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Vlerick Policy Paper Series

No. 1

The rise of crowdfunding,

Threat or opportunity for the banking industry ?

January 2015

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Vlerick Policy Paper Series, January 2015

Content:

How should the banking industry react to the impressive development of crowdfunding? This paper brings together insights from academic, professional and regulatory perspectives related to this question. More specifically, we focus on the following:

- What is crowdfunding?
- Europe being at the leading edge of the development of equity crowdfunding, what do we know so far on this crowdfunding form?
- What types of activities are financed by crowdfunding?
- What are the determinants of the trend?
- How is the regulation of crowdfunding going to evolve?
- How should banks react?

It does not seem to be the case that the rise of crowdfunding constitutes a threat for the banking industry. It appears as a niche in the credit market, for initiatives which would otherwise not be able to raise funds. Nevertheless, to the question of whether there is an opportunity for banks to enter this market, the answer is less clear.

This paper consists in a research summary followed by an interview with Armin Schwienbacher about the effect of crowdfunding on the financial services sector, and the report of a Vlerick regulatory workshop dedicated to this topic, where 25 representatives from the financial sector were present (authorities, banks, crowdfunfing networks). The Vlerick Centre for Financial Services hopes that this contribution will inspire the actors of the financial industry in their future decisions.

In the context of the Vlerick CFS regulatory programme, this first policy paper deals with the rise of crowdfunding, and its effect on the banking industry. It consists in a review of existing research, an academic expert interview, and a report of the 2nd Vlerick Regulatory Workshop. Related academic publications are therefore reviewed in the first part, the second part transcribes the interview of Pr. Armin Schwienbacher, the workshop report is presented in the third part. We are very thankful to Armin Schwienbacher for having accepted to be associated to this initiative, as well as Bruno Colmant (Roland Berger), Jean-Paul Servais (FSMA), Olivier De Duve (MyMicroInvest), Bart Van Haeren (KBC Securities) and Maria-Teresa Fabregas-Fernandez (European Commission) and all the participants of the 2nd Vlerick Regulatory Workshop for their valuable contribution.

Summary of Existing Research

Definitions

Crowdfunding practices are receiving a growing interest since only a few years. Given this recent nature, commonly accepted definitions are still hardly identified in existing publications. Wilson and Testoni (2014) define crowdfunding as "*the collection of funds, usually through a web platform, from a large pool of backers to fund an initiative*". With this model, transaction costs are reduced and funders are directly in contact with entrepreneurs seeking access to finance.

The 4 types of crowdfunding

Four different forms of crowdfunding can be identified based on the type of compensation offered to the crowdfunders:

Crowdfunding forms	Compensation to the crowd
Reward-based crowdfunding	A product or a service
Equity crowdfunding, or crowdinvesting	A percentage of equity or profit-sharing arrangement
Loan-based crowdfunding, or crowdlending	Fixed periodic income and capital repayment
Donation-based crowdfunding	No expected compensation

Reward-based and equity crowdfunding (or crowdinvesting)

Belleflamme et al. (2013a) examine the economic factors that determine the choice between reward-based crowdfunding and equity crowdfunding.

The authors show that entrepreneurs prefer reward-based crowdfunding when capital requirement is small, and equity crowdfunding otherwise. While the reward-based form allows the entrepreneur to price-discriminate between crowdfunders and other customers, the equity-based form becomes more interesting with larger amounts since it induces the entrepreneurs to solicit more individuals with smaller effect on the fraction of capital he/she needs to give up.

Focus on equity crowdfunding (or crowdinvesting)

Although still representing a small fraction of crowdfunding activities, crowdinvesting is attracting a lot of attention due to its more complex form as well as its impressive growth in Europe over the past few years. Here we provide more insights on this specific crowdfunding type.

What are the factors that make crowdinvesting campaigns successful?

In an analysis of the German crowdinvesting market, 5 key determinants are identified in the literature for crowdinvesting campaigns to achieve their targets.

- **Firm age**: In Europe, campaigns initiated by newly created start-ups tend to work best than initiatives from pre-existing organizations (Lars Hornuf and Armin Schwienbacher, 2014a).

- **Ticket size**: For a given targeted amount, crowdinvesting campaigns with a smaller ticket size and therefore a larger number of crowdinvestors tend to be more successful (Lars Hornuf and Armin Schwienbacher, 2014a).

- **Platform experience**: Crowdinvesting campaigns that are launched through a platform with already some experience are more likely to raise higher amounts (Lars Hornuf and Armin Schwienbacher, 2014a).

- **Entrepreneur's network**: Using the universe of US-based projects on Kickstarter, research has shown that most crowdinvestors belong to the entrepreneurs' social network, especially in the first phase. The network size of the entrepreneur therefore emerges as a key success factor (Mollick, 2014).

- **Underlying project quality**: Still in the US context, Mollick (2014) finds that projects that signal a higher quality level are more likely to be funded. As an indicator of higher-quality project, the author measures whether a pitch had a video, whether project updates were provided within three days of launch, and whether there was spelling errors in project pitches.

Who is the 'average crowdinvestor'?

Almost by definition, it is difficult to build an "average profile" for crowdinvestors since "the crowd" includes a broad range of individuals. Some crowdinvestors have financial experience, some others do not. Portals can filter the crowd and target specific types of investors by setting up high ticket size. Some portals like *Fundsters* or *Companisto* virtually permit everyone to become a crowdinvestor with a ticket size of €1 or €5. Some others like *SiamoSoci* in Italy or *Fondatio* in France have sold minimum tickets of €50,000 for some campaigns.

For platforms with lower ticket size, the crowd can be very diversified. For platforms with higher ticket size, crowdinvestors may have more financial experience. The German *Innovestment* portal is characterized by a high minimum ticket ranging from €500 to €10,000. As reported by Köln and Hornuf (2012), its users appear to be willing to invest €124,100 on the portal and up to €59,500 per startup firm. The majority of them are self-employed, working in IT, consulting or finance.

Wilson and Testoni (2014) characterize crowdinvestors as follows:

- They have many different backgrounds, with many having no investment experience
- They invest their own money
- Most investors are geographically distant from the venture

- They generally have a passive role, some platforms represent the interests of the crowd
- Financial return is not the only reason for investing

Is crowdinvesting transforming the crowd into small business angels?

The boundary between crowdinvestors and traditional business angels is rather vague, as reported by Armin Schwienbacher and Lars Hornuf in their book chapter entitled "*Crowdinvesting – Angel investing for the masses?*". Both are similar, but the structures of financial transactions differ to a great extent. Crowdinvesting appears as complementary to angel finance rather than a substitute. This complementarity is well illustrated by the fact that some portals, like MyMicroInvest in Belgium, are now building on co-investment of both crowdinvestors and business angels.

The two big differences with angel investment are as follows:

1. Crowdinvesting provides the entrepreneur with an access to a larger pool of investors (the crowd). Business angels are generally former entrepreneurs while crowdinvestors have much more diverse backgrounds. Crowdinvesting is therefore available to a broader pool of investors.

2. Crowdinvesting portals provide "*boilerplate contracts*" while angel investment allows more customized contracts. Crowdinvesting indeed makes tailor-made contractual arrangements more difficult to implement. Most commonly the crowd buys profit participating certificates with no associated voting rights while business angels may opt for preferred shares giving them higher priority in case of bankruptcy.

The distinction between crowd- and angel- investing relies also largely on securities regulation. Registration and prospectus exemptions ensure less protection to crowdinvestors: the firm discloses less information, and in case of bankruptcy crowdinvestors often rank last. Business angels benefit from more protection either by investing in firms which comply with general securities regulation, or negotiate customized protection.

Which securities regulation facilitates crowdinvesting?

As we can see from the table below, the market of crowdinvesting in Europe has known an impressive growth over the past few years.

Development of the European Crowdinvesting Market, by Year

Year	# of portals started	# of successful campaigns	Average amount raised	Average # of investors	Average Investor contribution
2007 - 2009	2	1	€ 60,000	11	€ 5,455
2010	1	9	€ 100,589	61.56	€ 1,634
2011	6	21	€ 162,530	88.12	€ 1,844
2012	11	120	€ 100,270	115.12	€ 871
2013	21	261	€ 224,400	164.23	€ 1,366

Source: Hornuf and Schwienbacher, 2014a

As argued in the literature, exemption to registration and prospectus disclosure under a certain threshold is a major regulatory facilitator of crowdinvesting practices.

The issuance of a formal prospectus allows investors to be informed about how the funds will be used. In this respect, imposing prospectus disclosure enables investor protection against opportunism. On the other hand, as reported by Armin Schwienbacher and Lars Hornuf (2014c), too strong investor protection is harmful to the development of small firms for which complying with registration and disclosing good-quality prospectus is too costly. Regulatory exemptions to prospectus and registration requirements therefore allow small firms to benefit from funding by the general public (i.e. the *crowd*). In turn, these exemptions also come with a limitation on the amount of capital that firms are allowed to raise.

Within the EU, companies are exempted to comply with prospectus and registration requirements if a public offering does not exceed €100,000 within a 12 month time interval. In the US, as soon as the 3rd part of the JOBS Act (CROWDFUND Act) will come into force, similar opportunities will be offered and crowdinvesting will no longer be restricted to accredited investors. Armin Schwienbacher and Lars Hornuf compared how securities regulation differs across several EU countries and the US, and show that indeed, strong investor protection (fewer exemptions) hurts the development of entrepreneurial projects because firms are not able to support costs of compliance.

Interview with Armin Schwienbacher

Armin Schwienbacher is professor of finance at the *University of Lille Skema Business School* (France) and a research fellow at the *Duisenberg School of Finance* (The Netherlands). He obtained a PhD in Finance from the *University of Namur* in 2003, with a focus on exit strategies of venture capitalists. Since then, he has been collaborating with various institutions, including the *York University Schulich School of Business*, the *University of Amsterdam Business School*, the *Université catholique de Louvain* and the *University of California at Berkeley*. His work in the field of corporate finance, and more particularly on crowdfunding, venture capital, entrepreneurial finance and private equity was published in numerous international refereed journals, including *Journal of Financial Intermediation, Economic Journal, Journal of Banking and Finance, Entrepreneurship Theory and Practice, Journal of Business Venturing, Financial Management, Journal of Corporate Finance*.
Email: armin.schwienbacher@univ-lille2.fr

Thank you Armin for accepting this interview. The purpose is to get your view about the effect of crowdfunding practices on the financial services sector.

"Crowdfunding is a really interesting topic that attracts a lot of interest from different players. More and more people but also policy makers are getting interested. It took a bit of time to get attention but now the crowdfunding players also become more integrated in the financial sector.

It is actually very difficult to talk about crowdfunding in general terms. There are different types of crowdfunding models and they are differently regulated. *Kickstarter* has nothing to do with *MyMicroInvest* for example. Investors' and entrepreneurs' behaviours are also very different across different crowdfunding models. They also have very different pros and cons, also for banks. That is the reason why we no longer find research on crowdfunding in general but rather on specific types of crowdfunding."

How would you categorize the different types of crowdfunding?

"From a regulatory perspective, there are at least four different types: securities-based (crowdinvesting), loan-based (crowdlending), reward-based, and donation-based. Crowdinvesting is about selling securities and falls under securities regulation. Loan-based crowdfunding or crowdlending has to do with loans and is therefore regulated by banking regulation. With reward-based crowdfunding, like Kickstarter, the crowd receives a product. You provide a small amount to the company and the entrepreneur promises you to send you the product before other consumers can buy it. It is very different from participating in a company. It is more dependent on consumption preferences of the crowd. And it is a very different regulation again. Finally, donation-based crowdfunding is under the regulation of donations. From the perspective of banks, it is good to separate along these dimensions as well."

The type of activities financed

Are there some industries that are more or less likely to be financed through crowdfunding?

"It depends on the type of crowdfunding. There is a broad range of industries that could be affected by crowdfunding. But they would cluster into specific types of crowdfunding platforms. If you want to start a project that you can link to a product that is almost ready but you need money to start producing, then you can go on Kickstarter or any other reward-based platform. On these platforms, you will often see industries that produce products like videos, games, high-tech devices, software... If your company is a research-and-development-oriented company, that is not where you want to go because you cannot reward the crowd with a specific product. Then you are more likely to rely on crowdinvesting. On crowdinvesting platforms, you will see different innovative companies that are looking for long-term capital and thus for investors who are ready to hold securities (shares, notes) for many years. On crowdlending platforms, it is more about financing specific acquisitions, like a car or a new machine. Instead of going to the bank companies are asking money to the crowd. But they need to make sure that they can generate cash flow quickly enough to pay back the interests and the principal of the loan within the next one or two years. Generally, you will not see on crowdlending platforms any R&D-oriented projects. Social projects can be found on donation-based crowdfunding platforms. So, everything can be covered by crowdfunding but project types are clustered in specific crowdfunding models. Nowadays, platforms tend to be specialized in one type of crowdfunding and therefore target very specific types of projects. But no industry seems to be excluded."

In one of your papers, it is argued that non-for-profit crowdfunding organizations are more successful. It is indeed easier to attract money for initiatives that are of interest for the general community due to reduced focus on profit. Does that mean that industries with a lower public interest should not rely on crowdfunding? E.g. B2B industries, pollution-intensive industries…

"The result on non-for-profit is a result based on a ceteris paribus assumption: a same project will raise more money through crowdfunding if it is non-for-profit, while keeping all other characteristics constant. But taken on an average level, non-profits raise less money but finance different types of projects. The trick in crowdfunding is to create audience, you need to attract attention so that people start funding your project. The more the crowd feels attracted to your project, the more it is likely to fund it. Things that are disconnected to the crowd seem to me less likely to get funding. The more catchy your project is and the better your pitch is, the more likely you will be able to convince the crowd."

It seems that in most cases, the gathered amounts remain rather low (thousands of dollars only). Do you see crowdfunding as an appropriate financing solution to large-scale innovations?

"Again, it will depend on the type of crowdfunding. On reward-based crowdfunding, it is true that the average amount is only a few thousands euros. On Kickstarter, the bulk receives below 10,000 dollars but also because they have projects that do not need more. If you look at crowdinvesting platforms in Europe, some of them raise one to three million euros. Protonet raised € 1.5 million within 10 hours on Seedmatch (Germany) and then continued to raise more to eventually reach €3 million. That is the amount of money that R&D-oriented companies need to start with. On crowdinvesting platforms, the average campaign amount is much larger because the projects are different. A large number of them raise more than € 500,000. There, companies offer securities (shares, participating or convertible notes) in order to finance its long-term development, not only a short-term project. The idea is to fill a gap: go first on a crowdinvesting platform and in a follow-up round raise money from venture capitalists for larger amounts. With crowdinvesting platforms, the average campaign amount goes up year by year. In the UK, some of the startups are now raising impressive amounts of money on crowdinvesting platforms; these amounts are at a reasonable scale to start serious R&D-oriented companies. One interesting success story is Oculus Rift which raised $ 2.4 million on Kickstarter in 2012. One and a half year later the company was acquired by Facebook for $ 2 billion!"

Understanding the trend

With the financial crisis, the weakness of banks has been an opportunity for newcomers in the credit markets. Do you think this explains why crowdfunding has developed so far? Do you see other determinants to this trend?

"Perhaps a bit but I think it cannot be the entire story. Certainly, there is the view that the financial crisis has reduced the interest of banks to fund SMEs. I think indeed it has become more difficult for small firms to get funding. Banks prefer to fund larger companies because the processing of evaluating funding needs has fixed costs, which tends to favour larger firms with larger needs. I think that the rise of social media explains much more the recent development of crowdfunding. And social media is not just a hype, everyone now is well connected. Crowdfunding is not new, it already existed before but now social media makes it much easier for entrepreneurs to use crowdfunding because the internet allows interacting with a large crowd at no cost. So the emergence of internet and social media is a much bigger reason for why this has taken place. That said, I think certainly the financial crisis may have had an impact in terms of distrust towards traditional players. People are looking for alternatives to bank finance or bank-intermediated finance. There may be additional factors, but the rise of social media probably explains most."

Do you see crowdfunding as a short-term hype? Or do you think that it takes part to a fundamental shift in financial intermediation?

"Social media are not a hype, nor crowdfunding. But the high growth levels will not last as the market will eventually mature. However, a recent study by Mollick and Kuppuswamy shows that fraud on Kickstarter is very rare. We have not seen much on crowdinvesting and crowdlending platforms either, although it may happen at some point and may certainly create some damage. But I think it is more a question of how big the crowdfunding market will eventually become than whether it is only a hype. My view is that it will always remain a niche. It will remain a small market for projects that other financial players are not funding. Most of these projects will not get a bank loan simply because they are too small, lack collateral or are not yet sufficiently organized. That said, we should view the economic contribution of crowdfunding on how it may foster entrepreneurial initiatives and not on the actual size of the market. Venture capital is not that big either compared to the entire banking sector, but nobody would claim that venture capital is not important. Most of the Silicon Valley was created with venture capital. They provide funding at a time when nobody else provides funding and at a very early stage when the means are still small. Crowdfunding is similar. It will be worthwhile to look at the economic contribution of crowdfunding

10 years from now, its economic impact in terms of promoting entrepreneurship, and job and company creation. However, it is too early to make such an assessment.

Another issue which I want to raise is that the bigger threat to the current development is not fraud but crowd misperception. That may create a correction in the market in the near future. It is not clear to me that the crowd always understands the risks involved in crowdinvesting, crowdlending or even in other forms of crowdfunding. We observe behaviours that suggest that the crowd does not fully understand the risks. That may create disappointments later on. Underestimation of risk is a key ingredient of a financial bubble. For example in crowdinvesting, a lot of money is pledged to start-ups very quickly, suggesting herding behaviour. I hope the crowd understands that these are risky start-ups, that a non-negligible fraction will fail and thus not deliver any return. The same is true for crowdlending: the platform assesses the riskiness but it is not sure that people understand sufficiently well what should be the appropriate risk premium. Today we do not have a clear view on which fraction of the borrowers or issuers will fail, and that may create frustrations soon. Similarly on reward-based platforms, where some projects do not deliver or deliver very late, it is not like ordering a book on Amazon; there is always a risk that the product will not be delivered and the money may be gone. So I think the potential disappointment of the crowd may be a bigger threat to the current growth. Fraud is a much smaller problem."

Banks reaction

What would you recommend to banks as to how they should react to the development of crowdfunding?

"Since crowdfunding is likely to stay a niche, it is not going to affect significantly their scope of activities. Also it is not clear whether banks have a comparative advantage in the crowdfunding market. We do see some banks having already entered the market: ABN AMRO is one example. Some banks are now setting up their own platforms or getting associated with an existing platform. In some countries, platforms face regulatory constraints that may induce platforms to collaborate with banks. In others there is an interest from banks to understand the development of that market. But overall, whether there is a comparative advantage for a bank to be in this market is not clear. The first generation of platforms were not much connected with traditional financial institutions. The new platforms are much better integrated with existing financial players. For instance, crowdinvesting platforms more often bundle with business angels networks or venture capital firms. This can make sense since the type of deals are more similar."

Instead of competing with crowdfunding platforms, can banks play a role in this development? Can they facilitate this development through innovating payment or reporting solutions?

"Banks may add value, especially if crowdfunding platforms become more and more regulated. Platforms will need to comply with different types of regulations: for crowdinvesting, there is already a broad range of regulatory constraints that is going to be put in place in different countries, including France and the United Kingdom. Some forms of crowdfunding will become more regulated in the future and there I think banks may help because banks have already licenses to be financial intermediaries, which is often very difficult and expensive for small platforms to obtain. So it will very much depend on how crowdfunding regulation will evolve in the future, and specific regulatory settings could make it worthwhile."

Is there any other comments which you would like to add with respect to banks reaction to crowdfunding?

"Crowdfunding is also a way to test a new product or assess the existence of a market. We have seen examples where entrepreneurs did not get money from banks. But once they had a successful crowdfunding campaign, they were able to show that there is interest for the product, they could go back to banks and more easily get funding as their record has now improved.

Crowdfunding itself is an interesting source of entrepreneurial finance, but I do not think it is a major threat for banks. The risk would be to over-regulate crowdfunding. Some regulation is needed. But if we start regulating it just like banks, then the platforms will evolve to become also banks. If we want crowdfunding platforms to be different from banks, we need to regulate them lighter."

Report of the 2nd Vlerick regulatory workshop

This section summarizes the content of the presentations and discussions of the 2nd Vlerick regulatory workshop which took place on 15 October 2014 at Vlerick Business School on the following topic:

ALTERNATIVE FINANCE: A HYPE OR A FUNDAMENTAL SHIFT IN FINANCIAL INTERMEDIATION?

25 experts were present, from different horizons: regulators (FSMA, European Commission), lawyers (Allen & Overy), the European Crowdfunding Network, consultants (KPMG, Roland Berger), financial companies (KBC, BNP Paribas Fortis, Euroclear), crowdfunding platforms (MyMicroInvest, Bolero). The workshop was organized as follows. In a first part, Bruno Colmant (Roland Berger) presented a helicopter view on the alternative finance market. In a second part, Jean-Paul Servais (FSMA) the presented regulatory plans and concerns with respect to alternative finance in general and to crowdfunding in particular. The third part was dedicated to crowdfunding in practice and the possible role of banks, with one presentation from Olivier De Duve (MyMicroInvest), and one from Bart Vanhaeren (KBC securities). Finally, Maria-Teresa Fabregas-Fernandez presented the vision of the European Union. Each part was followed by a discussion with the audience, as reported hereafter.

Helicopter view on the alternative finance market

Bruno Colmant, Director of Roland Berger

A financial institution "condensates" risks and covers them with equity. Hence, equity of financial institutions captures the counterpart of risk and is hopefully adequately rewarded. Accordingly, the risk appetite must match the expected return on equity. The question is: which risks should be retained by financial institutions ?

Major organic issues are affecting financial institutions:

- Before the crisis, banks were too risky mainly because their assets were underdiversified. Risk today should be decreased in order to avoid bankruptcy. The de-risking of financial institutions aims at decreasing the "societal "cost.
- Financial institutions create a money flow, their equity level determines the "churning" of money. Prudential regulation immediately impact the money creation, even more than before since banks are now controlled by the ECB.
- Risk never disappears. Since systemic risk cannot be diversified, the risk is always put somewhere else. Ultimately we could see a situation where shadow banking will gather all the risks: this would a big concern for the regulators.

This is the reason why crowdfunding is of major interest for the regulators: they do not want risk to be relocated somewhere else without a relevant control. Crowdfunding may be justified for regulators if investors have enough choice to diversify away.

Other related issues should be mentioned:

- We are facing today an abnormal proximity between financial institutions and governments. One may argue that banks today are already nationalized, because the level of regulation is so high that ultimately banks cannot diversify away. If this proximity is too strong, then a private economy can be expected to rise significantly.
- Banks are trying to compensate low interest rates in a deflationary context, leading to a decline in profitability. Therefore, crowdfunding appears as a way to raise money that is no longer accessible through banks.

The picture of the world is changing. Given the currently low level of ROE for banks, alternative evolutions can be foreseen: what will be the value of a banking license in the future? What risks will be retained by banks? What will be the distribution channels in the future? Other players like Apple and retailers now become market infrastructures through credit cards and capture the banking flow, and it may get harder to get money from banks because of their low profitability. A de-bankarisation of the credit market may therefore be expected. In such a context, there is definitely a case for alternative finance.

Discussion

The presentation of Bruno Colmant was followed by a discussion during which additional and complementary issues were raised. It was first mentioned that a potential consequence of overregulation could be that investors would make less reflected and concerned investments.

Then, the issue of securitization of SMEs was put forward. Within the new regulatory framework, the cost of SMEs' securitization has become too expensive. SMEs in Europe should be of major interest for insurance companies. What we observe is that insurance companies are investing mostly in their own country and that is we want to avoid: investing abroad is a way to decrease systemic risk. In this respect, the concept of securitization should come back. Securitization should be the solution, not the problem. The problem that has to be solved is moral hazard. One solution is to define high quality securitization and create the appropriate incentives for financial institutions.

Digitalization was discussed as well. The digital world is changing the game and banks should not resist: it is now the digital intermediaries that are carrying the money flows. This trend will go on, and faster than we think.

De-risking the banks' balance sheet was finally evoked. Is it the case that banks will be brought back to what they were 15 to 20 years ago ? It might be but if one would recreate an old-fashioned banking system, the need for diversification would have to be addressed.

Overall, we are now shifting from a bank intermediation system (banks take care of risk) to a market intermediation system (individual investors are taking their own risk). As a consequence, integrity, safety and transparency of the market become major issues. While crowdfunding illustrates this shift, how would it be regulated?

Regulatory concerns and plans

Jean-Paul Servais, President of the FSMA

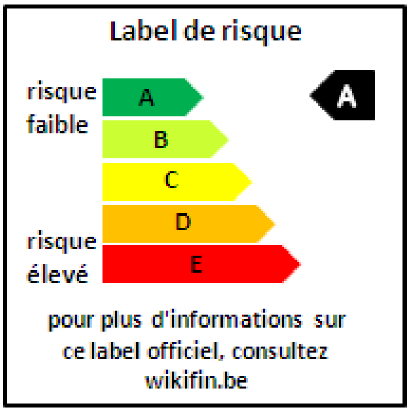
Does alternative finance lead to alternative ways of regulating? This question is currently raising a debate not only at a national level, but also at the worldwide level. There are many new developments: infrastructure projects, mini-bonds, liquid alternative funds, virtual currencies… And these innovations are often linked to new technologies. It is attractive for young people, for people "angry" at traditional finance, and promised returns may be attractive in the current low-rate environment. New regulation has to be designed.

Concerning crowdfunding, there is some kind of emergency: the whole crowdfunding industry was estimated to be around $5 billion in 2013 (worldwide), which is really significant. There are 3 crowdfunding categories to be considered independently from a regulator point of view: donation-based, reward-based (including pre-sales), investment-based (equity and lending). The first two categories currently represent approximately half of the amount raised through CF. Given these proportions, the regulators mainly focus on the last category.

Crowdfunding is growing and this growth is expected to continue in the future. The associated risks are fraud, credit default, illiquidity and lack of information. The Lemon's problem also has to be considered: it might be the case that project owners using crowdfunding are those that have not been able to obtain traditional funding. Lastly, the avoidance of over-indebtedness has to be ensured. It can be argued that investing in crowdfunding is riskier than more traditional investments. It thus seems logical to set up rules to protect investors, notably retail investors who are the primary target of crowdfunding. There is a need to find a right balance.

Crowdfunding is therefore a real challenge for regulators. Different measures are implemented.

- Any public offer below a defined threshold is exempted from prospectus requirements. In 2014 this threshold was upgraded in Belgium from €100,000 to €300,000 provided that individual investments are limited to €1,000.
- In parallel, a new regulation has been designed for all kinds of financial products. Issuers will need to inform investors on the level of risk associated to their product by means of a standardized risk label, as illustrated by the figure below. This label will also apply to the advertising of crowdfunding investment products and aims at improving investors' protection. It is not yet a requirement but it will be in force in June 2015.



Overall, regulation must not be seen as a threat, but as an opportunity to ensure confidence. What is at stake is simply the credibility of this new « market ».

Discussion

The first question raised by the audience was about the presented rating scheme (or risk label). While perceived as an interesting measure, the issue is: who is going to put the rating? As Jean-Paul Servais explained, the issuer will be rating the product and the regulator will control that this is done correctly. The objective is therefore to have a clear definition of the 5 classes of assets.

The audience shared very positive comments on the presented regulations. The upgrade of the prospectus threshold to 300,000 € was seen as relevant and necessary. It was nevertheless mentioned that disclosing a prospectus is generally useful. As Jean-Paul Servais mentioned, in any case "it should not be seen as a burden, but as an advantage". Writing a prospectus indeed allows to improve communication, and helps building a competitive advantage. The FSMA has approved crowdfunding prospectusses in the past. Writing a prospectus may therefore also be seen as an opportunity.

Overall, there is a consensus among major players in the industry that avoiding a "crowdfunding bubble" requires proper regulation. From the practitioners' point of view, the focus should be on information, and on the avoidance of crowd misperceptions. Trust is again at stake and being transparent about risk is key.

Crowdfunding in practice

An introduction to Crowdfunding

Olivier De Duve, CEO of MyMicroInvest

Traditionally, banks were the only intermediary between savings and investments. Nowadays, many other players are playing in that field. Crowdfunding platforms are one of them.

In Belgium, the reason why crowdfunding is important is that it promotes entrepreneurship. Too few individuals want to become entrepreneurs in this country. In the US, 51% of the individuals wants to create a company while only 4% in Belgium wants to be an entrepreneur... And what is really worrying is that, for this small fraction of people willing to create a company, there is a big equity gap. However, our economy's regeneration depends on entrepreneurs. SMEs represent 66% of the employment and 85% of the net job creation, fuelled by start-ups.

In Belgium, we have €250,000,000,000 from savings. 1% of this amount could finance 10,000 new companies, which would lead to a decrease of 12% in unemployment, and create more than 50,000 new jobs. One issue is that today investing in SMEs is reserved to wealthy people. With business angels and venture capitalists, the minimum ticket is way too high for average people. Crowdfunding is about giving the possibility to everyone to finance the company they want to support. It is about building the economy of tomorrow: democratize capitalism, enable societal investments, create jobs and fill the entrepreneurs' equity gap.

In addition, crowdfunding is a form of market validation. This can be a way to attract further sources of funding like venture capital and business angels, which would otherwise have come later in the process. Crowdfunding also allows to use collective intelligence, one can get much more from the crowd than just money.

Crowdfunding, the possible role of banks

Bart Vanhaeren, Managing director at KBC securities/Bolero

Digitalisation is a big game changer in the banking sector. Crowdfunding also takes part to this digital revolution. Do banks have a role to play there? Different attitudes are possible for banks with respect to crowdfunding: they can either inform their clients about it, refer to another platform, or they can engage themselves.

Crowdfunding can represent an opportunity for banks but entering this market only makes sense if it rewards a competitive advantage. In this respect, banks have more to offer in the financial forms of crowdfunding (equity- and loan-based) than in non-financial ones (donation- and reward-based). And for a bank, it is about defining a new asset class and targeting financial investors. The exit possibility is also an important aspect: it is important to talk about whether the objective is to go public or to repay dividends. Emotional connection is key with crowdfunding, and the exit issue needs to be tackled.

A bank has unique advantages through both the possible deal flow and its investor database. An efficient crowdfunding platform needs both investment opportunities and crowdfunding investors. Banks can help to detect potential opportunities through deep involvement and connections with industry organisations, as well as through the branch network. On the other side they can help to find investors among their retail clients and their private banking clientele. In addition, the access to in-house expertise is also a strong advantage for banks, especially with respect to compliance with regulations, but also regarding M&As, credit, operations, ICT, risk, etc.

Discussion

During the discussion, it was evoked that crowdfunding should not be reserved to people who have poor financial expertise but needs to be opened to corporations with a lot of cash as well. That is also where banks may help.

The benefits of asset diversification from the investors' perspective were also discussed. Both direct equity and bond financing make a lot of sense for start-ups. The fact that crowdfunding platforms offer both bonds and equity gives the possibility to investors to make a choice and to diversify.

Finally, the relevance of the exit question was emphasized. This question is indeed surprisingly hardly ever mentioned. But investors at a certain moment will look for an exit. An ideal world would have a secondary market. At MyMicroInvest, since sufficient liquidity is not expected before several years, the exit problem is solved by the fact that professional investors are co-investing with the crowd. Business angels and venture capitalists negotiated certain exit conditions, entrepreneurs are imposed to have a tag along between the crowd and other investors. So when they sell, they are obliged to sell the shares of the crowd.

The EU vision

Maria-Teresa Fabregas-Fernandez, Head of Unit at the European Commission

Last summer, the European Commission organized a big conference on crowdfunding. Interestingly, new entrepreneurs in the crowdfunding area were asking for action, their main concerns being the reliability of platforms and the risk of fraud. Trust is an important piece of the crowdfunding puzzle and the European Union may have a role to play there.

There are benefits and challenges with crowdfunding, and the European authorities are rather looking at the related initiatives with a positive view. The key challenges for crowdfunding in the EU include transparency on the applicable rules, market access and investor protection, tax treatments, awareness, possibilities for matched (public and private) financing. Financial regulations already exist about taxation, accounting, property rights, fraud, prospectus… But the question that regulators are asking themselves is whether the existing legislation is tailored for crowdfunding, or whether something specific to this new type of activities should be developed. It also still needs to be seen whether, given cultural differences across the member states, crowdfunding should rather be regulated at the national level, or if European regulation is needed.

In Belgium, the European Commission does not see a need to go for some specific immediate action for the moment, given the measures already put in place by the FSMA. However, the Commission will review the provisions of the prospectus directives. The purpose of such a review would rather be to ensure a sufficient level of flexibility, rather than to add new administrative requirements.

Discussion

Given all different regulations in EU countries, it was discussed whether there should be one homogenised regulatory system at the EU level to ensure that crowdfunding initiatives do not all go to the countries with the most favourable regulatory environments. It was argued that this could actually rather be more an issue for the national authorities. In terms of subsidiarity, the position of the European Commission is that it should be possible for platforms from one country to accept contributors from another country.

Then the timeframe for an action from the European Commission on crowdfunding regulation was discussed. A prospectus directive could be proposed in 2016.

The discussion ended with a question on the position of the European Commission regarding the use of crowdfunding to redevelop capital within SMEs in Europe. Overall, the Commission views crowdfunding as a very good new type of financing. Job creation and economic growth in Europe are the final overall goal.

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