



WORKING PAPER

Crowdfunding and Financial Inclusion

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TABLE OF CONTENTS

ACKNOWLEDGMENTS	v
ACRONYMS AND INITIALISMS	vi
EXECUTIVE SUMMARY	vii
SECTION 1. WHAT IS CROWDFUNDING?	1
1.1. Definition and Evolution.....	1
1.2. Ecosystem and Categorization.....	4
SECTION 2. MAIN CATEGORIES OF CROWDFUNDING	5
2.1. Donation-Based Crowdfunding.....	5
2.1.1. Model Description and Use.....	5
2.1.2. Benefits and Risks.....	6
2.1.3. Regulation.....	7
2.2. Reward-Based Crowdfunding.....	8
2.2.1. Model Description and Use.....	8
2.2.2. Benefits and Risks.....	9
2.2.3. Regulation.....	10
2.3. Debt Crowdfunding.....	10
2.3.1. Model Description and Use.....	10
2.3.2. Benefits and Risks.....	13
2.3.3. Regulation.....	16
2.4. Equity Crowdfunding.....	17
2.4.1. Model Description and Use.....	17
2.4.2. Benefits and Risks.....	18
2.4.3. Regulation.....	20
SECTION 3. EVOLVING FRONTIERS	21
SECTION 4. CROWDFUNDING AND FINANCIAL INCLUSION	24
4.1. Opportunities.....	24
4.2. Risks and Challenges.....	26
SECTION 5. NEXT STEPS	29
ANNEX 1. EXAMPLES OF CROWDFUNDING PLATFORMS	31
ANNEX 2. EXAMPLES OF CROWDFUNDING PLATFORMS SERVING EMDES	35
BIBLIOGRAPHY	37

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ACRONYMS AND INITIALISMS

ASIC	Australian Securities and Investments Commission
B2P	Business-to-Person
B2B	Business-to-Business
BoP	Base of the Pyramid
CGAP	Consultative Group to Assist the Poor
EMDEs	Emerging and Developing Economies
EU	European Union
FCA	Financial Conduct Authority (United Kingdom)
FinTech	Financial Technology
FSP	Financial Service Provider
GPFI	Global Partnership for Financial Inclusion
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
MSME	Micro, Small, Medium Enterprise/Entrepreneur
NGO	Nongovernmental Organization
OECD	Organization for Economic Co-operation and Development
P2P	Person-to-Person/Peer-to-Peer
P2B	Person-to-Business
SME	Small- and Medium-Sized Enterprise
SSBs	Standard-Setting Bodies
WBG	World Bank Group

EXECUTIVE SUMMARY

Crowdfunding has been touted as a financial innovation, a FinTech, the fastest growing financial industry, and the next big thing in finance. “Crowdfunding” typically describes a method of financing whereby small amounts of funds are raised from large numbers of individuals or legal entities to fund businesses, specific projects, individual consumption, or other needs. It involves bypassing traditional financial intermediaries and using online web-based platforms to connect users of funds with retail funders. Definitions of crowdfunding vary, but they often include the following key components: (i) raising funds in small amounts, (ii) from many to many, (iii) using digital technology.

The idea of matching people who need money with the people who have money to invest is not new; what is new is the way this concept of intermediation is facilitated (and made easier) by technology. Crowdfunding has the potential to transform retail financial services as the use of technology, increasing connectivity through mobile phones and other devices, the legal and regulatory framework, and constantly changing economic conditions allow new and innovative firms to compete with incumbents. This competition could foster economic growth and entrepreneurship, especially in countries with less developed financial systems.

A down side of crowdfunding is that it has the potential to be harmful to customers at the base of the pyramid. By design, a crowdfunding platform often matches consumers (funders) with a consumer (a fundraiser). This creates a peculiar regulatory challenge that requires a framework to be in place to protect funders and fundraisers. However, thus far, policy makers are predominantly focused on the risks faced by the supply side (investors, lenders, and other suppliers of funds), while neglecting the fact that the platform is often the only “professional” in the crowdfunding transaction, where both the investor and the fundraiser are equally vulnerable and inexperienced individuals or small businesses.

In this paper we argue that crowdfunding is a phenomenon that can play an important role in financial inclusion if an enabling and safe environment is in place. Examples of how crowdfunding may potentially benefit financially excluded and underserved people include improving access to finance to unserved and underserved borrowers; creating cheaper, community-based insurance products; and facilitating access to digital investments by people who currently have limited or no options to get financial returns on their savings. There are many stories illustrating this potential, such as the one of Lydiah from Kenya, who has been using crowdfunding to finance her small electrical supply shop and her side business of serving M-Pesa customers.¹ Moreover, crowdfunding first emerged in developed countries, but took off fairly recently, with some of the emerging markets and developing economies leading the peloton.

This paper aims to map the crowdfunding phenomenon globally, explain its main characteristics and modalities within the framework of financial inclusion, and highlight the areas that require further attention of policy makers. It is based on a combination of secondary, desk-based research and interviews with stakeholders, including independent researchers, policy makers, regulators, supervisors,

¹ See <https://www.zidisha.org/loan/zidisha-loan-to-boost-my-business-capital-1>.

standard-setting bodies (SSBs), and development professionals. This paper is written for a broad audience because the topic requires engagement by multiple stakeholders, including SSBs responsible for the regulatory and supervisory issues relevant to crowdfunding, other global bodies, and development agencies.

Section 1 of this paper defines crowdfunding, provides an overview of its evolution, and outlines a crowdfunding ecosystem; Section 2 explains in detail four basic categories of crowdfunding (donation, reward, debt, and equity), and lists their key benefits and risks; Section 3 focuses on modalities of the four categories of crowdfunding (hybrid models) with specific emphasis on the most recent trends; Section 4 highlights benefits of crowdfunding for broadening and deepening financial inclusion, while it also acknowledges risks and emphasizes the need for policy makers to keep up with the industry and intervene accordingly when necessary; in conclusion, Section 5 suggests possible directions for further research.

SECTION 1. WHAT IS CROWDFUNDING?

1.1 Definition and Evolution

Crowdfunding is part of the broader universe of financial innovations enabled by technological advancements (European Commission 2016a) also known as FinTech. FinTech has been changing the way the financial sector operates (see Box 1). Crowdfunding is specifically part of FinTech's subcategory called alternative finance (AltFi). AltFi refers to technology-enabled market-based funding outside the traditional financial system and includes online marketplaces

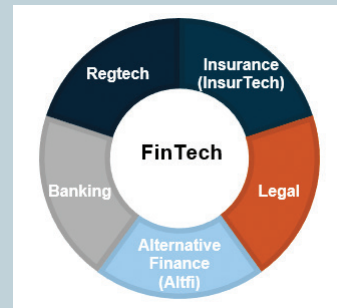
for consumer and business lending, invoice trading, and third-party payment platforms.

“Crowdfunding” describes a mechanism of sourcing capital by soliciting to a pool of individuals or organizations through an online platform or mobile phone. The idea is simple: a large number of people, through small individual contributions, can raise big amounts to finance other individuals and projects without the involvement of conventional financial institutions. This is usually done through

BOX 1. Examples of the Areas Disrupted by FinTech (R)evolution

Banking and Payments. The rapid spread of digital innovations, such as Internet banking, mobile payments, and mobile wallets, is changing traditional banking for consumers and businesses. New start-ups promise to deliver traditional services in a cheaper, faster, and more transparent way than traditional banks. Providers include, for instance, [Atom Bank](#), [Mondo](#), [TransferWise](#), and [GoCardless](#).

InsureTech. As with banking, technology facilitates access to and handling of insurance policies. Simple insurance policies (car, travel, home) can be purchased and managed over a smartphone. Phones are also used to optimize and tailor insurance products to reflect the risk profile of an individual customer by tracking his or her driving style, or monitoring his or her mobile money balance. Technology has been an important factor driving two products with impact on customers in emerging markets and developing economies (EMDEs): (i) index crop insurance and (ii) “freemium” life insurance bundled with mobile money products. It also helps assess property damage and monitor compliance with insurance policy. Providers include, for instance, [Metromile](#), [Oscar](#), [Zhong An](#), and [CoverFox](#).



RegTech. This term refers to the use of technology to address regulatory and compliance challenges efficiently and effectively (see, e.g., IOSCO 2016). RegTech is changing how companies perform identity verification (biometrics) and know-your-customer policy, protect their clients' data (cryptography), and settle transactions (distributed ledgers). To keep pace with the industry, supervisors are now more intensely exploring ways to improve their capacity by implementing new technology solutions. Providers include, for instance, [Suade](#), [Trulioo](#), [KYC Exchange Net](#), and [Vizor](#).

Note: The examples of providers listed in this box have been selected solely to illustrate practical use of FinTech.

the Internet on so-called crowdfunding platforms, where projects are presented and where each individual in the “crowd” of funders chooses which fundraiser to finance. Definitions of crowdfunding vary as demonstrated in Box 2, but they have the following key components in common: (i) raising funds in small amounts, (ii) from many to many, while (iii) using digital technology. The key disruptive effect of crowdfunding is that the intermediation by traditional financial institutions is reduced to a minimum as funds are channeled directly

from funders to fundraisers through a given platform (Terry, Schwartz, and Sun 2015).

The emergence of crowdfunding has its origins in “collaborative finance”² and the “crowdsourcing” idea. While crowdsourcing taps into the power of the crowd to increase efficiency and realize tasks that would be impossible for a single individual to undertake alone (Brabham 2008) (e.g., [Wikipedia](#)), crowdfunding taps into the wallet of the crowd, bringing together an

BOX 2. Examples of Crowdfunding Definitions

Global Standard-Setting Bodies and Financial Inclusion the Evolving Landscape (GPMI 2016)

“In the financial inclusion context, crowdfunding refers to a market-based financing technique where funds are raised from large numbers of individuals or legal entities in small amounts, bypassing traditional financial intermediaries, and using mobile phones and online web-based platforms to connect with borrowers, whether to fund a business, a specific project, or other needs.”

Crowd-funding: An Infant Industry Growing Fast (IOSCO 2014)

“Crowd-funding is an umbrella term that describes the use of small amounts of money, obtained from a large number of individuals or organizations, to raise funds for a project, business/personal loan or other financing needs through online web-based platforms. Peer-to-peer lending is a form of crowd-funding used to fund loans, which are paid back with interest. Equity crowd-funding is the raising of capital through the issuance of stock to a number of individual investors using the same method as crowd-funding.”

Crowdfunding in the EU Capital Markets Union (European Commission 2016)

“Crowdfunding refers to an open call to the public to raise funds for a specific project. Crowdfunding platforms are websites that enable interaction between fundraisers and the crowd. Financial pledges can be made and collected through the platform.”

Crowdfunding’s Potential for the Developing World (World Bank 2013)

“Crowdfunding is an Internet-enabled way for businesses or other organizations to raise money—typically from about US\$1,000 to US\$1 million—in the form of either donations or investments from multiple individuals.”

² The development of collaborative finance was made possible through digital networking and communication infrastructures that provided a platform for instantaneous communication and cooperation. This new form of finance is characterized by highly personalized loan transactions, providing much more flexibility for borrowers in terms of loan purpose, interest rates, collateral requirements, maturity periods, and debt rescheduling. See, e.g., https://en.wikipedia.org/wiki/Collaborative_finance.

individual or entity in need of funding with community members willing to contribute.

Crowdfunding that targets a mass market started in the United Kingdom in 2006, followed by the United States in 2007, and (after the 2008 financial crisis) other markets, including in EMDEs (Kirby and Worner 2014). The global financial crisis meant a big push for the crowdfunding industry because it caused a fall in confidence in the financial system, especially in the banking sector. Since then, crowdfunding has grown rapidly in markets across the income spectrum, with high demand at both ends of the transaction. The fast growth of crowdfunding is driven by technological, as well as macroeconomic and regulatory, factors:

- **Technological factors.** Improved access to the Internet via mobile phones and other devices, user-generated web content, boom of online applications, increasing use of social networks, “Big Data” analytics,³ and the FinTech revolution made crowdfunding viable by reducing operational costs and increasing the potential reach of crowdfunding platforms (Terry, Schwartz, and Sun 2015).
- **Macroeconomic environment.** The financial crisis and the subsequent credit crunch presented a major challenge for the financial system (Terry, Schwartz, and Sun 2015). Banks and other financial intermediaries have tightened access

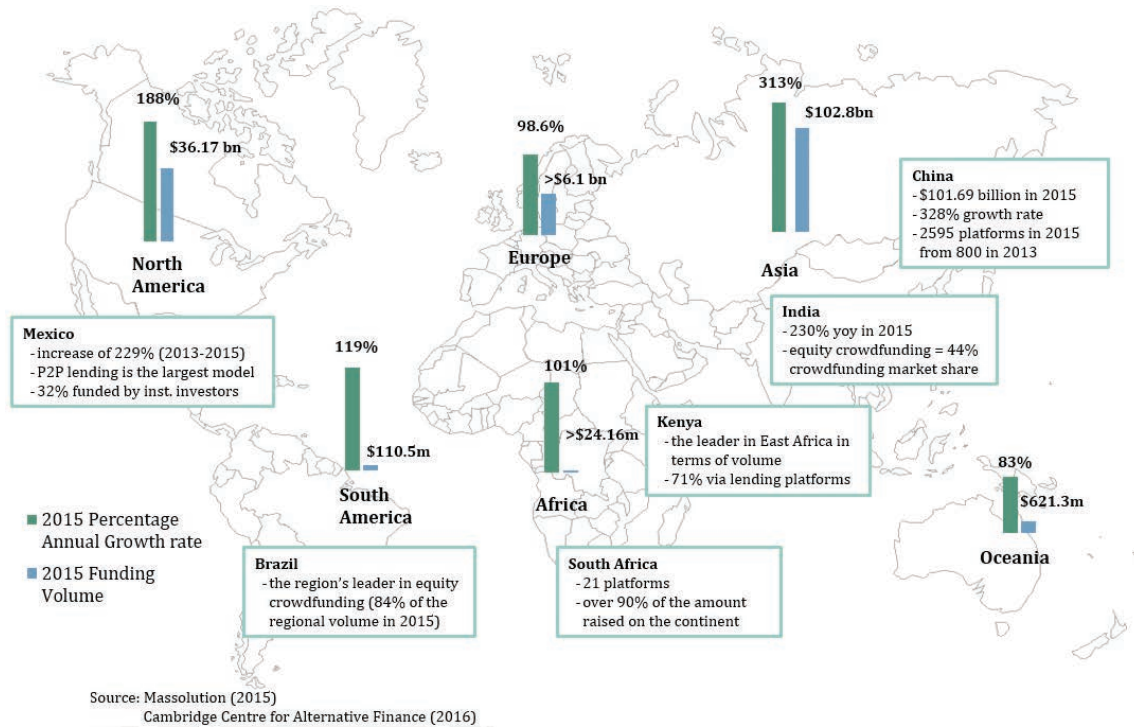
to credit, especially for smaller loans because of cost efficiency concerns and for loans to clients who do not have sufficient collateral because of prudential considerations. This has created a new demand for capital (fundraisers). On the supply side (funders), the protracted low-interest rate environment, which diminished the returns on traditional saving products, has driven a “search for yield” (BIS 2012) and pushed funders and retail savers to alternative forms of income generation.

- **Regulatory factors.** Crowdfunding platforms have been benefitting from the regulatory changes that took place after the crisis (Terry, Schwartz, and Sun 2015). The more stringent regulatory requirements significantly increased banking costs of competing in certain markets. Because crowdfunding is just starting to be regulated across the globe, many jurisdictions do not impose stringent regulations on crowdfunding just yet (IOSCO 2015a). This approach gives the crowdfunding industry advantage over its competitors, particularly incumbent financial service providers. The question as to whether this amounts to the level of regulatory arbitrage remains to be answered.⁴

Since its infancy, the crowdfunding industry has grown tremendously around the world. The volume of funds raised grew from US\$1.5 billion in 2011 to over US\$100 billion in 2015

3 “Big Data” has been defined in various ways. Many tend to highlight the following definitional features: (i) high-volume data, (ii) produced, collected, and processed with high speed, (iii) variety information assets, and (iv) technology-based processing of data in a meaningful way to enhance insights and decision-making. Examples of Big Data being used in a financial services context include Ant Financial (the Alibaba financial services arm), M-Shwari, Cignifi, and Lenddo. See, e.g., Gartner IT Glossary (<http://www.gartner.com/it-glossary/big-data>).

4 “This development [in the crowdfunding industry] leads to questions over the extent to which loan-based crowdfunding platforms allow for regulatory arbitrage with banking business, without being subject to the same consumer protection requirements, or whether the way they describe their business models or the products on offer could be misleading to consumers” (FCA 2016, p. 14).

FIGURE 1. Crowdfunding around the World

worldwide (see, e.g., Massolution 2015 and Zhang et al. 2016a). Regardless of recent signs of a slowdown (European Commission 2016a), the crowdfunding industry keeps growing fast—the fastest in Asia, with 210 percent year-on-year growth (Massolution 2015), driven by countries such as China (estimated between US\$60 billion and US\$100 billion), India (US\$27.8 million), the Philippines (US\$26.9 million), and Nepal (US\$25.5 million) (Allied Crowds 2016). In Africa, crowdfunding platforms raised US\$37.2 million in 2015 in Kenya, Rwanda, Tanzania, and Uganda (Allied Crowds 2016b). Figure 1 shows a global picture that combines numbers from various reports.

1.2. Ecosystem and Categorization

A crowdfunding ecosystem can be complex and may vary substantially from model to model. The central point of every crowdfunding ecosystem is a platform—a technologically enabled solution used to match demand with

supply. The demand side consists of people and entities seeking funds. Depending on the specific model, we talk about beneficiaries (donations, reward-based crowdfunding), borrowers (debt), or issuers (equity), who can range from individuals to micro, small, and medium enterprises (MSMEs), nongovernmental organizations (NGOs), nonprofit entities (e.g., charities), start-ups, and financial businesses. The supply side consists of donors (donation), backers (reward), lenders (debt), and investors (debt, equity). Funders range from private individuals, to angel investors and venture capitalists, businesses, and large financial institutions. In this paper we refer to the supply side as “funders” and to the demand side as “fundraisers,” unless otherwise specified. Besides the platform, the fundraisers, and the “crowd” of funders, other entities are necessary for the crowdfunding ecosystem to work (enablers), including payment systems and payment service providers, technology infrastructure, and data analytics.

SECTION 2. MAIN CATEGORIES OF CROWDFUNDING

The most common classification of crowdfunding features four main categories—donation, reward, debt, and equity (Kirby and Worner 2014). These categories are based on what funders expect in return for their money (and their primary motivation to invest). While this basic, supply-side-oriented categorization allows us to explain the key variations of crowdfunding, it may not be fit-for-purpose as a means of understanding the financial inclusion issues of crowdfunding at the base of the pyramid (BoP), where a categorization based on customer use cases (e.g., crowdfunded credit, crowdfunded insurance) might be at least as important to the risk picture for the platform as a whole as are expectations of suppliers of funds.

This section is further divided into four subsections, each dedicated to an individual category of crowdfunding, that are presented in terms of (i) model description and use, (ii) key benefits and risks, and (iii) regulatory approaches. Annex 1 provides practical examples of each model that illustrate how the model operates. The key benefits and risks presented in this section can be connected to the innovative aspects of crowdfunding platforms, particular segments of funders and fundraisers attracted by crowdfunding, regulatory framework, and/or a mix of several factors.

This section follows the chronological order in which the categories have emerged. Therefore, it starts with

donation and reward-based crowdfunding. While these two categories were crucial for the overall emergence and development of the industry, and in some instances may even create a gateway for users (funders or fundraisers) into more complex forms of crowdfunding, they typically are not considered financial activities and are less important to the overall focus of this paper. Excluded and underserved people may benefit from donations made over the platform that facilitate mobility of funds among communities and beyond, but those categories of crowdfunding are likely to be less scalable and sustainable in the long term to meet the ultimate objective of financial inclusion and poverty elevation. It would be a mistake to exclude the two categories or to put too much emphasis on them.

2.1. Donation-Based Crowdfunding

2.1.1. Model Description and Use

Donations-based crowdfunding allows individuals (donors) to send money to people (or projects) in need (beneficiaries), with no financial (return) consideration in exchange for their money. This form of crowdfunding is used primarily in the nonprofit sector to support various causes (social, environmental, political, charitable). The platform derives its revenue stream primarily from fees collected from each donation (typically 5 percent or more, see Box 3).

BOX 3. Example of Charges

“All donations go through the GlobalGiving Foundation, a registered 501(c)3 nonprofit organization. There are no costs for nonprofits to join GlobalGiving, but GlobalGiving retains a 15% fee on donations. When a donor makes a \$100 donation, \$85 goes to the project(s) of his/her choosing, and \$10 goes to fund the many programs and services we offer nonprofits. Then \$3 goes to cover standard credit card or transaction fees, and the remaining \$2 goes to administrative costs of running GlobalGiving” (www.globalgiving.org/aboutus/).

There are two common subcategories of donation-based crowdfunding: (i) personal campaigns and (ii) charity fundraising (Vargas, Dasari, and Vargas 2014). Personal campaigns typically involve an individual beneficiary, a household, or a small community raising money for a cause of its own interest. Typical examples include campaigns to fund medical treatment, education, or personal hobbies. Charity fundraising involves a registered charity. Both personal campaigns and charity fundraising can be promoted as either all-or-nothing or keep-what-you-raise campaigns. In case of the former, the beneficiary receives the collected funds only if the initial threshold has been met. In case of the latter, the beneficiary can keep the funds even if below the threshold.

The largest market for donation-based crowdfunding is in North America, with \$210.38 million funded in 2015. For the whole American continent, the volume generated from donation-based crowdfunding increased from US\$151.09 million in 2014 to US\$215.56 million in 2015 (Latin America accounted for US\$5.18 million). This represents a yearly growth rate of 43 percent (Wardrop et al. 2016). In the Asia-Pacific region (excluding China), donation-based crowdfunding raised almost US\$25 million in 2015, up from US\$12 million in 2014 and US\$6.3 million in 2013. In China, donation crowdfunding raised US\$141.69 million in 2015 (Zhang et al. 2016). In Europe (excluding the United Kingdom), donation-based crowdfunding has been growing steadily, raising €19.91 million (approximately US\$22 million) in 2014 (Wardrop et al. 2015). In the United Kingdom alone, it raised £12 million (approximately US\$15 million) in 2015 (Zhang et al. 2016b).

2.1.2. Benefits and Risks⁵

A. Benefits

The nonprofit character of donation-based crowdfunding limits the key benefits donors enjoy to nonmonetary values:

- **Community participation and a feeling of glow.** Besides “good vibrations,” a big attraction of donating money to a crowdfunding campaign lies in the opportunity for donors to stay closely in touch with the projects they support. Platforms (and beneficiaries) often allow donors to see how their money is being spent, thus providing a unique level of transparency.
- **Voting with money.** By supporting a certain project, cause, or individual, donors are effectively using their money to voice their own views, preferences, and support.
- **Formalization of support.** Donors who contribute to the campaigns of their relatives and friends may find it beneficial to use the platform to formalize their contribution (e.g., for tax purposes). This can bring the additional benefit of discouraging excessive risk-taking, because project failure may also negatively impact the social relationship (Lee and Persson 2012).

For beneficiaries, the key benefit is access to cheaper funds regardless of geographical barriers. Beneficiaries can leverage social networks to raise funds in an efficient and cheap way (liquidity farming) (Mas and Gitau 2014). Using social networks helps to give visibility to the campaign and reach individuals outside the beneficiary’s immediate social circle. Beneficiaries also benefit from additional services provided by platforms, including the formalization

⁵ Most risks and benefits in donation-based crowdfunding apply to other categories of crowdfunding as well.

of donations, basic accounting, advice, education and training, and marketing.

B. Risks

The most obvious risk donors face is fraud, either in the form of fake campaigns or cyber-attack. The risk of fake campaigns is particularly relevant when a campaign is not run by an institution, such as a charity, that is often registered in a public register and subject to some minimum requirements (e.g., financial statements disclosure). Individual-run campaigns can be created for any lawful purpose, including for purely selfish reasons initially not disclosed to donors. When the platform does not guarantee enough transparency, donors may not be able to check whether or not their donations were used for the intended purpose.

Risks that beneficiaries face have to do with the cost of the campaign. As mentioned earlier, platforms typically charge fees. In addition, beneficiaries need to spend extra money to design and run the campaign, administer donations (often in small increments), and manage relationships with donors (e.g., send regular updates on how the donations have been spent). Academic research has shown that while donations are positively correlated to charity efficiency (and arguably the size and brand of the charity) because donors value the importance and likelihood of “having an impact”; they are negatively correlated with high competition (the more similar projects are, the less probability of raising funds) (Meer 2013). This means that, for some types of campaigns, crowdfunding is not an optimal solution.

Fees and the cost of the campaign are only some of the reasons the final amount disbursed to the beneficiary may be diminished. International crowdfunding platforms offer only major global currencies as a default for

any transaction; this creates currency exchange risk on the beneficiary’s (and to a lesser extent donor’s) side. Donations received are subject to taxes, further diminishing the total amount. Some pledged money might not be collected because of other reasons, such as expired credit card or incorrect payment information, insufficient funds, or death of the donor. The higher the number of donors, the greater the variety of risks and the higher likelihood of the risks materializing. Thus the beneficiary may not be able to collect all the money initially expected, or may collect the funds later than initially planned.

Donors and beneficiaries may be affected by issues faced by the platform. Besides cyber-attack, other risks concern failure of the platform’s technology or closure of the platform potentially resulting in the loss of data as well as funds. Another common risk has to do with the international character of most transactions. This has implications in many areas, including intellectual property law, tax law, and contractual law.

Crowdfunding platforms may be abused for money laundering and terrorist financing purposes, particularly where platforms escape the regulatory framework for anti-money laundering and counter terrorist financing due to a gap in their regulation and oversight.

2.1.3. Regulation

Given the nature of the activity, donation-based crowdfunding per se is typically not regulated. The platform provides administrative services to facilitate transactions between donors and beneficiaries, and it is not subject to licensing or any ongoing regulatory requirements, unless it provides additional services that are regulated (e.g., payment services). General laws and regulations would apply to parties transacting over the platform, typically (*i*) contract law/a

civil code, (ii) tax law, (iii) a law regulating charities and public fundraising, (iv) consumer protection law, (v) data protection law, and (vi) criminal law (fraud, cyber-attack).

2.2. Reward-Based Crowdfunding

2.2.1. Model Description and Use

Reward-based crowdfunding allows funders (donors) to contribute to campaigns in exchange for a nonfinancial reward. Rewards often take the form of tokens of appreciation (artist's autograph, mentioning the donor's name in the credits, T-shirt) or the prepurchasing of a product or service (the actual invention) according to the contributed amount. Reward-based crowdfunding shares many commonalities with donation-based crowdfunding, and sometimes is included in the same category (Vargas, Dasari, and Vargas 2014). In addition to the key motivations described for donation-based crowdfunding, donors expect a more tangible outcome of their investment. Revenues for a platform come from the fees deduced from each contribution (see Box 4). There are two main common subcategories of reward-based crowdfunding: (i) all-or-nothing and (ii) keep-what-you-raise.

This category of crowdfunding is primarily used to fund art (movies, music) and for the development of new products and innovations. In addition to financing, crowdfunding can serve marketing purposes: through the

campaign, entrepreneurs raise awareness about new projects and products, and receive feedback from potential customers. For instance, a start-up may test interest in an innovative idea⁶ or an established company may test potential uptake of a new product.⁷

The Asia-Pacific region is leading in reward-based crowdfunding numbers. Excluding China, the total reward-based crowdfunding volume within the Asia-Pacific region in 2015 was more than US\$81 million, almost double the US\$41.7 million raised in 2014. In China, the earliest reward crowdfunding platforms were start-ups, but a number of China's largest e-commerce companies have launched reward-based crowdfunding platforms since 2013. It is estimated that it raised US\$829.52 million in 2015 (Zhang et al. 2016a). In the Americas, the market volume of US\$658.37 million was generated in 2015, up 22 percent from 2014's US\$513.96 million. This model accounted for 2 percent of the total market in 2015. North America accounted for US\$645.70 million (Wardrop et al. 2016). Reward-based crowdfunding is the second largest sector within the European online alternative finance market (excluding the United Kingdom) with €120.33 million (approximately US\$130 million) raised in 2014 (compared with €63.18 million in 2013). In the United Kingdom, £42 million (approximately US\$55 million) was facilitated through reward-based crowdfunding platforms in 2015 (Wardrop et al. 2015).

BOX 4. Example of Charges

"Fees are only charged on successfully funded projects. We charge 5%, in addition to any fees from our payments partners" (www.kickstarter.com/terms-of-use?ref=footer/).

6 See, e.g., www.kickstarter.com/projects/1523379957/oculus-rift-step-into-the-game.

7 See, e.g., <https://www.kickstarter.com/projects/1016374822/risky-adventure>.

2.2.2. Benefits and Risks

A. Benefits

The benefits for donors largely overlap with the benefits mentioned for donation-based crowdfunding with some additional points to mention:

- **Pioneer status.** For many donors, investing on a crowdfunding platform is an inherently social activity, and part of the reason for the investment is to obtain preferential access to the inventor (e.g., for updates, direct communication) and the invention (early-adopter status) (Schweinbacher and Larralde 2010).
- **Crowd due diligence.** Typically, “crowdsourcing” of experience and variety of perspectives due to higher numbers of funders who review any given campaign can improve the collective ability of funders to spot and assess risks. In fact, academic studies compared the decisions of venture capitalists to funders and found that both groups assess entrepreneurial quality in similar ways (Mollick 2013).⁸

Reward-based crowdfunding enables beneficiaries to access capital at a lower cost compared to traditional sources for three reasons (Agrawal, Catalini, and Goldfarb 2013):

- Better outreach and targeting—donors are not constrained by their geographical location, and campaigns can have global reach, thus targeting interested crowds with no or limited geographical barriers.
- Monetization of assets—beneficiaries can leverage assets that are difficult

to trade in traditional markets (e.g., nonpecuniary rewards, such as recognition).

- Technological innovations—including streamlined online procedure to set up a campaign, social media marketing, increased transparency and competition.

Entrepreneurs may also seek nonmonetary benefits such as customer feedback. Crowdfunding campaigns may serve as a particularly informative type of market research, provide feedback on the project, and predict potential demand for the product or service concerned. In addition, crowdfunding was found to “democratize” finance and alleviate some of the geographic and gender biases associated with traditional venture capital financing (Agrawal, Catalini, and Goldfarb 2011).

B. Risks

In addition to the risks described for donation-based crowdfunding, donors face the following risks (which often have to do with funding start-ups):

- **Incompetence.** Donors and beneficiaries may be initially over-optimistic about outcomes. Entrepreneurs may have little experience in building a product and dealing with logistics and suppliers, which may lead to delays or subquality products. For instance, in the technology and design categories on Kickstarter, estimates suggest that more than 50 percent of products are delivered late (Mollick 2013) and 9 percent are not delivered at all.⁹ Even when a reward is delivered, it may not have the promised (or expected) quality.

⁸ Similar findings are echoed by another study of artistic projects, where the investor decisions were compared to “expert” evaluators of art quality. The authors found no differences between projects selected by the crowd and those selected with involvement of experts. See Mollick (2015), pp. 1533–53.

⁹ www.kickstarter.com/fulfillment

- **Lack of due diligence.** Relying on “the wisdom of the crowd”¹⁰ may discourage donors from proper due diligence. In the short-term perspective, this appears to be a rational decision, because they typically have a much smaller stake and therefore less incentive to spend time and money investigating creators. In the long term, however, wisdom of the crowd may get corrupted (also due to the adverse selection and free-rider problem).

Beneficiaries face the risk of high opportunity costs because running a successful crowdfunding campaign requires many elements and resources. In addition, beneficiaries face risks, such as the following:

- **Compromised intellectual property rights.** Beneficiaries disclose their plans and innovations in a public forum. This can create a risk of imitation and unfair competition and have repercussions on intellectual property protection as illustrated by the following quote from the terms of use of one of the largest reward-based platforms: “[w]hen you [. . .] launch a project, you [. . .] grant to us, and others acting on our behalf, the worldwide, non-exclusive, perpetual, irrevocable, royalty-free, sub-licensable, transferable right to use, exercise, commercialize, and exploit the copyright, publicity, trademark, and database rights with respect to your [c]ontent.”
- **Crowding out professional investors.** Angel investors and venture capitalists, who often bring additional value to the company, such as industry knowledge, professional networks, and status, may be crowded out by nonprofessional donors.

2.2.3 Regulation

Similar to donation-based crowdfunding, reward-based crowdfunding is not subject to any particular regulatory regime comparable to other financial intermediaries. Crowdfunding platforms act as matchmakers that enable beneficiaries to enter into agreements with multiple donors, but bear limited liability in case of violation of the contract by either party. At its best, the key obligation of the beneficiary is to spend the donated money on a (often vaguely) defined purpose and deliver the promised reward within a (often vaguely) defined time frame. Should either of the parties fail to perform, the platform would likely offer some assistance to mediate the dispute, but ultimately it would be up to the aggrieved party to enforce compliance before a court of law.

Despite recent lawsuits, case law is lacking (Grella 2015), and there are reasons why donors may hesitate to sue a beneficiary. The monetary value concerned is often too small and, unless class action is available, the aggrieved donors may find it too costly to sue. Some rewards may be difficult to obtain, even with assistance of courts, and instead another form of compensation would need to be sought. The international nature of transactions, where different legal regimes may apply regardless of a (common) arbitration clause used by platforms, can also be a big hurdle.

2.3. Debt Crowdfunding

2.3.1. Model Description and Use

Debt crowdfunding allows funders (lenders) to directly lend to fundraisers or invest in debt obligations issued through a platform. Debt crowdfunding is also known

¹⁰ The term “wisdom of the crowd” has been used in a study focused on accuracy of the collective decision-making process. See Surowiecki (2004).

as lending-based crowdfunding, marketplace lending, or person-to-person (P2P) lending—terms that are not as broad as debt crowdfunding. Debt crowdfunding is best thought of as a new approach to lending rather than a completely new financial product. By leveraging the Internet’s interconnectivity, this form of crowdfunding builds a direct relationship between the funder and the fundraiser.

Based on the key objective promoted by the platform, we can distinguish (i) nonprofit lending, (ii) socially oriented lending, and (iii) commercial lending. Funders on nonprofit platforms actively seek to reach communities with limited access to formal lenders without expectations of a financial return. Many of these platforms rely on volunteer work, donations, and/or grants to operate. The most prominent example is Kiva,¹¹ which lends money collected from lenders leveraging local microfinance infrastructures in the hardest to reach places. Zidisha, another example of nonprofit lending, describes itself as the first direct philanthropic microlending community.¹² Socially oriented lending is driven by the opportunity to earn profits and support specific communities or geographic regions. For instance, MYC4 enables funders to lend money to SMEs in developing countries in Africa for a small yield. Platforms for commercial lending usually do not target specific groups of fundraisers or social causes. Examples of these include CreditEase in China, RainFin in South Africa, Crowdo in Malaysia, Zopa in the United Kingdom, and LendingClub in the United States.

Debt crowdfunding is used to raise funds for all sorts of purposes ranging from individual consumption to business

loans. There are different subcategories of debt crowdfunding distinguished by who the funders and fundraisers are:

- **P2P lending** where individual funders lend to individual fundraisers and entrepreneurs. In many cases, the loan is unsecured. Based on the information disclosed by the fundraiser, funders decide to cover all or a certain amount of the requested loan sum (Savarese 2015). If the campaign is successful, the loan is disbursed to the fundraiser, and later repaid with interest to the funder(s). To mitigate the default risk, some P2P platforms pool, slice, and sell packaged loans corresponding to the risk appetite indicated by the funder.
- **Peer-to-business (P2B) lending** where individual funders lend to SMEs. The loans are not secured. Speed, flexibility, and cost (Savarese 2015) make P2B lending a viable business funding alternative¹³ that is attractive mostly for start-ups, small enterprises with growth potential, and medium-sized enterprises with specific plans for diversification and expansion to new markets.
- **Business-to-business (B2B) lending** where the funder is made up of different businesses—often very small companies—that want to lend money for good rates of return. Lending to businesses (both P2B and B2B) may also involve funding of pooled investment vehicles instead of individual businesses. We can also argue that there is a business-to-peer subcategory where large institutional funders provide funds

11 www.kiva.org/about/where-kiva-works

12 www.zidisha.org/why-zidisha

13 For instance in the United Kingdom there is a product called “mini-bonds.” Similar to traditional bonds, mini-bonds allow issuing companies to crowdfund unsecured debt at competitive rates; however, the regulatory requirements are much less stringent for mini-bonds than for regular bonds (see, e.g., <https://www.syndicatoroom.com/crowd-investing/mini-bonds>).

to lend to individual fundraisers as described in the following.

Debt crowdfunding platforms are diverse in their operational models, which largely depend on the legal and regulatory framework. Based on categorization introduced by IOSCO and other researchers (Kirby and Worner 2014), there are five major operational models of debt crowdfunding: (i) client-segregated account, (ii) balance sheet lending, (iii) notary, (iv) “guaranteed” return, and (v) offline.

In the client-segregated account model, an individual funder is matched to an individual fundraiser through the platform, and a contract is set up between them. The platform is not a contractual party to the loan agreement between the funder and the fundraiser, and all funds from the funder and the fundraiser are separated from the platform’s balance sheet through a legally segregated account (Figure 2). The platform derives its revenues and covers expenses, including debt collection and fundraiser screening, from fees and other costs charged to either or both the fundraiser (e.g., an origination fee, administration fee) and the funder (e.g., an administration fee).

In the balance sheet lending model, the platform lends directly to fundraisers and holds the loan on its balance sheet. Platforms generate their revenue through interest rate spread (the difference between the platform cost of borrowing and the interest rate it charges to fundraisers). The platform also charges additional fees as in other models, including fees for servicing loans sold to the crowd. As the industry evolves, balance sheet

lenders increasingly rely on a range of capital sources, including credit facilities, whole loan sales, and securitizations to fund origination.

In the notary model, loans are originated by a partner bank and distributed through the platform. This model reflects the regulatory requirement that lenders need to be authorized (e.g., hold a license). The loans issued by the partner bank are held on its balance sheet for one to two days before they are purchased and resold by the platform to the crowd (funders) in the form of notes (which, in many jurisdictions, are regulated as securities). Funders receive repayments directly linked to the performance of the underlying loan proportional to their initial investment (Figure 3). This shifts the risk of default to the crowd away from both the issuing bank and the platform.

The “guaranteed” return model and offline model are both related (although not exclusively) to the Chinese crowdfunding market. In the guaranteed model, the platform guarantees a certain return agreed on with the funder. A third-party provider, who effectively insures the investment, guarantees the return. This model may resemble the model in which the platform creates a provision fund from which nonperforming loans are covered. However, in that case, the provision fund is funded from mandatory contributions charged to fundraisers (or funders). Until its recent ban, guaranteed return model was prevalent in China. Also operating in China was the “offline” model, where fundraisers were typically recruited

FIGURE 2. Segregated Account Model

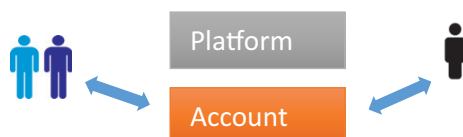
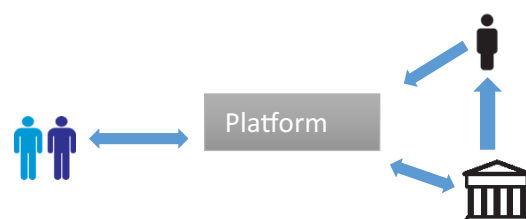


FIGURE 3. Notary Model



offline through direct channels and in-person sales techniques, including the process of creditworthiness assessment. Once the loan was funded and disbursed, the platform collected repayments in person on behalf of funders (Aveni et al. 2015).

Debt dominates crowdfunding markets around the world, with the Asia-Pacific region ranking at the top. In China, P2P lending is the largest category of Internet finance, with reported market volume of US\$52.44 billion in 2015 (Zhang et al. 2016a) compared to US\$36.16 billion in North America (Wardrop et al. 2016). In Latin America and the Caribbean, between 2013 and 2015, P2P platforms raised US\$19.43 million in 2015 (Wardrop et al. 2016). In Europe, debt crowdfunding is estimated to have raised €3.21 billion (approximately US\$3.60 billion) in 2015 (European Commission 2016a). P2P lending reached £909 million (approximately US\$1.2 billion) in the United Kingdom alone in 2015, compared with £547 million (approximately US\$700 million) in 2014 (Zhang et al. 2016b).

2.3.2. Benefits and Risks

A. Benefits

The major benefits of debt crowdfunding are convenience, efficiencies, and potential to improve access to credit by excluded and underserved groups. Application for a loan typically takes only a couple of minutes, can be done from a distant location, does not require credit history, and may concern personal loans and business-development loans. The same convenience benefits funders. In addition, debt crowdfunding preserves the advantages described for the previous two categories of crowdfunding (donation and reward-based), including community participation and philanthropy, formalization of contracts, and wisdom of the crowd. In addition, it

offers more tangible benefits to funders (investors):

- **Access to a new asset class.** Kirby and Worner (2014, p. 21) argue that “[p]eer-to-peer lending platforms have in effect provided investors with a brand new asset in the form of un-collateralised debt.” They further argue that this may allow for better portfolio diversification, ultimately leading to reduced systemic risk as funders invest small amounts in diversified assets instead of over-relying on a single asset. Whether or not crowdfunded loans would be treated as a new asset class ultimately depends on the relevant regulatory regime. Regardless, debt crowdfunding widens access to an investment class not easily available to retail investors in the past. Putting aside institutional investors and professional lenders, some of the funders lending money over the platform to individuals, MSMEs did not previously have this option and would instead place their savings in savings accounts, in collective investment schemes, or the like (although the risk inherent in such savings/investment products is likely to be different from that of investment in crowdfunded assets).
- **Higher financial return.** Crowdfunding offers a higher return for funders than savings (corresponding to a higher risk). This is particularly important in the current low-interest environment where many investors and savers search for yield. In particular, crowdfunding can help satisfy a demand from funders who want the higher average return and are prepared to accept the high volatility of that return and/or lower levels of consumer protection and funders who are willing to compromise on services traditionally

offered by intermediaries, such as banks, to increase their average (gross) return.

For fundraisers, the key advantages overlap with donation and reward crowdfunding; the most important one being improved access to finance. In particular, debt crowdfunding may offer the following benefits:

- **Enables access to capital at a lower cost than traditional sources.** Online platforms, unlike banks, have little need for a physical presence. This, coupled with the use of innovative algorithms to determine the creditworthiness of applicants, streamlined application and approval processes, and specialization in a limited number of products and services allow platforms to operate with a relatively low infrastructure cost, which reduces the cost of the loan to the fundraiser, although this may not necessarily be true for all platforms. Platforms may also create incentives for traditional financial institutions to innovate (European Commission 2016a).
- **Fills a gap left by banks.** The tighter restrictions on traditional lenders introduced post-crisis have reduced their appetite for lending (see, e.g., IMF 2016), particularly to the least profitable and the riskiest segments, including uncollateralized personal loans or SME loans (see, e.g., EBA 2016, OECD 2014, OECD 2009). Particularly in some markets, crowdfunding has stepped in as an alternative to traditional lending.

- **Provides convenience.** As mentioned, online platforms are accessible to a fundraiser 24/7 from the comfort of his or her home. Technology allows for less documentation, making application and disbursement processes quicker.

B. Risks

In addition to common dangers associated with crowdfunding and investment products, there are risks specific to debt crowdfunding. The risks simultaneously affect funders and fundraisers, raising consumer protection concerns for both sides of the crowdfunding transaction, because the platform is often the only professional involved.

Funders face many risks, and to a large extent, these risks stem from the very nature of the underlying asset—the unsecured loan:¹⁴

- **Risk of financial loss.** Funders may lose their money if the fundraiser defaults. The risk of default is higher due to the nature of unsecured loans to individual consumers, SMEs, and start-ups. Regulatory safeguards, such as deposit insurance or investor protection schemes, do not protect these investments (European Commission 2016a). In addition, credit assessment methods used by platforms are largely new and untested through the credit cycle.¹⁵ To mitigate this risk, some platforms have established a provision fund (a contingency/reserve fund) or introduced third-party guarantees.

14 Some platforms require or allow borrowers to provide collateral (see, e.g., www.crowdo.com, where borrowers often offer jewelry or gold as collateral).

15 Debt crowdfunding has grown mainly during a period of relatively stable economic recovery, but the platforms that experienced the global financial crisis saw greater loan losses. For instance, Zopa claims to have one of the best loan performances among all P2P lenders with post-crisis (since 2010) bad debt at only 0.25 percent (see www.zopa.com/lending/risk-management); however, Zopa's default rate in 2008 was 4.33 percent (see www.zopa.com/lending/risk-data). For Prosper, currently the second biggest P2P platform in the United States, the 2008–2010 loan portfolio in 1–14 day arrears was nearly 30 percent, according to Lendstats (see lendstats.com/wordpress/?p=218).

- **Lack of transparency.** When disclosure is not standardized across the market and emphasizes benefits rather than risks, funders may not be in a position to make informed decisions (EBA 2015). Moreover, funders may wrongly assume that offerings are endorsed by the platform or are subject to an approved credit scoring methodology.
- **Illiquidity.** Investment in a crowd-funded loan is locked until the loan matures. Funders are paid back in regular installments or as a lump sum. They cannot withdraw the invested amount, unless the platform allows funders to do so (typically for a fee). A platform that offers early withdrawals (and thus effectively engages in maturity transformation) can pay funders either from its own balance sheet, build a liquidity-improvement fund, or use money from other funders.
- **Costs.** Crowdfunding can be more difficult and costly than most fundraisers anticipate. Running a successful campaign requires significant human and financial resources. Fundraisers should also consider opportunity costs when other sources of financing may be available. In addition, and specifically with regard to entrepreneurs, crowdfunding works well for a one-off injection of capital, not necessarily for longer-term or ongoing support.
- **Weak protection.** Safeguards common to consumer loans (standardized disclosure, a cooling-off period, the early repayment right, the right to access an effective complaints handling process, ban on unfair collection practices)¹⁶ may not necessarily apply to debt crowdfunding (see Section 2.3.3).

Risks faced by fundraisers often relate to the key benefits mentioned, most importantly the convenience and the ease of credit access. These risks should not be underestimated given that over-indebtedness, one of the key risks, has become a serious economic, social, and political issue in many countries. Key risks include the following:

- **Mis-selling and over-indebtedness.** In many jurisdictions, platforms are not obligated to assess whether the fundraiser can afford the loan. To the contrary, platforms have incentives to make loan application as easy as possible because they derive their income from origination fees, which are not contingent on successful repayment. In other words, platforms face a conflict of interest because their incentive is to

focus on volume, rather than on the quality of loans.

There are also more general risks associated with platforms and the way they operate. As mentioned for the other categories of crowdfunding, there is a risk of failure of the platform's technology or closure of the platform, which may lead to loss of data and funds. Platforms that hold the loans on their balance sheets are exposed to a higher risk of failure should the underlying loans prove to be of bad quality or funders' appetite for buying drop. Even failure of a platform that only intermediates contracts between the funder and the fundraiser may have significant impact on them. Although the funder-fundraiser contract would naturally outlive the failure, it might be difficult to restore information about the disbursed amounts, repayments, interest rates, etc.

¹⁶ See, e.g., OECD/G20 (2011).

Platforms have limited access to credit history in many jurisdictions and need to rely on innovative, yet unproven, alternative ways of credit scoring (Miller and Jenik 2016). As long as access to bank-generated data on credit and credit bureaus is limited to the banking sector, crowdfunding platforms have no option but to rely on alternative credit scoring methods. This may lead to inaccurate assessment of the default risk, but also to discrimination where a bias is embedded in the underlying algorithm. Access to credit history is now available to crowdfunding platforms in the United States and China, for instance, with more countries likely to follow.

2.3.3. Regulation

Approaches to regulation of debt crowdfunding vary by business model and jurisdiction. The great variety of business models, together with dynamic evolution of the industry, makes the development of a single regulatory regime for debt crowdfunding difficult. IOSCO has identified the following regulatory approaches (Kirby and Worner 2014):

- **Exempted or unregulated.** Some countries have opted for a “wait-and-see” approach and require lending platforms to comply only with existing general rules governing lending, such as financial consumer protection rules, usury laws, and laws against misleading and aggressive sales practices. However, since platforms do not issue loans (with the exception of the balance sheet lending model), they may not be subject to rules that bind direct lenders. Examples include Ecuador, Egypt, South Korea, and Tunisia.
- **Prohibited.** The practice of debt crowdfunding (P2P lending) is

specifically prohibited (until recently, this was the case in Israel and Japan).

- **Regulated as an intermediary.** Crowdfunding platforms are classified as intermediaries or brokers, and are required to register or even to obtain a license. Obligations and requirements for intermediaries vary by jurisdiction. Generally, there are rules regulating access to the market (regulation/licensing) and conduct of business. In the United States, at the federal level, each platform is required to be registered with the Securities and Exchange Commission (SEC) and is treated as a public company that has to fully disclose its finances, loan origination, and practices. In addition, each state has its own regulations.
- **Regulated as banking.** Crowdfunding platforms are classified and regulated as banks because of their credit intermediation function; all platforms must obtain a banking license and meet (modified) prudential and business conduct requirements. Examples include France, Germany, and Italy.

In addition to regulatory frameworks put in place by governments, in some countries, several industry associations have introduced self-regulation (European Commission 2016a). For example, in the United Kingdom, the Peer2Peer Finance Association (representing 90 percent of the market) asks its members to apply the operating principles setting out the standards of business conduct, such as transparency, risk management, and reporting.¹⁷ These align with, and in some areas supplement, requirements of the Financial Conduct Authority (FCA).

¹⁷ <http://p2pfa.info/wp-content/uploads/2015/09/Operating-Principals-vfinal.pdf>

2.4. Equity Crowdfunding

2.4.1. Model Description and Use

Equity crowdfunding allows individual and institutional investors to invest in unlisted entities (issuers) in exchange for shares in the entity. By definition, equity crowdfunding serves funding of legal entities that can raise funds by selling their equity. It is suitable for start-ups and SMEs, in particular. If an investment target is reached, the deal is closed between the pool of funders, the issuer, and the platform. The platform charges a commission based on the amount raised and, in some cases, on the basis of future profit.

Equity crowdfunding is relatively small, but it has experienced dramatic growth in recent years. In 2015, it made up merely 11 percent of the total crowd-funded amount; however, in terms of year-on-year growth, it has been outpacing the growth of the wider crowdfunding industry by 60 percent versus 53 percent (AlliedCrowds 2016). On the American continent, US\$598.05 million in equity was sold over crowdfunding platforms in 2015 (120 percent more than in 2014), mostly in the United States and Canada (Wardrop et al. 2016). In Europe, equity crowdfunding was estimated to reach €422 million (approximately US\$467 million) in 2015 (European Commission 2016a). In the United Kingdom alone, equity-based crowdfunding (excluding real estate crowdfunding) increased on a year-to-year basis by 295 percent to £245 million (approximately US\$325 million) in 2015 (Zhang et al. 2016b). Although many countries in the Asia-Pacific region lack a regulatory framework¹⁸ and equity-based crowdfunding typically consists of small

online private placements, this region raised over US\$64 million in 2015 (excluding China) (Zhang et al. 2016a).

As equity crowdfunding platforms continue innovating, different business models have emerged (Gabison 2015), such as (i) a club model where platforms recruit potential funders as members of a closed “investment club” to avoid regulation of public offerings and investor protection typically enjoyed by “non-qualified” investors; (ii) a cooperative model (also known as a holding model or vehicle model) where platforms create a special-purpose cooperative vehicle to pool money to be invested in an individual project;¹⁹ (iii) an investor-led model; and (iv) a coinvestment model.

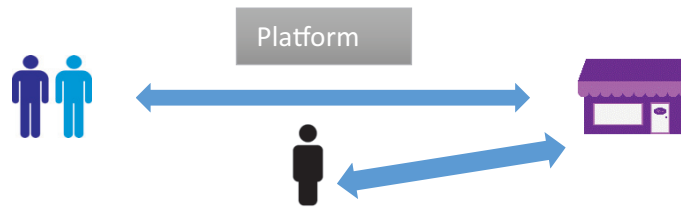
In the investor-led model (also known as syndicate funding), an accredited lead investor carries out due diligence, negotiates the investment terms directly with the company raising finance, and invests its (or if an individual, his or her) own money. The crowd is then invited to co-invest alongside the lead investor. This gives other funders peace of mind by investing alongside professional investors, as equity crowdfunding can be very complex for inexperienced funders. Platforms benefit by taking a slice of the carry on deal. For example, [AngelList](#) allows funders to form “syndicates,” which are similar to investment funds for potential contributors to invest together in a project.²⁰ (See Figure 4.)

Similarly, the co-investment model allows funders to co-invest alongside established venture capitalists. The platform looks for deals and is responsible for due diligence and investment management; it usually sources, vets,

¹⁸ Exceptions include Indonesia, Korea, Malaysia, and Taiwan, which have passed a special tailored regime to allow equity crowdfunding, while Indonesia, Thailand, and Vietnam are working toward it.

¹⁹ See, e.g., Symbid investment, which is done through a cooperative vehicle established in the Netherlands (<http://symbid.com/pages/model>).

²⁰ <https://angel.co/syndicates>

FIGURE 4. Investor-led Model

and organizes investments and presents them to potential “backers,” as well as invests its own funds. Some of these platforms also retain preemptive rights and provide a framework to help funders raise and investors invest additional funds in future rounds and follow-ons.²¹ (See Figure 5.)

2.4.2. Benefits and Risks

The key benefit lies in efficient and effective intermediation of funds allowing funders to invest in a new asset class for higher yield and entrepreneurs to access funding (Kirby and Worner 2014). In that regard, equity crowdfunding is similar to debt crowdfunding, and it also retains the benefits (and risks) of the donation and reward-based crowdfunding, such as community participation and voting with the money. In addition, there are more specific benefits:

(i) Benefits for funders

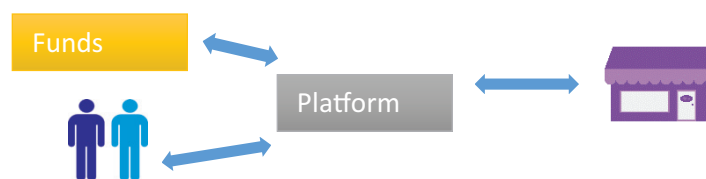
- **Access to investment opportunities.** Access to investment opportunities concerning start-ups and SMEs used to be restricted to traditional

financial intermediaries and venture capitalists. Equity crowdfunding opens these opportunities to a much broader funder group (Gubler 2013).

- **Unlimited potential for financial gain.** Unlike in debt crowdfunding, funders have (at least theoretically) the possibility to unlimitedly multiply their investment if they bet on a new start-up that becomes the next market leader.
- **Aligned incentives between funders and fundraisers.** More than in any other category of crowdfunding, interests of funders and fundraisers are aligned because they share the same risks (including the risk of dilution and financial loss) and have similar options to exit the investment (a sale, merger, or initial public offering [IPO]). This reduces conflict of interest between the two parties.

(ii) Advantages for fundraisers

- **Limited liability.** In case of default, the fundraiser is not burdened with unlimited liability for unpaid debts,

FIGURE 5. Co-investment Model

²¹ For instance, OurCrowd has a due diligence team that vets deals before they are presented to investors and is an active investor in the deal; it retains preemptive rights, thus providing the companies and investors a framework to raise and invest additional funds in future rounds and follow-ons (www.ourcrowd.com/how_it_works/an_introduction).

and instead, funders take the hit alongside the fundraiser.

- **Global reach.** Equity crowdfunding allows access to funders all around the world. This is particularly relevant in countries with underdeveloped capital markets.
- **Improved investment attractiveness.** A successful campaign may act as a signal to established investors (including venture capitalists), showing potential consumer demand, thus attracting additional sources of funding.

Equity crowdfunding is highly risky and illiquid. A recent study shows that of the 367 businesses that attracted investment through the United Kingdom's five major equity crowdfunding platforms between 2011 and 2013, only 22 percent have gone on to raise funds at a higher valuation or have realized a return for their funders through a sale or other form of exit (Altfi 2015). This is most likely because early-stage ventures and SMEs are inherently risky,²² and the risk is further exacerbated by the lack of incentives for individual funders to conduct due diligence given typically small equity stakes.

Investments made through crowdfunding are likely to be subject to dilution when the business raises additional capital at a later date and issues new shares to the new investors. Illiquidity poses another major risk to crowdfunding and available options for exit are limited. In the absence of a secondary market, funders may either sell their position over the counter to any interested party or wait until the company is acquired by a strategic investor, merges with another company, or issues an IPO. However, there is not

enough evidence yet regarding whether and how likely these scenarios are. Until they exit, funders are unlikely to receive any payment because early-stage and growth-focused businesses rarely pay dividends. Should a funder realize a profit, complex tax obligations may be triggered as a result of the international nature of crowdfunding.

Issues surrounding the gap in protection of fundraisers in debt crowdfunding are even more relevant in equity crowdfunding. Equity crowdfunding is marketed to fundraisers as a simpler and cheaper way to fund business development (as compared to more traditional sources of capital). Fundraisers may then underestimate actual campaign costs, compliance costs (e.g., of regular reporting), investor management costs (e.g., communication with hundreds and thousands of funders), and opportunity costs in terms of foregone expertise because venture capitalists often bring industry knowledge and networking opportunities. Traditional equity investors may even be able to offer capital at a lower price than equity crowdfunding because of their capacity to assess and price risks better.

The regulatory requirements, with which fundraisers need to comply, may expose fundraisers to unwanted public scrutiny. Other sources of funding, including nonequity private debt, home-equity loans, and loans from friends and family members, allow fundraisers to keep their business know-how and innovation hidden from the general public, while crowdfunding requires a higher level of disclosure. In addition to the risk of disclosing too much information to competitors, this may have negative repercussions on intellectual property protection (patentability).

22 See, e.g., www.statisticbrain.com/startup-failure-by-industry.

TABLE 1. Special Regime for Equity Crowdfunding

Special Regime in Place			Special Regime under Way	
Canada	Japan	Spain	Australia	Mexico
China	Korea	Taiwan	Brazil	Thailand
France	Malaysia	United Kingdom	India	Vietnam
Germany	The Netherlands	United States		
Indonesia	New Zealand			
Israel	Portugal			
Italy	Singapore			

2.4.3. Regulation

In the jurisdictions where equity crowdfunding is not prohibited, it is either subject to general securities law or to a specific regime (Kirby and Worner 2014). A clear disadvantage of the former is that general securities law is often cumbersome to comply with and is often at odds with the innovative aspects of crowdfunding, thus increasing barriers to entry by imposing strict limits on who can intermediate the investment (the platform), who can issue securities and under what circumstances (the fundraiser), and who can invest in this form of equity (qualified investors). Lack of clear rules also makes for an environment that platforms find difficult to navigate.²³

To promote equity crowdfunding as a viable alternative to capital markets, some jurisdictions have recently adopted a special tailored regime. Examples

include Title III of the Jumpstart Our Business Startups Act in the United States and the new Capital Market Services Act in Malaysia (see Table 1). Lighter entry requirements, special conduct of business provisions for the platforms, and limited reporting requirements for fundraisers (issuers) typical of tailored regimes are counterbalanced by several limits on the services and activities a platform is permitted to perform, the duty to appoint a third-party custodian to hold funder's assets, investment limits, and the imposition of risk acknowledgement and funder education regimes. Moreover, to address most common risks of equity crowdfunding, additional requirements are often imposed, such as requiring the platform to conduct due diligence on the issuer and/or the crowdfunding offerings and to have "a living will," as well as a limit on the amount nonqualified funders can invest (IOSCO 2015).

²³ A World Bank study of the Kenyan securities regulatory environment determined that various pieces of securities legislation allow for crowdfunding, but they are subject to interpretation, making it hard for businesses to set up a crowdfunding platform (Raymond 2014).

SECTION 3. EVOLVING FRONTIERS

As crowdfunding has grown in scale and expanded globally in its geographic reach, it has evolved and diversified in different ways, sometimes departing quite decisively from its original concept. In this section we focus on the most recent trends of (i) hybridization, (ii) institutionalization and complexity, and (iii) consolidation and how these trends may affect excluded and underserved customers.

A. Hybridization

Platforms combine features of different crowdfunding categories, but also cater to niche markets with a specific focus on transactions in real estate, art, or video game financing. Examples include (i) invoice trading, (ii) royalty crowdfunding, (iii) revenue sharing, (iv) real estate crowdfunding, and (v) P2P insurance. Invoice trading is another way for businesses to raise capital by using their invoices or receivables, usually selling those at a discount to a pool of primarily high net worth individuals or institutional investors (e.g., [Invoicefair](#), [Invoiceinterchange](#)).

In the royalty crowdfunding model, funders receive a share in a unit trust, which acquires a royalty interest in the intellectual property of the fundraising company. A percentage of revenue is paid out over time, and the payout varies depending on the periodic revenue. Royalty crowdfunding platforms typically invest in art and entertainment (e.g., [Tubestart](#) for videos and films, [AppsFunder](#) for mobile apps, and [Gideen](#) for music) and natural resources.²⁴ The idea of revenue sharing is similar, where funders fund a business, and repayments are determined by a percentage

of future revenue (or profits) of the business (e.g., [Startwise](#), [Quirky](#)).

Another innovation that has been particularly successful in Asia is the use of debt and equity crowdfunding for real estate projects. As a variation of debt crowdfunding, real estate lending funders provide a loan to property developers secured against property of a consumer or business fundraiser. In equity real estate crowdfunding, funders invest in a property through the purchase of an equity instrument issued by a special purpose vehicle established to facilitate financing for a single project (e.g., [Patchofland](#), [RealtyShares](#), [RealtyMogul.com](#), and [Lendinghome](#)). Real estate may also open equity crowdfunding to individual fundraisers by allowing them to sell stakes in their home equity.²⁵ In P2P insurance, a group of individuals pools its members' premiums and pays out some or all of the claims made by the group. Advantages include less fraud, lower acquisition costs (through referrals/social networks), greater loyalty, and better pricing over time. Some examples are [Guevara](#) in the United Kingdom and [Friendsurance](#) in Germany.

The trend of hybridization demonstrates the flexibility of crowdfunding and different use cases on the demand side. Most of the hybrid examples cited earlier could benefit primarily MSMEs, but concepts such as P2P insurance may have a large impact on individuals as well. For instance, the concept of P2P insurance better adapts to the system of Takaful,²⁶ an equivalent of insurance in Islamic finance, which is based on the idea of risk-sharing rather than risk-shifting. Crowdfunded insurance may, therefore, become a driving

²⁴ www.energyfunders.com

²⁵ See, e.g., Foley (2016).

²⁶ See, e.g., Gönülal (2013).

force to increase coverage in many under-insured regions.

Another example where a hybrid model may benefit unserved and underserved regions is remittances. Crowdfunding platforms could potentially facilitate the use of remittances as collateral by applying alternative credit scoring models to reflect the estimated inflow from remittances and carrying securitization of the remittance inflows on behalf of the fundraiser.

B. Institutionalization and Complexity

Some crowdfunding models evolved from relying on “the crowd” to more complex models involving hedge funds and banks feeding in institutional money (institutional investors not only invest in crowdfunded assets, but also take stakes in platforms²⁷). The involvement of institutional investors is likely to become more prominent in the future, according to recent evidence. For example, in 2015, 45 percent of debt crowdfunding platforms in the United Kingdom reported institutional involvement as compared to 28 percent in 2014 and just 11 percent in 2013 (Zhang et al. 2016b); 26 percent of business loans and 32 percent of consumer loans were funded by institutions (FCA 2016, p. 14). One of the risks potentially affecting nonprofessional users of crowdfunding is the risk that professional investors will keep the best projects, leaving only the worst for the crowd.

The most active institutional players are hedge funds: San Francisco-based fund Colchis Capital Management had US\$663 million of P2P loan investments at the end of 2014, which represented

10 percent of all loans originated by the crowdfunding sector in the United States. During the last quarter of 2014, almost 60 percent of the US\$1.1 billion in loans originated by Lending Club were bought by institutional investors (Aquilina and Kraus 2016).

The involvement of institutional investors raises concerns that platforms may ramp up origination before the strengths and weaknesses of their models are properly tested (Aquilina and Kraus 2016). This is because of the pressure they face from institutional investors, who are attracted by higher yields, but their increasing demand may soon outpace the capacity of the industry, thus putting stress on the technology, operations, infrastructure, and underwriting capabilities of platforms. More importantly, crowdfunding platforms may become more aggressive in seeking new customers and adopt mis-selling practices used by some consumer credit providers, for instance. If the business model shifts toward push sales, it may have a significant impact on customers as in many countries the regulatory framework for crowdfunding does not provide enough protection to fund users. This is a particularly serious risk given the changes in the underwriting process enabled by the technology and the speed with which thousands of customers can be offered and instantly approved for a loan, including over their feature or smart phone.

The increased demand from institutional investors has provided a powerful incentive for securitization of crowdfunded assets. The first large deal occurred in October 2013, when hedge fund manager Eaglewood Capital closed on a US\$53 million securitization

²⁷ For instance, Australian Westpac has acquired a stake in SocietyOne, Australia’s leading P2P lending platform. Barclays Africa has acquired a stake in RainFin, the leading South African P2P lending platform. See, e.g., Renton (2014).

deal involving loans originated by Lending Club (see, e.g., Renton 2013). The recent launches of several funds investing in loans originated on P2P lending platforms underscore the growing interest from institutional investors in this sector. This may potentially create a situation with important similarities to the origination of subprime mortgages that preceded the global financial crisis. On the other hand, so far the number of new securitizations of P2P loans has been lower than expected because of a combination of rising defaults, market volatility, and corporate governance issues. For example, two major Wall Street investment banks, Goldman Sachs Group Inc. and Jefferies LLC, decided to stop buying Lending Club's loans after the company's CEO Renaud Laplace resigned (Rudegeair and Baer 2016).

C. Consolidation

Another trend is consolidation of the crowdfunding sector. After years of platform proliferation, a recent study in the United Kingdom shows that several crowdfunding platforms have either "gone quiet" or disappeared altogether, and the year-on-year growth rate is slowing, from 161 percent between 2013 and 2014 to 84 percent between 2014 and 2015 (European Commission 2016a). This is also happening across borders. One reason for this slowdown could be that, after the initial boom, it is now difficult for existing platforms to find new projects or other

use cases to sustain growth at current rates. Compliance cost could be another reason because costs increase as new regulation is put in place. Finally, the growing complexity of crowdfunding business models may also discourage new entrants. While setting up a platform is fairly easy and cheap, coping with the dynamic and often uncertain regulatory environment and strong competition can be daunting.

Although it is not a trend yet, the development of secondary markets for crowdfunding related securities is noteworthy. The emergence of functional and transparent secondary markets, particularly for equities and loans, may substantially boost interest of retail funders. Secondary markets can take different forms. One model entails the direct involvement of the crowdfunding platform, which may provide an online bulletin board that connects funders who intend to sell their investments to potential buyers who are looking to invest in previously funded projects. In this case, funders can offer or bid on equity shares and directly negotiate a price. Another model involves a crowdfunding platform or a third party that is running a marketplace for crowdfunding-based securities as an online trading venue. This type of secondary market that has well-defined and regulated rules can bring together multiple buyers and sellers. Finally, crowdfunding platforms may team up with existing marketplaces for unlisted companies (European Commission 2016a).

SECTION 4. CROWDFUNDING AND FINANCIAL INCLUSION

4.1. Opportunities

Crowdfunding has the potential to contribute to financial inclusion efforts by providing improved access to funds and financial assets. A GPMI White Paper (2016, p. xix) notes that crowdfunding may support financial inclusion as it “. . . can be a quick way to raise funds with potentially few regulatory requirements; it can be cost-efficient and can produce a good return for the lender; and its potential market reach is limited only by access barriers to the platform and regulatory restrictions where applicable.” The hypothesis is that crowdfunding can benefit financial inclusion efforts in the following ways: (i) it improves access to finance by excluded and underserved individuals and MSMEs; (ii) it allows for innovations of existing models to serve BoP customers, such as microfinance and mobile financial services; and (iii) it opens access to more complex investment products for resilience and asset building.

Existing crowdfunding platforms require some minimum infrastructure to be in place for them to operate (see Section 1.2), and therefore, this innovation will more likely benefit different customer segments disproportionately. Access to a crowdfunding platform requires the ability to send and receive money electronically over a transactional account, such as a bank account or a mobile money account. Therefore, the most likely users of crowdfunding are customers who already own or have access to such an account. These customers, however, may still be underserved or excluded with regard to other financial products and services, such as credit, insurance, savings, and investment products; this would be particularly the case for BoP customers. Crowdfunding may also help deepen the financial market, thus

providing benefits to a broader group of customers excluded from certain segments of the financial system because of limited financial sector development. In the following we further explain our key hypotheses and how they are likely to play out with regard to different customer segments.

A. Improved Access to Finance

The most immediate benefit of all the categories of crowdfunding is improved access to finance by traditionally excluded and underserved groups of individuals and legal entities. A 2013 World Bank study indicates that there is an opportunity for up to 344 million people in developing economies to participate in crowdfunding. In particular, debt crowdfunding, as a form of digital credit, is highly relevant. Because of their alternative scoring feature, crowdfunding platforms may be positioned to serve MSMEs, start-ups, and individuals with limited or no credit history. Crowdfunded loans then may become a gateway to traditional lenders, because they will allow fundraisers to build their credit history over time.

Crowdfunding platforms could also out-compete traditional lenders as transactions can take place more quickly and cheaply. Thus, crowdfunding can help poor people with limited access to formal financial institutions to smooth their consumption and face financial shocks (e.g., unemployment, illness, conflict, crop failures, natural disasters, or accidents) without the need to take extreme measures such as reducing food consumption or selling productive assets (DFID 2012). The velocity of crowdfunding transactions and the agility of crowdfunding to accommodate various use cases play an important role in emergency situations more broadly (UNOCHA 2015).

Equity crowdfunding may be an important mechanism MSMEs can use to bridge the funding gap that exists in many countries. The issues of limited access to finance and shortage of market-based financing are particularly pressing in countries with underdeveloped capital markets and lack of venture capital offerings (IFC and McKinsey 2010). Equity crowdfunding provides an opportunity for more traditional investors in businesses or projects (including angel investors and venture capitalists), by reducing transaction costs and information asymmetries, and it may pave the way for other market-based funding opportunities to grow over time, particularly if an adequate regulatory framework is implemented.

B. Innovative Models for Financial Inclusion

Crowdfunding may facilitate digitization of traditional forms of finance. New technologies have already disrupted the business' landscape with mobile money, digital credit, and digital microinsurance. Crowdfunding platforms can follow the same trend driving the use of basic financial products and services and/or adapting new technologies to substitute or complement traditional financial institutions. An example of this potential is [M-Changa](#), a crowdfunding platform in Kenya that “digitizes” the practice of “Harambee”—community fundraising—by allowing people in the same community to use their mobile money to make donations to individuals (e.g., to support a relative’s education) or to community causes. Another example is digitization of the rotating savings and credit associations practice, such as [eMoneyPool](#), Monk (an app-based crowdfunding), and [Puddle](#). See Section 3.A for examples of P2P insurance and Takaful.

More generally, crowdfunding can facilitate more and new types of investment

from developed to developing economies. The most prominent instance is the work done by platforms such as [Kiva](#), which has helped facilitate more than 1 million loans from funders in developed economies to low-income entrepreneurs in developing countries. An example of a commercial lending platform is an equity crowdfunding platform called [EmergingCrowd](#), which offers retail investors the opportunity to directly buy shares and bonds in companies based in emerging markets. [Homestrings](#) provides investment opportunities in real estate, financial services, telecoms, and SMEs in 13 African countries.

Crowdfunding can play an important role in promoting government schemes to effectively channel remittance and investment flows. Platforms can facilitate the outreach to diaspora communities by offering investment opportunities in their respective home countries. The Syrian refugee crisis provides another example of mobilizing fund transfers from developed to EMDEs, while lowering transaction costs and engaging retail consumers as well as diaspora (www.kickstarter.com/aidrefugees).

Annex 2 provides examples of platforms that target EMDEs, unserved and underserved customers, and BoP consumers.

C. Access to New Asset Class

Crowdfunding opens access to investment opportunities that are currently widely unavailable to customers at the BoP. A new theory of change for the microfinance industry suggests that the use of financial services by poor households helps them anticipate, adapt to, and/or recover from the effects of shocks in a manner that protects their livelihoods, reduces chronic vulnerability, and facilitates growth (resiliency) (Gash and Gray 2016).

This higher resiliency, besides credit and insurance, can also be achieved through asset building (saving, investment). In the future, crowdfunding can offer such an investment opportunity as currently excluded and underserved customers have very limited access to formal financial products designed for resilience and asset building.

The lack of available options exposes them to a variety of risks, including the risk of fraud. In recent years, many people, including the very poor, have fallen victim to fraudulent investment schemes such as Ezubao in China (900,000 investors lost US\$7.6 billion), Sardaha in India (1.7 million investors lost US\$4 billion) (see, e.g., Karnik and Balachandran 2016), and Clip Investment Sacco, Ltd., in Kenya (more than 5,000 investors lost US\$18.7 million) (see, e.g., Kamau 2016).

4.2. Risks and Challenges

Despite the potential benefits mentioned, a significant impact of crowdfunding on financial inclusion is yet to be seen. From a development perspective, the key test of crowdfunding lies in the extent to which this form of finance is used to promote and support financial inclusion and economic growth rather than generate funds rapidly and cheaply to finance risky and unsustainable investment opportunities. In contrast to microfinance, which emerged with a specific purpose to reach the poor, financially excluded, and underserved, only a fraction of crowdfunding platforms to date have been designed to target this segment. Challenges include (i) inadequate legal and regulatory frameworks, (ii) untested credit scoring models, (iii) limited access to technology, and (iv) lack of awareness and trust. These challenges are not necessarily unique to crowdfunding and, in some jurisdictions, may concern broader areas.

A. Inadequate Legal and Regulatory Framework

The lack of clear rules hinders the industry, fundraisers, and funders. An inadequate legal and regulatory framework exists not only where there are no rules on crowdfunding whatsoever, but also where different crowdfunding models fall under different regulatory (and supervisory) regimes, or where the applicable regulatory regimes vary based on the nature of parties involved in the transaction (e.g., an institutional investor versus a consumer) without any specific guidance on how such a situation should be addressed. In the absence of regulatory clarity, the crowdfunding industry may remain underdeveloped or not develop at all, while funders and fundraisers may be exposed to unfair practices from unregulated or under-regulated and unsupervised or under-supervised platforms.

Across jurisdictions, a frequent gap in crowdfunding regulation concerns protection of participants on the demand side—fundraisers. Thus far, policy makers have focused predominantly on risks faced by the supply side (investors, lenders, and other funders), neglecting the fact that the platform is often the only “professional” in the crowdfunding game, while both the funder and the fundraiser are equally vulnerable and inexperienced individuals or small businesses. In jurisdictions where crowdfunding falls under capital markets regulation, the focus on investor protection is nearly exclusive, with rules prescribing disclosure requirements, the suitability test, the access to a dispute resolution mechanism, and the like. Yet, inexperienced fundraisers/issuers may underestimate the rules with which they need to comply (e.g., disclosure and reporting), and they may not fully appreciate the legal implications of equity distribution and future repercussions

of “managing the crowd” of creditors or stockholders.

Debt crowdfunding exposes fundraisers to the same risks as any other form of (digital) credit. Fundraisers may be steered into borrowing beyond their financial means without appreciating the risk of over-indebtedness, credit bureau blacklisting, and a range of possible penalties. To address those risks, some jurisdictions have adopted rules to protect individual fundraisers (e.g., Australia, Malaysia, the United Kingdom, the United States). However, even in those jurisdictions, the rules may not apply when the funder is another individual and not a financial institution (FCA 2016, p. 12). This obvious gap in consumer protection may become particularly dangerous as crowdfunding reaches scale in lower income countries and begins reaching poorer market segments.

Another important regulatory challenge is the inherent conflict of interest in most platforms’ business model. Many platforms have incentives built into their business model to prioritize volume over quality, thus reducing their motivation to properly screen prospective fundraisers and their projects. This type of the conflict of interest affects fundraisers (the risk of over-indebtedness) and funders (the risk of financial loss) and may translate into a conflict of interest between them, too (e.g., leveraging information asymmetry to borrow more).

B. Untested Credit Scoring Models

One true innovation of crowdfunding platforms—innovative credit scoring techniques—may extend access to credit, but it may also exacerbate the risk of over-indebtedness and discrimination. The real predictive value of alternative scoring models is yet to be tested through the credit cycle. While Big Data-driven credit scoring may be

shown to work for individuals over time, its value for credit assessment of complex business fundraisers remains unclear. In addition, platforms hesitate to fully disclose their proprietary algorithms, which they consider a part of their know-how and thus commercially sensitive. However, behind this secrecy, there are a number of privacy and data protection concerns, including transparency (what data are being used and where did they originate), consent (was permission provided), and access (can the consumer see their own data) (Miller and Jenik 2016), as well as the risk of discrimination and bias (U.S. Department of Treasury 2016).

C. Limited Access to Technology

While some countries have fairly high Internet penetration rates, the majority of Africa’s population does not have access to the web (www.internetworldstats.com/stats.htm). This makes it harder for entrepreneurs to reach potential international funders and to build a global network, thus foregoing some of the main advantages and opportunities of crowdfunding. This situation will improve as technology becomes more affordable, for example, according to one report, over half of the urban residents in Africa are online, and the price of basic smartphones has fallen below US\$100, making them accessible to the growing middle class (Manyika 2013).

A specific problem for developing countries is represented by the fact that payment systems impact the choice of platform. Most international crowdfunding platforms offer a limited number of payment options (e.g., a credit card, PayPal), hence excluding funders without access to these payment methods (World Bank 2015). Locally based platforms are likely to be better suited to engage in EMDEs, but they have a much smaller pool of potential contributors.

D. Lack of Awareness and Trust

Finally, another challenge for crowdfunding in developing markets is a lack of general awareness and trust. Because crowdfunding is a recent phenomenon, in many markets there is little overall awareness among potential users (funders and fundraisers) of this innovation. This is changing, however. For example, the

GeoPoll, GES, and the U.S. State Department African Entrepreneurship Survey 2015 found that 13 percent of respondents mentioned crowdfunding as a source of online funding (Mobile Accord 2015).

Table 2 summarizes the key benefits of crowdfunding, while highlighting important measures to put in place to address key challenges.

TABLE 2. Benefits of Crowdfunding in Financial Inclusion, Safeguards & Enabling Factors

		Benefits	Specific Conditions
SUPPLY	Debt	<ul style="list-style-type: none"> • Asset building, resilience enhancing • Portfolio diversification • Formalization of agreements • Digitization of existing schemes (collaborative financing) 	<ul style="list-style-type: none"> • Liability of the platform defined + skin in the game • Standardized due diligence (access to credit bureaus) • Standardized disclosure • Resolution regime (living will) • Funder education • Liquidity enhancement • Restrictions—profile, stakes • Guarantee mechanisms/diversification/portfolio management rules
	Equity	<ul style="list-style-type: none"> • Access to a new class of assets 	[Note: Equity crowdfunding does not seem to be particularly appropriate for BoP funders.]
		Benefits	Specific Conditions
DEMAND	Debt	<ul style="list-style-type: none"> • Fast access to loans • Access to cheaper loans • Ability to leverage social capital • Improving access to formal finance (creating credit history) • Democratization of finance 	<ul style="list-style-type: none"> • Rules to prevent over-indebtedness • Regulation of collection practices • Liability of the platform defined and skin in the game • Standardized scoring in place • Standardized disclosure in place • Resolution regime (living will) • Fundraisers education
	Equity	<ul style="list-style-type: none"> • Access to capital markets • Access to cheaper capital • Wisdom of the crowd • Access to professional investors • Democratization of finance 	Restrictions—legal form, type of business [Note: Equity crowdfunding does not seem to be particularly appropriate for BoP entrepreneurs.]

SECTION 5. NEXT STEPS

This paper summarizes the results of our initial mapping exercise aimed at shedding light on the crowdfunding phenomenon from the financial inclusion angle. Crowdfunding can potentially play an important role in financial inclusion by improving access to (digital) credit by unserved and underserved borrowers; creating cheaper, community-based insurance products; or facilitating access to digital investments by people who currently have limited or no options to get financial return on their savings, not to mention current barriers to access investment products.

The crowdfunding industry will deliver on its promise to promote financial inclusion only when a sound and enabling legal and regulatory framework is in place. Policy makers need to find a way to regulate crowdfunding so that it can achieve its market-building potential, while appropriately managing the risks that come with it. Platforms need to be subject to an appropriate regulatory regime that is adequately tailored to crowdfunding and adequately protects both funders and fundraisers. In the absence of such a framework, there is a risk that crowdfunding may worsen consumer trust in the very financial sector it was born to “revolutionize.” The recent issues faced by the industry (Ezubao in China, Lending Club in the United States) call for more coordinated approaches toward regulating and monitoring of crowdfunding. Several countries have already adopted a specific regulatory regime, but their approaches vary widely (IOSCO 2015a).

This paper addresses a broad audience because the topic requires engagement by multiple stakeholders. Standard-setting bodies in their respective domains should continue or start looking into regulatory and supervisory issues relevant to crowdfunding: Financial Stability Board from the perspective of shadow banking, Basel

Committee for Banking Supervision for areas where crowdfunding intersects with the banking industry, International Association of Insurance Supervisors for crowd-funded insurance, and Financial Action Task Force for issues relevant to money laundering and terrorist financing, to name a few examples. Other global bodies such as the G20/OECD Task Force on Financial Consumer Protection and the International Financial Consumer Protection Organization should contribute to this work and share their financial consumer protection expertise, particularly regarding consumer (digital) credit and protection of fundraisers.

We hope this paper provides a basis for further work, which should explore in more detail areas where crowdfunding may be of the highest relevance to financial inclusion. This paper provides background by defining crowdfunding, providing an overview of its evolution and ecosystem, explaining in detail the basic categories of crowdfunding, listing their key benefits and associated risks, describing the most recent trends, and highlighting benefits of crowdfunding for broadening and deepening of financial inclusion. Follow-up work, for instance, could focus specifically on the following issues:

- A more in-depth economic analysis of what the true competitive advantage of crowdfunding platforms is, how it plays out in different (economic and regulatory) contexts, and what implications it has on the potential of crowdfunding to serve excluded and underserved customers.
- The impact of crowdfunding on improved access of unserved and underserved customers to credit and other financial products.
- The potential of crowdfunding to supplement or substitute underdeveloped market-based finance in EMDEs.

- The adequacy of the legal and regulatory framework to address the risks faced by fundraisers and funders.
- Minimum regulatory standards for the industry and supervisory guidance for the responsible supervisory authorities.
- The risk or regulatory arbitrage, particularly in the light of the recent trend of institutionalization and hybridization.
- The level of customer awareness concerning the risks and benefits of crowdfunding.

ANNEX 1. EXAMPLES OF CROWDFUNDING PLATFORMS

1. Donation-Based Crowdfunding

1 Enable 40 people form a savings&loan association

A microproject by Mountains of hope childrens ministries **VETTED** **2**

3 \$25 raised of \$1,600 goal

1 donations 62 days left \$1,575 to go

Donate once Donate monthly

Enter donation amount (minimum \$10)

\$

4 DONATE NOW

VISA MASTERCARD DISCOVER AMERICAN EXPRESS PayPal JCB

View Other Payment Options

Donating through GlobalGiving is safe, secure, and easy with many payment options to choose from. [Learn more.](#)

ADD PROJECT TO FAVORITES

Share on Twitter Share on Facebook

Help raise money for this important cause by creating a personalized fundraising page for this project.

START A FUNDRAISER

5

6 \$1,600 total goal \$1,575 remaining 1 donor 0 monthly donors 28 days active

Summary
This project will support the communities in self-help micro financing initiative using Village Savings and Loans Association (VSLA) concept to mobilize financial resources to support livelihoods diversification. The scheme will also become a platform through which innovative technologies are disseminated to the masses.

Challenge
There is still a very large gap between the needs of the poor for financial services and the ability of banks to provide loans to the youth because they do not have security enough to enable them access bank loans. Community members will contribute start up income to the pool account, to enable them to start up their own financial service to loan them selves with out security, because this will provide the means by which the poor youth can invest their way out of poverty.

Solution
This project will equip 40 community members with knowledge for five days on how to save and

Legend:

1. The campaign objective
2. The certification indicating that the fundraiser has been subject to due diligence by the platform
3. Indication of the threshold, amount raised and time remaining
4. Payment methods available to donors
5. Information about the campaign, fundraiser and other disclosure
6. Indication of the threshold, amount raised and time remaining

Source: Kiva

2. Reward-Based Crowdfunding

1 Project Info Personal Info Payment and Processes Info

2 **General Info**

Financial goal
 Be realistic! So that you can offer the right rewards and mobilize support!
 \$ USD

Funding period
 You will receive raised funds within **20 working days after your project funding period ends.**
 40 days

Main category
 Choose category

Title Español English Português
 Make it simple and creative! 30

Summary Español English Português
 140

3

Upload image

tester
 Estados Unidos

raised \$ 0 USD

40 days 0

4 **The project**

Video
 In no more than 2 minutes tell who YOU are, what you hope to achieve and why. **The video is optional**, but we recommend you to create one to stand out from other projects.

IMPORTANT: Its Important to comply with the content rules and give an overview of your project!

Please upload your video to Youtube or Vimeo and copy the link here

You can publish your project and then use the [Admin Page](#) to add or change your video!

Additional Images
 Include images that help the community get to know your project and you (examples: sketches, photos, illustrations, where you work, pictures of YOU). **Minimum of 1 image and a maximum of 30 (file size max 2MB)**

Add image

Project description Español English Português

Recommendations

- ✓ Be transparent y inspire trust.
- ✓ Show that you are executing your project
- ✓ Put yourself in the shoes of your community and think carefully about what they'd like to know about your project.
- ✓ Ask your friends for feedback – make the creation process collaborative!
- ✓ Translate it to different languages to reach a broader community!

Legend:

1. Three steps to set up a campaign
2. Key features of the campaign
3. Beneficiary's profile
4. Information about the project

Source: IdeaMe

3. Debt Crowdfunding

The screenshot displays the Crowdo platform's bidding engine. At the top, there are navigation tabs: LEARN, MAKE, APPLY, INVESTING, and BORROWING. The main header features a promotional banner with the text 'Invest and earn solid returns while supporting local economy' and 'You can invest as little as IDR 500,000'. Below this, a blue bar encourages users to 'Start investing now!'. The interface includes filters for Grades (A, A+, A, B, C, D) and Term (3, 4, 5, 6, 9 months). A 'BIDDING ENGINE' button is prominently displayed. A table lists investment opportunities with columns for Loan ID, Return, Target Amount, Available For Bid, Collateral, Term, Progress %, and Time Left. A detailed view of a specific loan (CWD0011860) is shown at the bottom, including its return rate (13.2%), target amount (IDR 5,000,000), and progress status (90% Complete).

Investment	Loan ID	Return	Target Amount	Available For Bid	Collateral	Term	Progress %	Time Left
My Bid: IDR 0 in units of 1000 IDR	CWD0011860	A 13.2%	IDR 5,000,000	IDR 500,000	Jewelry	6 months	90% Complete	7 days
My Bid: IDR 0 in units of 1000 IDR	CWD0011855	A 13.2%	IDR 5,000,000	IDR 500,000	Jewelry	6 months	90% Complete	7 days

Loan ID	Return	Collateral	Term	Progress %	Time Left	Rating
IDR 5,500,000	16.2%					C
IDR 7,000,000	16.2%					C
IDR 9,500,000	15.0%					B
IDR 7,500,000	15.2%					B
IDR 7,500,000	15.2%					B
IDR 9,000,000	15.2%					B
IDR 6,500,000	15.0%					B
IDR 6,500,000	15.2%					B
IDR 6,500,000	16.5%					D

Legend:

1. The funder's main dashboard
2. The list of loan asks
3. The borrowers' credit rating provided by the platform
4. Detail of the loan ask, including the downloadable fact sheet with more details about the borrower

Source: Crowdo

4. Equity Crowdfunding

The screenshot shows the SEEDRS website interface for the SoundOut campaign. The top navigation bar includes 'INVEST', 'RAISE', and 'MORE' options, along with a 'Profile completeness: 20%' indicator and a 'LOGOUT' button. The main content area is titled 'SoundOut' and includes a company logo, a brief description of their business, location (Reading, United Kingdom), and website (www.soundout.com). Key financial metrics are displayed: 'INVESTMENT SOUGHT: £600,001', 'EQUITY OFFERED: 5.88%', and 'INVESTMENT ALREADY FUNDED: £284,931'. A progress bar indicates that 47% of the investment goal has been reached. Below the main content, there are tabs for 'Idea', 'Market', 'Team', 'Updates', 'Investors' (with a count of 53), 'Discussion', and 'Documents'. The 'Introduction' section is highlighted, showing the start of the campaign text: 'Our retail clients say we 'predict' the future, but we prefer 'compute'...'. At the bottom, a legal disclosure is provided regarding the U.S. Securities Act of 1933.

1

SEEDRS INVEST RAISE MORE ▾ Profile completeness: 20% ▾ LOGOUT

★ SoundOut ◀ BACK

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Introduction **2**

Our retail clients say we 'predict' the future, but we prefer 'compute'...

In accordance with Regulation S under the U.S. Securities Act of 1933, as amended (the "Securities Act"), the securities described in this campaign have not been registered under section 5 of the Securities Act. The securities therefore may not be offered or sold in the United States or to U.S. persons (other than distributors) unless the securities are registered under the Securities Act or are exempt from registration under the Securities Act. Hedging transactions involving the securities may not be conducted unless in compliance with the Securities Act. **3**

Legend:

1. The summary offer
2. The detailed information about the offer
3. Disclosure

Source: Seedrs

ANNEX 2. EXAMPLES OF CROWDFUNDING PLATFORMS SERVING EMDES

BOX A2-1. Examples of Platforms Targeting EMDEs

Babyloan—a French platform aimed at small entrepreneurs without access to the banking system and committed in the fight against poverty. It has recently partnered with Total to develop the first crowdfunding platform dedicated to access to energy. The collaboration aims to support the creation of local microbusinesses that will develop distribution networks to cover the last mile to reach isolated communities in Africa, Asia, and Latin America.

Cheetah Fund—was a €400,000 fund that partnered with the 1 percent Club Netherlands (a crowdfunding platform) aimed at supporting African start-ups to kick-start or boost their projects. If borrowers managed to crowdfund at least 30 percent of their target amount via 1 percent Club within 30 days, the Cheetah Fund then granted them the remaining amount.

Farmable.me—a Ghanaian crowdfunding platform that aims to provide money to solve the country's dependency on imported beef. By investing in a cow through the Farmable website, online investors become "CowBackers," and they are connected to their own cow on a real farm in Ghana. Every cow costs US\$500 and is made up of "cowshares." CowBackers can choose to fund a full cow or invite friends and family to share a cow, also known as "CowSharing."

Homestrings—a platform that allows overseas diaspora to invest in their home countries in market projects, including commercial real estate, telecoms, and SMEs. Homestrings recently started to offer development impact bonds, which provide upfront funding for development programs by way of private investors, who earn a return when specific preagreed outcomes are achieved.

Ketto—an Indian platform, where each borrower is assigned a manager who helps the borrower raise money. Moreover, to facilitate investor donation, it partners with a courier service to offer cash pick-up, tapping into India's cash culture.

Kiva—a nonprofit platform for P2P lending to underbanked microentrepreneurs. It operates in 80 countries with 300 "field partners," mostly MFIs. Lenders choose from borrowers' online profiles and lend for zero financial return. The pooled funds are disbursed to borrowers through local MFIs.

M-Changa—a Kenyan platform designed to resemble "Harambee," a tradition of funding friends' and family members' ventures to enhance this tradition by providing secure communication and record keeping capabilities for unprecedented end-to-end transparency. M-Changa has integrated mobile money and credit card payments, SMS, email, social networks, and geo location.

MYC4—a platform that allows investors to invest in SMEs in Africa. Once the project is approved by MYC4's local partners, prospective investors participate in an online auction where they bid the amount they wish to lend and at what interest rate. The investor offering the lowest interest rate ends up lending money to the business when the auction is over.

Orange Collecte—a mobile crowdfunding platform in Côte d'Ivoire launched by mobile network operator Orange. With this platform, private individuals and charities can finance their personal (weddings, birthdays, etc.) and charitable projects by making an appeal through their mobile network. Investors can then use their Orange Money electronic wallet to donate money.

United Prosperity—a nonprofit platform operating in Sri Lanka that partners with MFIs to offer funding solutions and reaches more unserved clients. The 0 percent interest capital raised on the platform is used by borrowers as cash collateral at local banks, and is not an actual loan, thus incentivizing banks to make loans to MFIs. Between 2009 and 2013, the platform has facilitated more than US\$280,000 in loans to 1,300 families (Aveni 2015).

Zidisha—a P2P lending platform, performing basic underwriting and sourcing borrowers through volunteers. Typical loans are charged 0–15 percent of the principal amount, but borrowers are able to decide specific conditions (such as loan terms and repayment frequency).

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