What is crowdfunding and why banks should appropriate it?

Towards Crowdbanking

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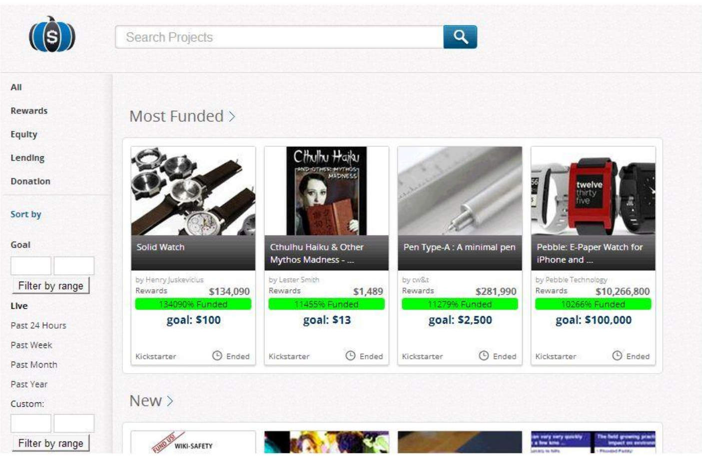
Crowdfunding is an alternative and convenient way of raising funds. Through an internet platform, anyone can present his project or ideas. Anyone can enter the platform so at first no one knows who he is addressing. Linking with social networks, online forums and blogs enables the viral – and inexpensive – marketing of the project. The point is to inspire as broad a group of people as possible by triggering collective fundraising via network effects. Some projects can then be implemented despite being rejected by traditional financial institutions, because the crowd considers the project to be worth supporting. The only restrictive rule is the setting of a cut-off date, by which the fundraising must be completed. If the fundraising target is not met within the allotted time, all involved usually withdraw their financial support. In other words, crowdfunding is generally an all-or-nothing endeavour.

Crowdfunding is becoming a popular means of supporting new ventures and creative projects. So far, many artists, filmmakers, musicians, software developers, entrepreneurs, and other professionals have already flocked to crowdfunding sites to try their hand at generating buzz and raising money for their ventures. Sites like Kickstarter or Indiegogo are most well-known. However, there are more than 500 crowdfunding platforms available worldwide to help people raise money for projects or campaigns. Recently, a specialized search engine was even launched for searching and comparing the crowdfunding sites: Seederella.com.



Investors in the genuine crowdfunding model are not traditional kind as they do not acquire any shares in the planned project or the business model created. They receive alternative compensation instead, which is often intangible or provided in kind (books, music CDs, tickets for the cinema, a mention in the closing credits of a film, a role in a video, private concerts etc.). The remuneration for the crowd in the form of tangible goods also provides the opportunity to integrate creative sponsors interactively in the value creation processes. The crowd can support the projects with ideas for design, blueprints or branding. Crowdfunding thereby acquires a type of open innovation.
Another area where crowdfunding sites have great potential is in the leveraging of data from a wide range of startups to forecast what sort of companies will succeed and which will fail. A crowdfunding platform can serve as a prediction market.

Nowadays, the game is changing for crowdfunding. It has become legal for platforms to give actual equity to investors and it's expected to draw a vast amount of capital. Some are predicting an influx of as much as $300 billion, 10 times the amount now deployed in the venture sector. It's "a virtual gold rush," says Scott Steinberg, who penned *The Crowdfunding Bible*. In fact, new crowdfunding extended models appear every day: for example New York-based Prodigy Network, best known for marketing the Trump SoHo hotel condominium, is bringing crowdfunding to real estate, soliciting thousands of investors to buy slices of a skyscraper in exchange for a share of rents and property appreciation. In Colombia, Prodigy has crowdfunded a building called BD Bacatá that will be the nation's tallest. About 3,100 investors kicked in $171.8 million of the $239 million needed to build the 66-story skyscraper in downtown Bogotá.

Eventually, the key-question is: will banks stay away from this phenomenon? Will it develop apart from them? For us, there is no reason why it should be so. In fact, a crowdbanking model is now emerging.

Contents:

What is it?

Crowdfunding transactions are most commonly conducted online. They differ from traditional funding methods in that they often involve a strong emotional dimension.

How it works?

Crowdfunding is a method in which individuals are considered the “crowd” to fund your personal or business product with their own money, usually in the form of a donation. According to a report from Massolution, more than 1 million projects were funded with more than $2 billion in 2012. This amount is expected to exceed $5 billion globally.

The proposal or project is presented online in front of a large group of people or investors. If the proposal is well-liked by the crowd, they will donate funds. It is quite simple, but there are several types of crowdfunding platforms, depending on the type of product or project that requires funding.

Three main practices of crowdfunding

There are three main practices of crowdfunding:

- Reward & Charity
- Lending
- Equity-based

Reward & Charity

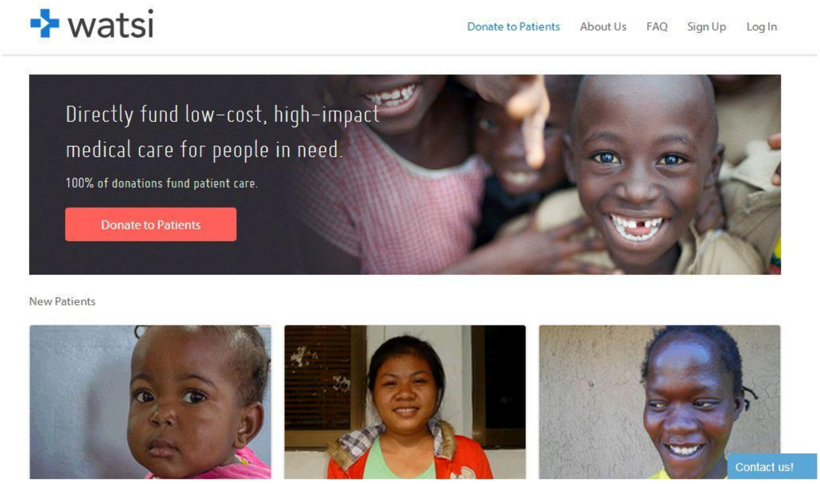
In reward-based crowdfunding, funds are contributed in exchange for future goods or services.

In charity-based crowdfunding, the crowd gives donations.

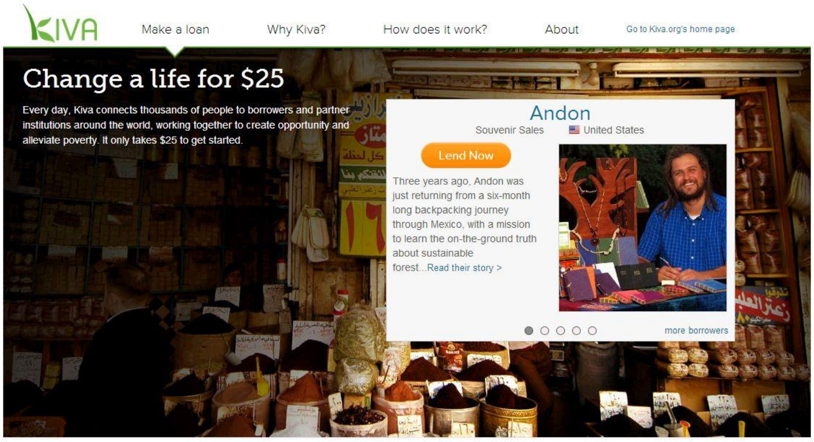
Reward and charity-based are still the most common forms of crowdfunding and are good options for non-profit organizations, social causes, artistic projects, and product development. Companies like Kickstarter and Indiegogo are prominent examples of reward-based crowdfunding.

***Kickstarter** is the most popular crowdfunding site. It has raised a total of over $220 million from 61,000 projects to date. It accepts all types of creative projects but not those that are focused on raising awareness, charity or small personal projects, like buying a new laptop. For example, Oscar-winning director Spike Lee asked fans to fund his latest film project through Kickstarter, instead of the reluctant studios. On **Go fund me** you can solicit funds from supporters to donate whether it's for a business or for traveling expenses or raising funds for tuition.*

Watsi *lets people donate as little as $5 toward low-cost, high-impact medical treatment for patients in third-world countries. It represents the next generation of charities dependent on online donors, evolving the model started by sites like Kiva.*



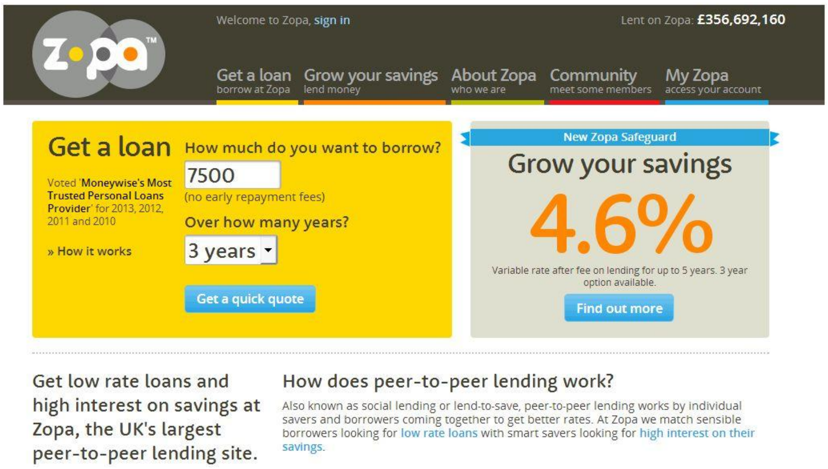
With just a few clicks, ***Kiva*** *users, for example, are able to lend money to a restaurant owner in the Philippines — to examine her loan proposal and repayment schedule, to read about her and to see her photograph. Charities have long recognized the importance of photographs and narratives in soliciting donations. Watsi's Web site, too, shows vivid images of its patients, and tells their stories.*



Indiegogo's current funding record is $1,665,380 which was raised by Scandu Scout - a scheme to build a Tricorder medical scanning device. Kickstarter's record is $10,266,845 for the Pebble smart watch.

Lending

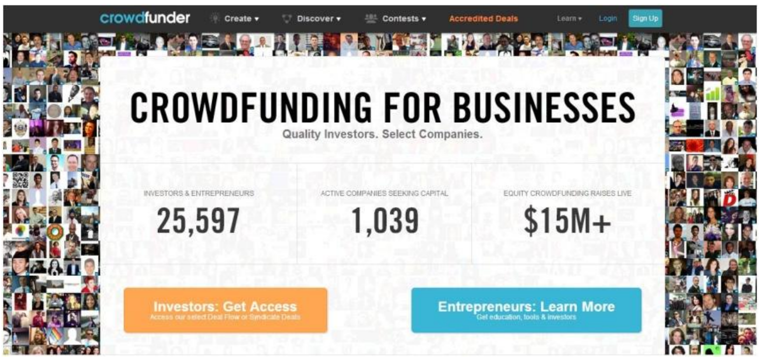
Lending-based crowdfunding, also called Peer-to-peer lending, allows individuals and businesses to borrow money from the “crowd” and repay it with interest. Loans are approved based on the borrower’s credit score and no collateral is required. For example, peer-to-peer lending sites like Lending Club or Prosper are used to finance small businesses, home improvements, medical treatment, vacations, and purchases of durable goods. Sites like Ratesetter,Smava, Prêt d’union, or the Payday lending sites (Cash America, Advance America) are more for individuals. One of the most famous is **Zopa** (“Zone of possible agreement”).



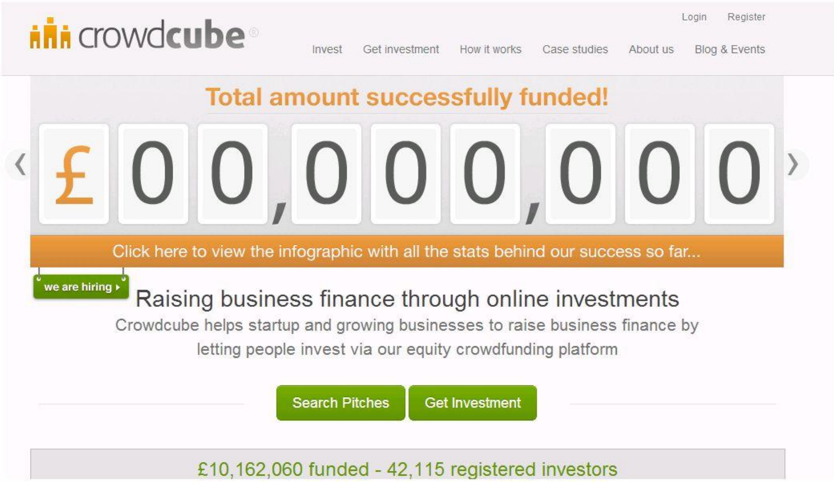
Equity

Equity-based crowdfunding allows companies to get capital from the crowd by selling equity to investors. Currently, equity-based crowdfunding is restricted to accredited investors, meaning high net worth individuals. It is also constrained by prohibitions on general solicitation and general advertising. This partially explains why equity-based crowdfunding has grown at a lower rate than other kinds of crowdfunding.

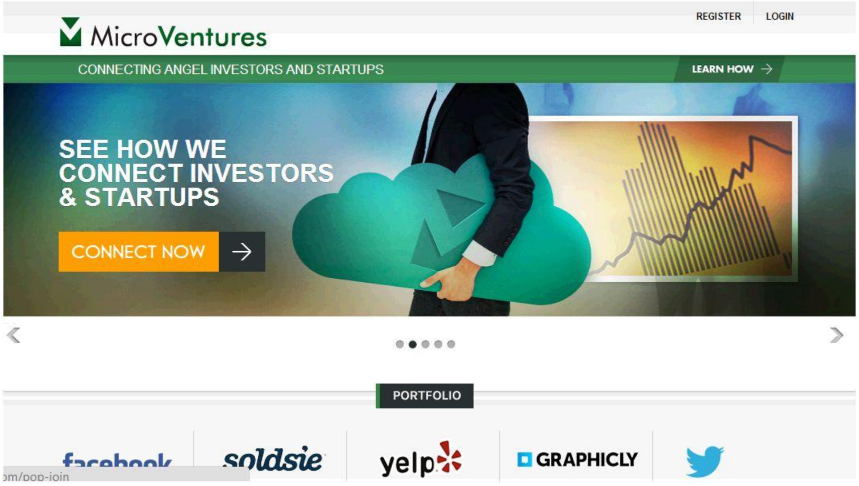
Nevertheless, in 2012 President Obama signed the Jumpstart Our Business Act, intended to encourage funding of small business in the U.S. by easing various securities regulations (see further). Indiegogo co-founder and CEO Slava Rubin said he thinks the equity model could "*complement*" his "*perks-based*" model.



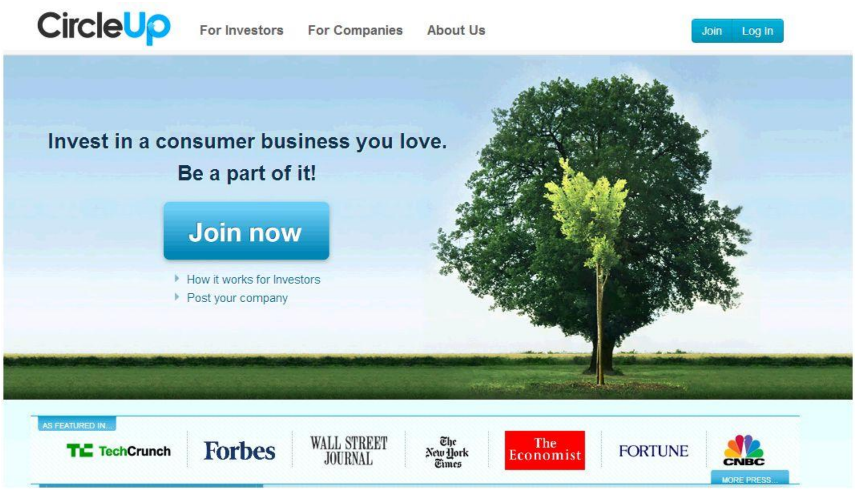
Crowdfunder *allows U.S. startup and small businesses to raise funds by selling equity, debt and revenue-based securities. The site offers contests where a startup can win up to $500,000 in funding for the best ideas.*



Crowdcube *is now authorized by the Financial Services Authority. This authorisation makes Crowdcube the only regulated equity crowdfunding platform where investors can become direct shareholders in UK businesses. Crowdcube will also now offer its investors' additional protection with access to independent experts from the Financial Ombudsman Service (FOS) and claim compensation from the Financial Services Compensation Scheme (FSCS). Crowdcube has raised over £5 million for UK businesses. More than 28,000 investors have registered on its website since its launch in February 2011.*



Microventures *says it's the first U.S. marketplace to use a crowdfunding model to sell equity stakes in private companies to wealthy investors. To do so, it had to register as a broker-dealer. Since closing its first deal in 2011, Microventures has handled more than $8 million in equity sales through 25 completed private placements.*



San Francisco-based ***CircleUp*** *provides an investor relationç-style site that encourages online investors to invest in companies whose products they like. Investors typically spend $1,000 to $15,000. The site provides full* *financials, growth projections, competitive landscape, biographies, a forum in which investors can ask questions to the CEOs, and conference calls. Investors can also request free samples of the products.*

Leading UK online platform for investing in startups - ***Seedrs*** *– has a 'crowdfunding done properly' model that uses a Nominee structure so that shares are held by a single entity. This provides essential post-investment protection for investors. And for entrepreneurs, it makes subsequent rounds of investment simple and straightforward relative to other crowdfunding models that create the often show-stopping logistical nightmare of having to deal with as many shareholders as investors.*

In the absence of specific rules, a small number of crowdfunding sites, like Rock the Post and EarlyShares, have partnered with broker-dealers, which can help companies sell equity to accredited investors in transactions called private placements. For example, CircleUp partnered with the broker-dealer WR Hambrecht. Then CircleUp took the partnership trend to its logical conclusion, registering as a broker-dealer with the Financial Industry Regulatory Authority (Finra). Only broker-dealers can earn transaction-based revenue. In other words, CircleUp needed to be registered with Finra before it could start charging commissions on the money it raises. Moreover, submitting itself to Finra regulation may give investors and companies greater confidence in CircleUp.

This is only one among many other possible extensions of the crowdfunding model.

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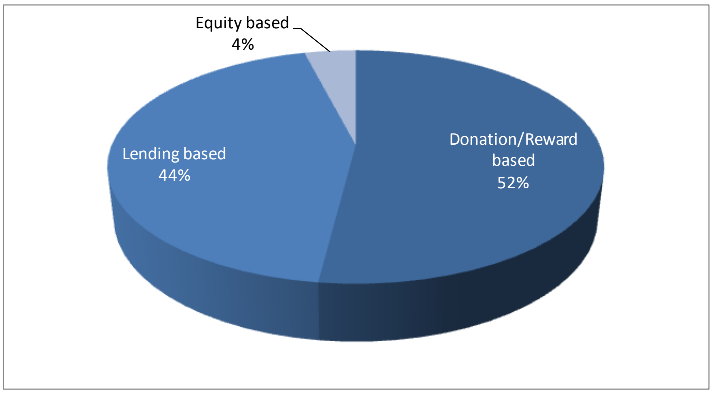
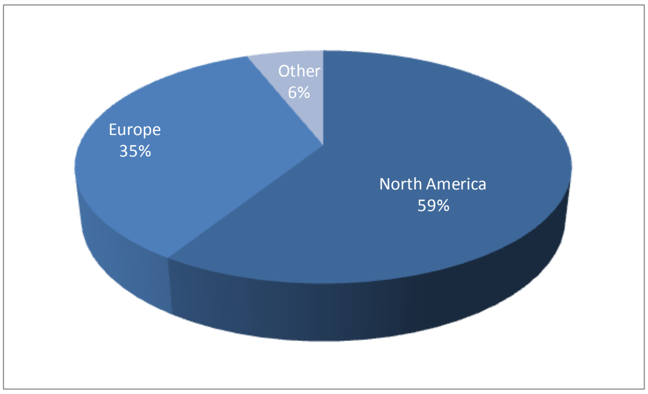
Here are the summarized figures for crowdfunding available so far:

Funds raised through crowdfunding platforms in 2012 by types:



Funds raised through crowdfunding platforms in 2012 by region:



Source: Massolution 2013CF. *The Crowddfunding Industry Report*

Are these figures accountable? Some objected to Massolution's use of a too broad definition of a crowdfunding platform: "an operator of a funding platform that facilitates monetary exchange between funders and fundraisers." With such a definition – that we also use – which doesn't even say that the crowdfunding platform needs to be online, some argue that anybody hosting a political fundraiser probably counts as a crowdfunding platform, and that even the New York Stock Exchange would qualify. Recently, SecondMarket has been moving into the business of raising money for fund managers of various descriptions — this too counts as crowdfunding under the Massolution definition, even if it's just a couple of high net worth individuals putting their money into an art fund. And SecondMarket is adamant that it does *not* want to get into the crowdfunding game.

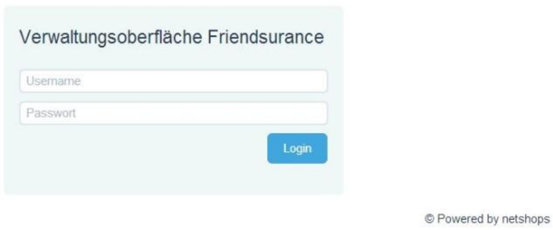
For sure, these are borderline examples. But the same people who are discussing the large definition quoted above do not consider peer-to-peer lending to be crowdfunding, and nor do they think that giving money to charity online counts as crowdfunding. Which very narrow understanding of crowdfunding would we have then? To our opinion, crowdfunding is a recent phenomenon that has to be considered under all its prospects, even if its frontiers are sometimes blurry.

Extending the crowdfunding model

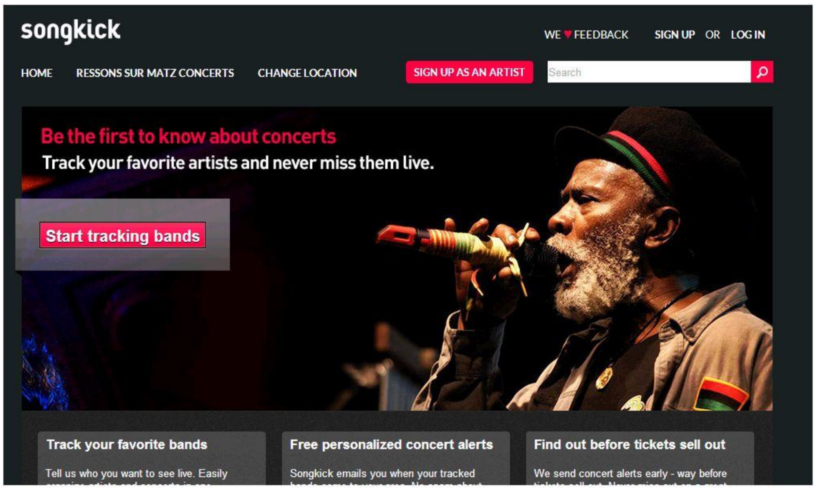
There is also a P2P insurance solution: the German **Friendsurance**, which seems to be first in this space so far. But, in the UK, focused on car insurance, **jFloat** will soon be launched (or has been launched, it's hard to say! They work on an invite only basis at this step).

The idea is that you can call your friends, or anyone, to be insured. Then a formal insurance company will complete the amount of guaranteed funds mutually gathered. The crowdfunding site acts like a broker with a very broad insurer basis. For individuals, this kind of insurance can pay the deductible.

Does it work? Well, it's not so easy to assess. See the Friendsurance internet page below:



Another good example of possible crowdfunding extensions is **Songkick**.



The Rolling Stones apparently charge $8m (£5m) to do a one-off performance, while Sir Elton John is said to require $4m. For those without superwealth, arranging such a gig seems impossible. However, help may now be at hand, thanks to the London-based company Songkick.

A concert notification website and app for your mobile phone and tablet, Songkick this year launched a new service called Detour. Essentially a form of crowdfunding, fans who wish to bring a certain band to their hometown or city can start a petition or "pledge" via Songkick. If a sufficiently large number of people also pledge, then Songkick informs the band in question and its promoters.

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Although all the examples given above show that crowfunding is both growing and diversifying today, a not-so-bright side of crowdfunding cannot be hidden away.

The not-so-bright side of crowdfunding

Can crowdfunding really become a large, mainstream way of financing or will it rapidly be as selective as venture capital ?

Delusions?

A study by Ethan Mollick, a professor of management at the Wharton School of the University of Pennsylvania, found that 75 percent of design- and technology-related projects on Kickstarter, most of which involve physical products, failed to meet their promised deadlines. "*The honeymoon period that we are experiencing around crowdfunding is beginning to come to a close,*" said Wil Schroter, co-founder and chief executive of Fundable, a company that is applying crowdfunding to the venture capital process. "*People realize there is real risk involved in investing in anything early-stage, whether it's an idea, a charity or a product, and they're starting to understand they aren't buying off of Amazon.*"

Kickstarter says it is not responsible for making sure a project is completed on time, or at all. It says project creators are legally obligated to fulfill their promises, but if they do not, Kickstarter has no mechanism for refunding the money that was pledged. The project creators can refund the money if they choose to.

The UK's Financial Services Authority (FSA) has posted the following note on its site warning potential crowdfunding investors that most projects are high risk and they have little protection if things go wrong: "*We believe most crowdfunding should be targeted at sophisticated investors who know how to value a startup business, understand the risks involved and that investors could lose all of their money. We want it to be clear that investors in a crowdfund have little or no protection if the business or project fails, and that they will probably lose all their investment if it does.*"

Sometimes project creators can be overwhelmed by the success of a crowdfunding campaign. The four college students behind Diaspora, a project that aimed to build an open alternative to Facebook, began with the modest goal of $10,000. They raised $200,000 from around 6,500 people. But after three years, they decided to start on another venture and turned the code over to anyone who might want to keep working on it. “We thought this would be a summer project,” they said. “*We wanted to make it because it was something we believed in, but we got roped into maintaining a relationship with a lot of people. We weren't prepared to have to deal with that.*” “*Going viral was crippling*,” they said. “*It was mayhem.*”

Today's flourishing landscape of crowdfunding platforms has to be considered with detachment. More and more candidate's projects will not necessarily mean more funding for everyone. In fact a “*winner takes all*” outcome could rapidly occur on platforms. That should be, on another hand, less numerous.

Towards concentration?

Among the crowdfunding platforms active in Germany, one single platform has gained predominance in raising capital. The Startnext platform generated around 82% of all capital raised. Last year the funds raised came to EUR 1.975 m, which represents an increase of 712% compared with 2011. The second biggest platform is VisionBakery with a funding volume of only EUR 149,109 in 2012. In addition, there are several small crowdfunding platforms that attract little attention because of their minimal funding volumes. The German crowdfunding market is gradually becoming established, but experts assume that consolidation will set in for two reasons: First, the platforms are competing in a relatively modest national market, so the commission fees are under threat of shrinking further. Secondly US-competitors (Kickstarter) are benefiting from an active and expanding global community. A platform like Indiegogo is already global:

Less platforms, more suspicious investors: the development of crowdfounding could reach a dead-end. Therefore, the impact of regulation will be decisive.

Regulation

Peer-to-peer and crowdfunding platforms have the potential to improve the retail banking market as both a source of competition to mainstream banks as well as an alternative to them. Furthermore, it could bring important consumer benefits by increasing the range of asset classes to which consumers have access. This access should not be restricted to high net worth individuals but access should be subject to consumer protections laws.

Nevertheless, crowdfunding can be a risky business. First, because you don't avoid investment risk by working apart of banks. Secondly, fraud is easy as any web site can call itself a "crowdfunding platform" and divert funds in a dishonest fashion.

That is why regulation will be of great importance for the crowdfunding market. Crowdfunding platforms do not collect deposits and thus, they are not regulated by Central Authorities. Although such Authorities, like the SEC, are expected to regulate equity-based crowdfunding, it is still unclear who will regulate the entire industry. So far, this sort of regulatory vacuum has been significantly reducing the cost of compliance and allowing platforms to speed up processing times. Therefore, the combination of no physical location and limited regulatory costs allows crowdfunding firms to keep operating costs low and offer better terms to their clients. That is why too severe rules would surely kill crowdfunding. But, given the investment risks it offers, leniency would definitively impede its growth.

On April 5 2012, President Obama signed into law, the Jumpstart Our Business Startups Act which is aimed at facilitating small business access to capital markets.

The JOBS Act

First, it creates a new definition of "small business" called emerging growth companies, firms with annual revenues no higher than $1 bn.

Second, it eases some of the rules that govern initial public offerings and allows companies to increase the number of shareholders permitted before they must be registered with the SEC.

The JOBS Act also creates a new exception of the Securities Act of 1933 that encourages the use of equity-based crowdfunding platforms. In addition, the law allows individual non-accredited investors to buy equity in small amounts in proportion to their annual income or net worth.

Summary of Key Provisions in the JOBS Act of 2012

Public advertising or solicitation in the Securities Act of 1933	• Instructs the SEC to revise Rule 506 of Regulation D in order to allow general solicitation and advertising for offerings that are exempt from registration under Rule 506. General solicitation and advertising is permitted as long as buyers of these offerings are accredited investors.
Crowdfunding	• A new exception to the Securities Act of 1933, section 4(6), allows securities to be sold in small quantities to large pools of non-accredited investors using crowdfunding platforms. • Securities must be sold through a broker or funding portal that complies with the requirements of the new section of the Securities Act. • Companies can raise up to $1 million per year. • Individual non-accredited investors are permitted to invest according to their annual income or net worth. o The greater of $2,000 or 5% of net income or net worth if these are lower than $100,000. o Up to 10% of net income or net worth if these are greater or equal than $100,000. Investors are subject to a cap of $100,000
IPOs for Emerging Growth Companies	• Creates a new category of issuer called "emerging growth company", an entity with less than $1 bn in annual revenue during its most recent fiscal year. • Emerging growth companies are allowed to file for an initial public offering under softer rules than non-emerging growth firms: o File the registration statement with the SEC until 21 days prior to the start of a road show with only two years of audited financial statements. o Omit certain disclosures required by Sarbanes-Oxley and Dodd-Frank. • Emerging growth companies will not be subject to comply entirely with SEC reporting rules until: o Achieving $1 bn or more in annual revenue. o Raising in excess of $1 bn in non-convertible debt over a three-year period o Being considered a large accelerated filer by having at least $700 million of outstanding shares in the hands of the public o Reaching the last day of the fiscal year in which the fifth anniversary of the pricing date of the IPO falls.
Number of Shareholders	• Under current legislation, companies with at least 500 shareholders and total assets in excess of 10 million are required to register with the SEC. The JOBS Act allows a company to have 2000 total shareholders or 500 who are not accredited investors before being required to registered with the SEC

Source: BBVA Research & Haynes and Boone, LLP

More than a year after President Obama signed the JOBS Act into law, the Securities and Exchange Commission has yet to formalize rules that would allow small companies to sell shares over crowdfunding platforms. In the meantime, the lack of SEC rules governing equity crowdfunding has done little to slow growth in the industry. A handful of companies that bill themselves as crowdfunding startups are already operating under exemptions in securities laws that predate the JOBS Act. In general, this is only legit if they restrict their offerings to an exclusive crowd: accredited investors, or people with enough money that the government assumes they're sophisticated enough to grasp the risks.

Such is the case in many countries. For example, in Germany, according to Section 2(3) of the Capital Investment Act (Vermögensanlagengesetz – VermAnlG), offerings worth up to certain de minimis limits are exempt from the requirement to issue a prospectus. The law assumes that the investor does not require special protection if the issuance volume does not exceed EUR 100,000 in twelve months (with financing via crowdfunding platforms this volume limit of EUR 100,000 is usually not exceeded). This provision is also to be found in the Securities Prospectus Act (WpPG) in keeping with the EU Prospectus Directive. Other exemptions in accordance with the VermAnlG, such as the limitation to a maximum of 20 shares or a minimum price of EUR 200,000 per share, do not apply to crowdfunding either, because the crowd consists of numerous investors whose stakes tend to be quite small amounts.

With rules to open offerings to the broader investing public, a whole industry of would-be crowdfunding sites that sprouted in anticipation is preparing. The fears that scammers would masquerade as legitimate crowdfunding sites haven't been justified so far but, even before the rules are in place, policing crowdfunding is a challenge for state watchdogs. In US, there were more than 8,000 registered Web domains with "crowdfunding" in their names late last year, according to an analysis by the North American Securities Administrators Association. Most of them were registered after the JOBS Act was signed. A lot of the websites were empty or placeholders, but about 2,000 had content.

For example, Massachusetts Secretary of the Commonwealth announced that its office is forming a new unit to police general solicitations and crowdfunding offerings. The new department, called the Internet Crowdfunding and Offerings Watch Department, or I-Crowd, will track how issuers of securities use general solicitation to market offerings, and monitor equity crowdfunding portals raising money in Massachusetts.

A potential for fraud

Now it's up to the Securities and Exchange Commission to figure out the details of how the new JOBS law will work. The agency held a forum in Washington, D.C., on Nov. 15 2012 to get recommendations from the small business community as it works on writing the rules to govern crowdfunding. Lots of questions remain unanswered.

Among other things, regulators are interested in the firm's due diligence process. The potential for fraud remains the biggest concern for regulators. "*You're going to have people investing in companies that weren't able to get the VCs' attention, that weren't of the quality a VC was looking for*," says Lynn Turner, a former chief accountant at the SEC who opposed the legislation. "*Then you're going to let the leftovers go try to raise a lot of money via crowdfunding, and they can do it without putting up the necessary warnings and disclosures to investors*."

The law provides for entities to connect companies raising money with people who want to invest. These can be existing securities brokers, or they can be what the law calls "funding portals." While lots of new companies want to play this role, questions about how they can operate remain: How will they oversee companies raising money? How will they make sure investors understand the risks? How will they make money?

The law directs crowdfunding platforms to “reduce the risk of fraud” by doing a background check on entrepreneurs asking for money. It doesn’t say what kind of background check is necessary or what kind of past problems should get someone barred. It would seem obvious that someone with a history of securities fraud ought to be kept out. What about other crimes? What about civil lawsuits? The law doesn’t say, and regulators have to figure it out.

If the SEC and the industry fail to keep the rip-off artists out, crowdfunding could become toxic to both investors and businesses. Even without deliberate fraud, big losses for people who don’t fully grasp the risks involved might have the same effect. In fact, even putting aside the risks of fraud or companies not playing by the rules, investors need to understand that crowdfunding means making speculative, non liquid investments in small companies with a high failure rate.

That’s why long term success of crowdfunding should not be overestimated, unless it receives credible promoters. What about banks?

Why banks should appropriate crowdfunding?

Many think that lending and equity-based crowdfunding are disruptive technologies for the banking industry with the potential to displace banks as the primary source of funding for personal and small business loans.

Like banks, lending and equity-based crowdfunding provide financial intermediation services to business and individuals; however, they do it in a different way. Crowdfunding relies on the internet to connect potentially large pools of business and individuals with capital/investment needs.

Will crowdfunding evolve to a point that it will become an alternative for the mainstream customers of banks?

Disruptive innovations tend to offer different value propositions than the industries they disrupt. Very often, these value propositions are focused on simplicity. Contrary to banks, crowdfunding firms don't offer elaborate financial products such as credit cards, mortgages, insurance or mutual funds. Instead, they limit their offer to a simple product offering either a basic personal loan that can be used for different purposes or brokerage services for companies seeking capital through equity selling.

An important characteristic of disruptive innovations is that they start by serving the "bottom of the market", meaning segments that big companies may consider unprofitable. The needs of these segments differ significantly from those of mainstream customers. In the banking industry that bottom includes the de-banked and small businesses, segments that crowdfunding seems to be serving with relative success. The fact is that many self-employed, freelancers and creative persons have difficulties financing their projects. Future monetary inflows – and thus the basis for credit repayments – are often difficult to gauge. This makes it a challenge to obtain financing from traditional financial institutions. Statistics show that the loan volumes especially for the self-employed between 2005 and now has fallen by nearly 5%. Meanwhile, the number of self-employed persons has risen sharply, due to those operating as one-person companies.

Because it may take a couple of years before new small businesses generate a stable stream of cash flow, they need several capital injections at their early stages in order to expand and operate in a highly competitive environment. This would make them a perfect target for the banking industry except for the fact that failure rates are elevated and it is difficult to assess the ability of small businesses to repay their loans. This creates a paradox. On the one hand, small businesses still rely on banks as their primary providers of funding (either directly through small business loans or indirectly through personal credit cards), but on the other hand, small business loans represent only a small fraction of depository institutions' assets, especially for large banks. Not surprisingly, the majority of small businesses lending falls on small community banks that solve the informational opacity problem by establishing a close relationship with local borrowers. In the United States, approximately half of small businesses do not get credit they apply for, and almost a third of them don't even apply out of fear of rejection.

Thus, lending and equity-based crowdfunding platforms have become attractive alternatives for small businesses who would find very difficult to get a bank loan. How crowdfunding firms have been able to serve this market has to do with a different approach to risk management. In lending-based crowdfunding the risk of financing a project is not assumed by a single depository institution (and its clients), but by investors who willingly decide which projects to finance based on their tolerance to risk and other considerations such as community involvement, geography, industries or environmental concerns. The informational opacity problem is not solved, but crowdfunding firms bypass it by breaking down the risk into small pieces and selling them to a potentially large group of investors.

In other words, risk is passed from the financial institution to the "crowd", where it is diluted.

In equity-based crowdfunding, entrepreneurs are allowed to sell a portion of their business in the form of equity to accredited investors. This is a strong innovation in small business financing. As startups struggle to become profitable, the credit risk tends to be too high for traditional banking debt, where interest rates must be paid on a regular basis. A higher credit risk is reflected in a higher cost of funding. Therefore, it makes sense for small business to engage in an equity funding structure or a combination of both. Equity-based crowdfunding is particularly attractive for small companies with strong potential.

Crowdfunding platforms could naturally evolve to become the primary source of financial services for young generations. Would future entrepreneurs continue to use their personal credit cards or would they rather go to platforms like Kickstarter or Indegogo to raise funds? In fact, by the time crowdfunding platforms appeal to mainstream customers it might be too late for banks to catch up with the new trend. In fact there is a real risk that banks will stop being the primary source for personal and small businesses loans.

On another hand, these customers will continue to go to banks to satisfy their demand for a more complex array of financial products: credit cards, auto loans, mortgages, Treasury management or merchant services; products that crowdfunding platforms do not offer yet. However, things could change over the next five or ten years. It is reasonable to expect that over time, crowdfunding platforms will increase the complexity of their product offering. This would depend on the pace of technological progress and regulation. However, overregulating this market at an early stage could end up destroying a new and efficient way to connect people with savings and borrowers.

Whether you find such a threat is relevant, or not, the surprise is that most banking institutions have not led the way and adopted the crowdfunding models so far but look at those as competition.. However, some banks have developed “crowd solutions” by which they do not only appropriate crowdfunding models but give them new dimensions.

A new crowdbanking model is emerging.

Banks already have access to:

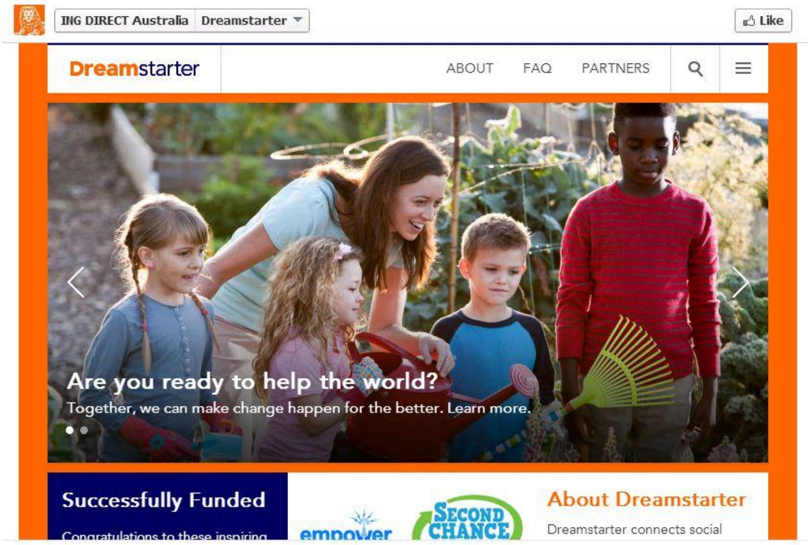
- Customers who have cash and could be potential investors
- Prospective customers who want money
- A lot of cash which they could invest as well.

Moreover, it would be easier for banks in terms of regulatory approvals in place, so that the entire model could scale much faster than it has so far.

Rather than replacing a traditional means of obtaining capital, crowdfunding could actually facilitate the process of securing a business loan from banks. Crowdfunding permits hundreds of eyes to scrutinize a company. The "crowd" is a testing ground, giving ideas and providing feedback on how to improve the product or company. In the very near future, venture capitalists and bankers may be sending clients to the crowds to get their ideas validated first. Then, after seed funding from the crowd is obtained and the business model is proven, banks will fund them. In France, such a solution was launched by two banks: Société Générale and Crédit municipal de Paris, through the **Spear** platform.

In crowdfunding, the "crowd" can take the place of a loan officer and determine whether a particular business, product or service will succeed by providing the ultimate vote of confidence-their own investment dollars. This makes crowdfunding the ultimate market test for a new product or service. Banks will feel more secure lending to businesses that have successfully raised their first round of capital through crowdfunding, and as a consequence, more banks will be making more loans.

The bank could use the "Wisdom of crowds" to decide which projects get funded and which do not. We could even go to the extent that the bank commits to fund an amount equal to the amount that the project secures from the other investors. This could potentially spread the risk on such investments and open up a new large market for the bank: social media banking. ING Direct Australia partnered with StartSomeGood to launch **Dreamstarter**, a P2P crowdfunding platform, to support social change projects.



Dreamstarter**,** offers social entrepreneurs an online platform to raise funds towards diverse social change projects. Successful projects that capture the imagination and support of the community will receive additional funding from ING Direct Australia.

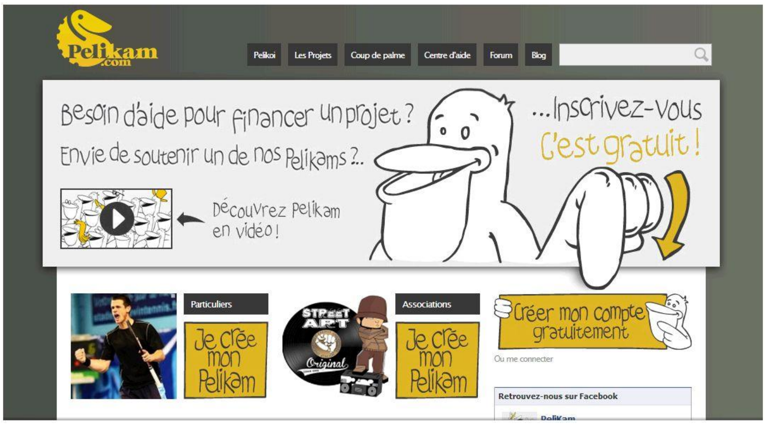
In France, another relevant example is the partnership between **La Banque postale** (the French postbank) and **Kiss Kiss Bank Bank**, a crowdfunding platform.

Crowdbanking could also fill the gap between the capital a business needs and the actual amount a bank is willing to loan. For example, a company requiring $500,000 to purchase equipment might be able to combine $100,000 raised from crowdfunding with a $400,000 bank loan.

Now the question is if any of the larger banks would take this up and launch their own crowd-funding platforms or acquire any of the existing platforms?

BBVA launched its own crowdfunding platform **Friends & Family** (in fact rather a friends-funding platform) as one service, among others, they offer to their customers.

Crédit Agricole Pyrénees-Gascogne offers a similar service called **Pelikam**.



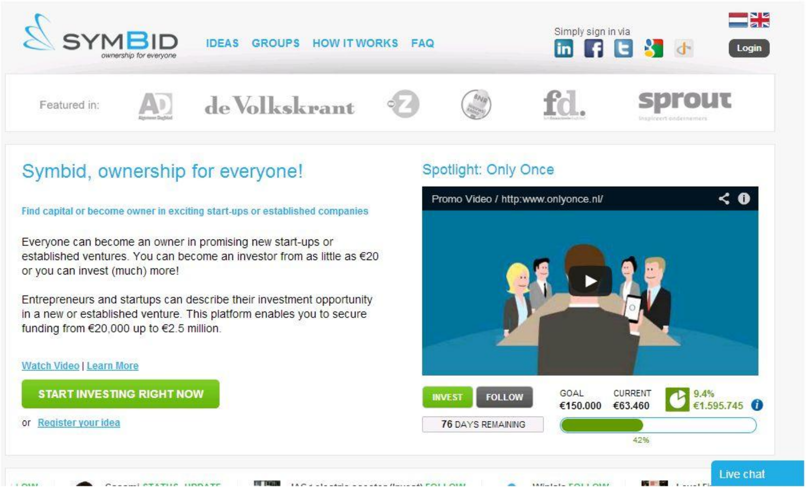
In Germany, **Volksbank Bühl**, one of the 1,100 cooperative Raiffeisen banks, was the first bank to offer their customers a regional crowd-funding platform.

In France, the main shareholder of **Prêt d'Union**, one of the leading P2P lending platform, is Crédit Mutuel Arkéa (part of one of the major French cooperative banks).

Fund transfers are another side on which crowdbanking makes sense, either for online payments processing or for securitization of funds.

- Since launching new currencies, languages and localized experiences in December, Indiegogo has seen a 20% increase in international activity on its platform, creating the need for a global payments solution that facilitates and localizes transactions across many countries. Indiegogo has selected Adyen to provide online payments processing for international customers. With more than 100,000 funded campaigns around the world, including an average of 7,000 active campaigns at any given time, Indiegogo collects and distributes millions of dollars in contributions via its platform each week. Adyen's global payments platform will enable Indiegogo to collect campaign contributions in local currencies through Europe and Canada, and route transactions through its network of more than 80 global banks and processing partners to minimize foreign exchange and other transaction fees. In addition to processing European and Canadian credit card payments, Adyen will provide support for a number of preferred local payment methods throughout Europe, including Maestro (UK), Carte Bleu (France), Sofortuberweisung (Germany, Austria), Giropay (Germany), iDeal (Netherlands), TrustPay (multiple countries throughout Eastern Europe), and bank transfer payments. Adyen will continue to add new local payment methods for Indiegogo in other countries in the coming months.
- Symbid uses a secure separate bank account for each investment project to ensure the money is used specifically for the original business idea and to keep the money safe until the funding goal is met, investors can freely withdraw their money from one project and put it into another. When the target amount is met, the investments are fixed and can no longer be withdrawn and all the

participants are bound together in one legal entity. The investors and entrepreneurs can then use Symbid's online collaboration community and its tools to communicate, manage and monitor the venture and they can also trade their shares.



These two last examples show that crowdfunding platforms cannot fulfill their core activity alone. Therefore, if we can fancy that such platforms will replace banks one day, it’s eventually easier to imagine that banks can appropriate crowdfunding models and develop crowdbanking solutions – if they want to.

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