securities purchased in a crowdfunding transaction could not be resold for a period of one year. Holders of these securities would not count toward the threshold that requires a company to register with the SEC under Section 12(g) of the Exchange Act.

Disclosure by Companies

Consistent with Title III of the JOBS Act, the proposed rules would require companies conducting a crowdfunding offering to file certain information with the SEC, provide it to investors and the relevant intermediary facilitating the crowdfunding offering, and make it available to potential investors.

In its offering documents, among the things the company would be required to disclose:

Information about officers and directors as well as owners of 20 percent or more of the company.

A description of the company's business and the use of proceeds from the offering.

The price to the public of the securities being offered, the target offering amount, the deadline to reach the target offering amount, and whether the company will accept investments in excess of the target offering amount.

Certain related-party transactions.

A description of the financial condition of the company.

Financial statements of the company that, depending on the amount offered and sold during a 12-month period, would have to be accompanied by a copy of the company's tax returns or reviewed or audited by an independent public accountant or auditor.

Companies would be required to amend the offering document to reflect material changes and provide updates on the company's progress toward reaching the target offering amount.

Companies relying on the crowdfunding exemption to offer and sell securities would be required to file an annual report with the SEC and provide it to investors.

Box 2. The JOBS Act Title III *(Cont.)*

Crowdfunding Platforms

One of the key investor protections Title III of the JOBS Act provides for crowdfunding is the requirement that crowdfunding transactions take place through an SEC-registered intermediary, either a broker-dealer or a funding portal. Under the proposed rules, the offerings would be conducted exclusively online through a platform operated by a registered broker or a funding portal, which is a new type of SEC registrant.

The proposed rules would require these intermediaries to:

Provide investors with educational materials.

Take measures to reduce the risk of fraud.

Make available information about the issuer and the offering.

Provide communication channels to permit discussions about offerings on the platform.

Facilitate the offer and sale of crowdfunded securities.

The proposed rules would prohibit funding portals from:

Offering investment advice or making recommendations.

Soliciting purchases, sales or offers to buy securities offered or displayed on its website.

Imposing certain restrictions on compensating people for solicitations.

Holding, possessing, or handling investor funds or securities.

The proposed rules would provide a safe harbour under which funding portals can engage in certain activities consistent with these restrictions.

Source: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540017677#.U_dBwCgvgXE.

Crowdfunding activities are regulated at both the federal and the state level. At the State level there is also regulation, which in some cases forbids crowdfunding activities (i.e. Texas, for both P2P and equity-based); in other cases (i.e. California) it places limits on the type of investors using the platform (ISCO, 2014). This lack of harmonisation of securities laws might inhibit the development of the industry in the United States (MIF, 2014).

European Union

Given the small size of the crowdfunding industry, there is currently no regulation at the European level although there is an expert group that assists the Commission and monitors the development of the industry, in case the need for European regulation/legislative measures arises (EC, 2014b). In 2011 the European Commission (EC) issued an action plan to improve access to finance for SMEs in the debt and equity markets, which did not discuss explicitly crowdfunding as an alternative finance option (De Buysere and others, 2012).

As of 2014, the EC has set up an expert group (the European Crowdfunding Stakeholders Forum, ECSF) that will assist the Commission in developing training modules, raising awareness, promoting transparency and exchange of best practices. The group members are 15 Member State representatives and 25 representatives of the civil society.[13]

The EU legislation that applies today to crowdfunding activities is (EC, 2014b):

- The Anti-Money Laundering Directive and the Regulation on information on the payer accompanying transfer of funds. Both pieces of legislation aim at prevent money laundering and apply to any type of financial transactions, including crowdfunding;
- The regulations on unitary patent protection – that aim a protect inventions before public disclosure;
- The E-commerce directive – that facilitates market access across the EU;
- The Directive on misleading and comparative advertising and the Directive on unfair commercial practices – that aim to protect consumers.

There are some pieces of legislation that intend to provide a high level of investor protection. Depending on the design of the crowdfunding campaign, only some of these instruments would apply:

- The Prospectus Directive14, the Payment Services Directive, Markets in Financial Instruments Directive (MiFID)15, Capital Requirements Regulation and Directive IV (CRD IV), Alternative Investment Fund Managers Directive (AIFMD), the Consumer Credit Directive, the Distance Marketing of Financial Services, and the Regulations on Capital requirements, European Venture Capital, and European Social Entrepreneurship funds.

Recent regulatory developments for crowd-investing

In terms of country specificities, in Belgium, Germany and the Netherlands, there is no regulation, but guidelines exist for crowd financing (ESMA, 2014a).[16] In Australia, although crowd-investing is not forbidden, regulation creates high barriers to entry, therefore in practice there is no crowd-investing market (IOSCO, 2014).

In France, from 1 October 2014, the regulation creates a status of equity investments advisors for platforms that offer securities to investors (crowd-equity) and an intermediate status for crowdfunding.

In Italy, regulation was quickly implemented to boost equity crowdfunding. Regulation Number 18,592 of 27 July 2012 allows equity-based crowdfunding in Italy, for any investor (local or international) successfully passing a test demonstrating both risk understanding

[13] More information available at: http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=3130&Lang=EN

[14] The Prospectus Directive and its amendments intend to: (i) strengthen investor protection; (ii) increase legal clarity and certainty; (iii) reduce administrative burdens (EC, 2012).

[15] De Buysere and others (2012) claim that some activities regulated under MiFID might face different national interpretations and ask the EC to clearly define activities mentioned in such Directive to avoid legal uncertainties.

[16] In Germany, crowdfunding activities are bound by the Prospectus legislation (i.e. only offerings under EUR 100,000 during a 12-month period are exempted, among other exemptions).

and that he/she can afford the possibility of losing the investment. It restricts crowdfunding to innovative start-ups (recognised by the Chamber of commerce); limits the total amount raised to EUR 5 million; an institution or a professional investor must subscribe at least 50% of the securities sold; and the platforms must be run by qualified professionals with experience in the financial sector (MIF, 2014).

One year after the enactment of the law, there are over 3,000 Italian firms that fit the innovative description, and an extension to any SME has been announced for the end of 2014.[17] There are some encouragements for investors, such as a 27% tax reduction from personal taxes for any individual investing in a start-up with social impact, or that any European start-up is allowed to raise equity on the web (Lerro, 2014).

In Spain, in 28 February 2014, the government presented a project to regulate crowdfunding activities in Spain. The law imposes restrictions on funders (a ceiling of EUR 3000 per project, and of EUR 6,000 per platform per year) and on borrowers, limiting crowdfunding amounts per project to EUR 1 million (Llobet, 2014).

The United Kingdom Regulation Agency (Financial Services Authority, FSA) is in the process of assessing a long-term strategy regarding equity crowdfunding. In parallel, FSA gives licenses to individuals applying for platforms (MIF, 2014). Crowdcube –founded in 2010- (www.crowdcube.com) was the first authorised and regulated equity-based platform in the United Kingdom (reg. number 572026). Crowdcube offers three possibilities for investors: equity shares, venture funds and mini-bonds. It charges entrepreneurs with a 5% success fee, plus legal and administration fees (about GBP 1750).

Regulation and capital flow models

When all transactions involve domestic participants, country-specific regulation suffices to enable an environment. However, the internet has enabled the participation of international investors. In the case of capital inflows (international investors funding domestic companies), they have to abide by the national regulatory environment. An enabling environment there means that there have to be clear and robust remedies for resolving fraud (MIF, 2014).

Figure 12 shows a capital flow model. When domestic crowd funders invest in foreign companies, they have to abide by the regulation of the country where the company is located. Crowdfunding activities can boost small foreign investments into domestic companies (i.e. through remittances).

Investment hubs enable a finance environment dealing with international participants. There, apart from technological infrastructure, confidence in institutions is essential to prevent fraud. Raising capital through the United States SEC gives protection to investors (MIF, 2014).

Figure 12. Crowdfunding Capital Flow Model

		CROWDFUNDERS	
		DOMESTIC	FOREIGN
FIRMS	DOMESTIC	Domestic	Capital Inflows
	FOREIGN	Capital Outflows	Investment Hub

Source: MIF (2014).

[17] http://www.crowdsourcing.org/editorial/italys-first-year-of-equity-crowdfunding/33287

4. Crowdfunding as a source of finance for SMEs (demand side)

This section focuses on the contextual factors that can improve or hamper SME and entrepreneurs' access to finance through crowdfunding instruments from the demand side. It reviews the current and potential relevance of the instrument for SME finance; and the types of SMEs for which the instrument is most suitable.

Relevance of the instrument for SME financing (current and potential)

Crowdfunding started as community funding of projects with social or artistic interests, but has expanded to the finance of new and innovative projects. Since the first crowdfunding data arrival in 2009, there has been a rapid expansion of this instrument, which as of today remains small in regard to funding volume of SMEs and entrepreneurs, but with growth potential.

Crowdfunding is particularly useful in the pre-seed and early stages of the firm. It is suitable to test what the demand for an innovative product is. It might as well be useful in the expansion of the firm. It is likely that at some point, traditional finance sources will intervene.

For established firms, loans-based crowdfunding might be more attractive than equity-based crowdfunding, because their idea has initially been tested, and only funding is needed. For new entrepreneurs, equity-based crowdfunding can serve to assess the market demand on the idea.

Crowdfunding requires technical expertise in preparing a project that will result attractive to investors; it also requires time, as a follow-up is needed while the project is gathering funds, and then an explanation of how funds are spent is required for investors.

Types of SMEs for which the instrument is most suitable

Since the late 1990s, the diffusion of crowdfunding practices has been especially related to non-profit organisations and the entertainment industry, where non-monetary benefits or an enhanced community experience represent important motivations for donors and investors. To date, projects with a creative or social focus, where non–financial rewards are offered in return for donations, have been the most successful at raising finance from the crowd (Collins and Pierrakis, 2012).

Nevertheless, over time, crowdfunding has become an alternative source of funding across many other sectors and it is increasingly used to support a wide range of for-profit activities. New product-development is an activity for which crowdfunding can provide specific advantages, as the financial dimension is importantly complemented by direct contact and feedback from current and potential customers.

The crowd-lending, or P2P lending, option can be attractive for small businesses that lack collateral or credit history to access traditional bank lending, as the loans offered are typically unsecured. P2P lending, however, is not only attractive to highly risky borrowers. Indeed, the main platforms for crowd-lending have been increasingly targeting high quality credit risk, often providing loans to refinance credit-card debt, and incentivising lenders to conduct thorough credit checks of applicants before accepting them, which has limited default rates. On their side, borrowers can receive lower rates than those offered by banks, since overhead costs and regulatory burdens are lower, as well as benefit from the interaction with customers that these platforms typically provide.

Crowdfunding has the potential to deliver equity finance to projects that have greater levels of risk attached relative to the potential financial gains they can deliver (i.e. new entrepreneurs). The non-monetary motivations of crowdfunding investors, such as being part of an entrepreneurial venture or receiving non-tangible rewards, can explain, at least in part, why they may be willing to accept more risk or less return than traditional risk capital investors. (Collins and Pierrakis, 2012).

There is no specific sector for which the instrument is most suitable, although the expansion of crowdfunding was initially seen in the creative industries (see Box 3). The consumer-facing business might be well suited to raising funds through crowdfunding (Collins and Pierrakis, 2012).

On the other hand, those projects whose owners feel sensitive about making ideas and financial details public on platforms, and those capital-intensive in early stages or with the need for post-investment support that can only be provided by institutional investors might not be suited for crowd-investing (Collins and Pierrakis, 2012).

The crowdfunding instrument needs engagement from the firm owners, and human capital skills in identifying what investors are searching for when trying to finance products.

Box 3. Crowdfunding and creative industries

Crowdfunding is a growing and increasingly mature industry. It has become a significant way for people to fund their ideas and projects across a number of industries. In particular, it has become popular in the creative industries.

In recent years there has been a growing recognition of the significance of the creative industries in knowledge-based economies. Not only are they regarded as a vehicle to foster growth and employment, but they also contribute to promoting innovation and skills development and maintaining cultural identity, and play an important role in enhancing cultural diversity. As a result, many countries, regions and cities are attracted by their potential as an engine for development (OECD, 2014d).

The importance of the creative industries in Europe has been steadily increasing in recent years. The employment volume of the creative industries of 6.4 million is high above that of the automobile and chemical industries (2.2 and 1.9 million respectively) (EENC, 2011). In Europe around 80% of enterprises in the CCIs consist of SMEs (HKU, 2010).

However, one of the greatest obstacles faced by entrepreneurs and enterprises in the creative sector is how to access to funds to finance their endeavours. Considering that creative industries main asset is intangible, financial institutions such as banks often fail to sufficiently recognise their economic value (HKU, 2010).

For this reason, many entrepreneurs and SMEs are now turning to crowdfunding as an alternative source of access to capital. In the creative sector crowdfunding also has a unique dual function of providing both private financing and generating publicity and attention for a project. For example, Kickstarter, the most successful creative crowdfunding platform in the United States, in 2013 3 million people pledged USD 480 million to Kickstarter, and funded over 19,900 creative projects (Kickstarter, 2013).

Furthermore, it can be stated that crowdfunding is already an established financing instrument in the creative industries, with a large space for growth. Policies should be oriented to the potential role of creative crowdfunding as a driver of innovation and competition in the creative sector is likely to keep growing, thus creative SMEs and entrepreneurs access to information and knowledge about which project characteristics and crowdfunding practices are feasible to success are key for achieving growth and sustainability.

Source: Roure (2014) based on information from Kickstarter (2013) The year in Kickstarter - https://www.kickstarter.com/year/2013/?ref=footer#5-successfully-funded; HKU (2010) The Entrepreneurial Dimension of the Cultural and Creative Industries,Hogeschool vor de Kunsten Utrecht, Utrecht.; EENC, (2011) Crowdfunding Schemes in Europe. European Expert Network on Culture (EENC).

Investors need not be national. The use of internet platforms overcomes the geographical distance when financing and searching for finance. Agrawal, Catalini and Goldfarb (2010) find that crowdfunding overcomes the geographical distance for investors. However,

Mollick (2014) finds that the percentage of creative individuals (borrowers) in a geographical area affect the success of a crowdfunding campaign, thus suggesting that geography still plays a role for borrowers.[18] Language and cultural barriers might also pose a challenge.

Marom, Robb and Sade (2013) find that in the United States, using data from Kickstarter (mostly non-financial crowdfunding), female-led projects were more likely to attract female investors: more than 40% funds of female investors went to female-led projects, while 22.5% of funds of male investors went to female-led projects. See Box 4 for a summary of Greenberg and Mollick (2014).

Box 4. Gender and Crowdfunding

Female borrowers seek and receive less startup capital than male entrepreneurs. One reason for this disparity is a lack of female representation among investors of startups, and a potential solution is to increase the proportion of women in decision-making roles. Both the problem and the solution implicitly rely on homophily – that women will support other women given a chance. However, a lack of clarity over when and how homophily influences individual choices makes it uncertain when better representation is actually advantageous.

Using data from crowdfunding, Greenberg and Mollick (2014) empirically examine whether a higher proportion of female investors leads to a higher success rate in capital-raising for women. They find that women outperform men, and are more likely to succeed at a crowdfunding campaign, all other things being equal. This effect primarily holds for female borrowers proposing technological projects, a category that is largely dominated by male borrowers and investors. Using a laboratory experiment the authors find that a small proportion of female backers disproportionately support women-led projects in areas where women are historically underrepresented. This suggests an activist variant of choice homophily, and implies that mere representation of female investors without activism may not always be enough to overcome the barriers faced by female borrowers.

Source : Greenberg and Mollick (2014).

5. Policies

This section explores the rationale for policy intervention in the area of crowdfunding and illustrates policy experiences and identifies good practices in selected countries.

Rationale for policy intervention

The crowdfunding market began essentially unregulated, in the late 2000s. With the expansion towards financial crowdfunding, some countries have started designing a regulatory framework to protect investors (in financial crowdfunding), while some other jurisdictions have tried to just provide guidelines.

Under both conceptualisations, there is room for policy intervention in the provision of an enabling technological and financial environment, as in order to operate, platforms need internet access, bank accounts and online payment systems. There is also room for policy intervention in ensuring cyber-security, in designing fraud prevention mechanism, prudential rules, and dispute and resolution mechanisms. Agents (leaders, investors, businesses) also need financial literacy, and financial access.

[18] Mollick (2014) calculates the percentage of creative individuals as the proportion of employment in the category "Arts, Design, Entertainment, Sports, and Media Occupations" to all employment categories in a city.

Policy experiences

Public support for crowdfunding in France is provided through the portal www.tousnosprojets.fr supported by Bpifrance (the French public financial institution that oversees SME and entrepreneurship lending). This search engine allows the public to find crowdfunding platforms for donations, loans and equity (categories can be displayed separately). The available platforms are engaged to observe rules and regulations. Although Bpifrance manages the search engine for French projects, it is not involved in subsequent transactions, which correspond directly to the investors and borrowers.

In Mexico, a 2014 report by an international organisation (MIF/FOMIN) assessed the business environment for crowdfunding, and suggested a set of key actions to boost crowdfunding opportunities. Some of them relate to the general business environment (such as improving human capital of entrepreneurs, and support an enabling technological environment), and some are very specific to the Mexican case, identifying key actors from the public and private sector that could backup the expansion and uptake of crowdfunding.

In the Netherlands, in addition to standard loan guarantees, and in order to alleviate the financial constraints that SME and entrepreneurs face, the government offers SME loan guarantees for non-bank financial institutions. New SME finance institutions like SME funds, credit unions and crowdfunding, are being developed and some of them were introduced in 2012. Moreover, the Dutch government commissioned a study on the potential barriers and opportunities for crowdfunding to stepping up as a financial source for SMEs and entrepreneurs. The main barriers that the report identified concern lack of visibility, lack of trust and the small scale of operations (Douw and Koren, 2013). See Box 5 for a description of the government measures taken to boost crowdfunding in the Netherlands.

Box 5. Crowdfunding in the Netherlands

The Dutch Ministry of Economic Affairs commanded a consultancy firm (Douw&Koren) to research on the current state, developments, barriers and opportunities for crowdfunding in the Netherlands, in particular for new firms and SMEs. The report concluded that during 2012, 118 Dutch companies raised EUR 11.4 million through crowdfunding, and expects that by 2015 more than EUR 250 million can be raised through that modality in the Netherlands. The main barriers and opportunities that the report identified concern: visibility, trust, and scale of operations.

The main barrier for the expansion of the crowdfunding instrument is lack of knowledge on the part of SMEs. Most companies do not know what crowdfunding is and how it works, thus, they do not consider crowdfunding as a suitable instrument. The diffusion and increase in awareness of this instrument, through targeted campaigns could stimulate its adoption.

Another barrier for the expansion of this instrument is lack of trust. Regulation could play a role in increasing trust. In order to promote the instrument, the Dutch authorities have published their view on crowdfunding as an alternative source of funds for SMEs and new firms. In addition to regulation, the harmonisation and the creation of a set of quality standards for operation could improve the uptake of the instrument. The Dutch Government is in the process of creating a Code of Conduct for crowdfinance in the Netherlands.

Although the potential size of the market is large, most of the crowdfunding platforms are SMEs themselves, and cannot finance their expansion. The report suggests providing a financial impulse to the crowdfunding platforms in order to help their expansion and thus the provision of funds through this instrument to SMEs.

Source: Douw and Koren (2013).

In the United Kingdom, the P2P Finance Association, a crowdfunding advocate, provides a set of good practices for their platform members regarding transparency, credit risk management and dispute resolution mechanisms (See Box 6).

Box 6. A set of good practices developed by the private sector in the United Kingdom

In the United Kingdom, the P2P Finance Association is a private sector association that promotes good practices within the industry. They have developed a set of rules for their participating platform members:

i) All members have to maintain a minimum amount of funds in the platform.

ii) Members have to keep their client's funds separate from their own.

iii) Members have to lead responsibly and manage credit risk.

iv) Transparency: members have to communicate clients the likely default rates, terms of the product, risks and likely returns, and fees and charges. In addition, each member has to verify that clear, not misleading and fair information is published on their website.

v) Members have to make sure that their IT systems are secure and reliable.

vi) Members must have a clear complaints handling policy.

vii) Each member has to make arrangements to ensure the administration of contracts in the event the platform ceases to operate.

Source : P2PFA (2013).

In March 2014, the European Commission (EC) highlighted a set of key actions to put forward regarding crowdfunding, although at the moment, there is no plan on legislative action on behalf of EC:

- Stimulate industry best practices, raise awareness and enable the development of a quality label
- Monitor the development of crowdfunding markets and national legal frameworks
- On a regular basis evaluate whether any form of legal actions is necessary (EC, 2014a)

In particular for the Mexican case, a 2014 report carried out by MIF/FOMIN suggested that in order to increase crowdfunding awareness and uptake, technological literacy and confidence in the market had to improve. The report assessed the entrepreneurial environment, the technological infrastructure, and concluded that based on the proximity to the United States' capital market, Mexico has the potential to step up as a regional leader (see Box 7).

Box 7. Recommendations for boosting crowdfunding in Mexico

A 2014 report by MIF/FOMIN analyses the crowdfunding environment in Mexico and suggests the following recommendations to boost crowdfunding as a finance source for SMEs and entrepreneurs:

- Improve SME capacity to access capital to fuel innovation
- Improve technological literacy
- Generate confidence in the market
- Coordinate key actors and support an enabling environment through rules and regulations

The report assesses the entrepreneurial environment, the technological infrastructure, and concludes that, based on the proximity to the United States' capital market, there is potential for Mexico to step up as a regional leader.

Source : MIF (2014).

Evaluation of policy effectiveness

As usual, policy effectiveness evaluation is difficult, because of interacting and second order effects. Moreover, in the case of crowdfunding, it is a technique in its early days (first crowdfunding amounts reported date from 2009); not all platforms are registered (most of them are not), and there are differences between crowdfunding business models. More data is needed to assess the effectiveness of the instrument itself and on the policy measures that intend to boost it.

Policy considerations

While it may be premature to provide policy recommendations at this early stage of development of crowdfunding, a set of good practices related to the SME and entrepreneurship environment can be applied to crowdfunding activities. For example, correcting information asymmetries can help diminishing the credit rationing that small firms face, and this would apply to crowdfunding as well.

Likewise, in the area of financial literacy, lack of skills and human capital for entrepreneurs has been identified as one of the impediments to increase productivity, innovation, and access to finance for SMEs and entrepreneurs. Regarding crowdfunding finance, entrepreneurs should become aware of the risks and opportunities that the instrument presents, and need to be trained in how to present their business model to attract funders. The provision of workshops to target SME sectors (in particular those that cannot find

finance in the market) can raise awareness and uptake of crowdfunding. Workshops can also help as networking events, not only technical support (MIF, 2014). While this report is concerned with financial crowdfunding, the dissemination of community crowdfunding can serve as a training stage and can facilitate the transition towards financial crowdfunding.

It is also desirable to improve the data on crowdfunding, as well as evaluation of policy measures in this area. The provision of public data on size and uptake of crowdfunding campaigns, on success rates, and existence of complementary finance sources, on the business organisation and location of the stakeholders (both borrowers and lenders) can contribute to impact assessment of the benefits and risks of crowdfunding. The use of accounting data standards can be fostered in order to increase transparency (De Buysere and others, 2012).

6. Conclusions and the way forward

Understanding how to broaden the finance options available and accessible to SMEs is a key challenge for policy makers in the quest for fostering their development and sustaining the most dynamic enterprises, in a credit constrained environment. It also represents a long-term challenge to improve the SME sector capital structure and investment capacity, reducing its over-reliance – and vulnerability – to the traditional lending channels.

This report provides a case study of crowdfunding as an alternative finance instrument for SMEs and entrepreneurs, which is close to conventional lending (both debt and equity), but presents opportunities for traditionally credit-constrained SMEs and new projects.

The report has analysed the existing data available on crowdfunding activities, the regulatory environment in which crowdfunding platforms operate, and has identified a set of good practices that could serve to increase uptake and awareness of this alternative finance instrument. Crowdfunding is currently a potential complement to traditional debt financing for some SMEs. At its current scale and coverage, it does not compete with traditional banking; indeed, it reaches segments that are often overlooked by the traditional finance sector, such as start-ups and innovative (and unproven) projects. Moreover, the banking sector is essential for the functioning of crowd-lending activities, as all transactions are on-line, which requires an online payment system, credit cards, and existence of credit records.[19]

The small amounts traded do not pose a systemic risk for the market at present, and do not appear to necessitate a dedicated regulatory framework for its operation, although stable regulations and guidance may contribute to providing an environment in which crowdfunding can expand. It will be important to monitor the evolution of crowdfunding in the coming years to determine its full potential as a viable, large-scale financing option for SMEs, as well as any policies that may be needed to support or regulate its operation.

[19] Crowdfunding might compete with micro-finance institutions. Over time, crowdfunding might become a tool for micro-finance institutions.

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Annex: Selected crowdfunding sites (as of July 2014)

Name	Website		Country of Origin
Kickstarter	www.kickstarter.com	Donations-Rewards	United States
Fondeadora	www.fondeadora.mex	Equity	Mexico
Idea	www.idea.me	Equity	Argentina
Crowdcube	www.crowdcube.com	Equity	United Kingdom
Lending Club	https://www.lendingclub.com	Loans	United States
FinanceUtile	www.financeutile.com	Equity	France
Crowdfunder	www.crowdfunder.mx	Equity	Mexico/United States
Kiva	www.kiva.org	Loans	United States
Prestadero	www.prestadero.com	Loans	Mexico
Kubo Financiero	www.kubofinanciero.com	Loans	Mexico
Afluenta	www.afluenta.com	Loans	Argentina
Angelcrunch	www.angelcrunch.com	Equity	China
Seedrs	www.seedrs.com	Equity	United Kingdom
Afexios	www.afexios.com	Equity	France
Anaxago	www.anaxago.com	Equity	France
Babyloan	www.babyloan.org	Loans	France/Europe
HappyCapital	www.happycapital.com	Equity	France
HelloMerci	www.hellomerci.com	Loans	France
Particeep	www.particeep.com	Equity	France
Spear	www.spear.fr	Loans	France

SmartAngels	www.smartangels.fr	Equity	France
Wised	www.wiseed.com	Equity	France
Prosper	www.prosper.com	Loans	United States
Seedups		Equity RM	Northern Ireland
CircleUp		Equity RM	
AngelList		Equity RM	United States
Symbdid		Equity	Netherlands
Innovestment		Equity	Germany
BankToTheFuture		Equity	United Kingdom
Sellaband		Equity	Germany
Starsup	www.starsup.it	Equity	Italy
Assiteca	http://www.assitecacrowd.com/	Equity	Italy
Unicaseed	http://www.unicaseed.it/	Equity	Italy
Jompeame	www.jompeame.net/	Donations/Rewards	Dominican Republic
Hithit	www.hithit.com		Czech Republic
Startovač	www.startovac.cz		Czech Republic
KreativciSobě	www.kreativcisobe.cz		Czech Republic
Nakopni.me	www.nakopni.me		Czech Republic
Fondomat	www.fondomat.com		Czech Republic