

tonic



EUROPEAN
CROWDFUNDING
NETWORK



crowdfunding for **impact** in europe and the usa

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toniic

is a global network of action-oriented impact investors, both individuals and institutions. We increase the velocity of money and services into impact investing to address global challenges. Our members commit to discover, evaluate, nurture and invest in entrepreneurs, enterprises and funds that promote a just and sustainable economy.

Toniic has members in over 20 countries and its members have invested in over 15 countries.

the european crowdfunding network AISBL (ECN)

is a professional network promoting adequate transparency, (self) regulation and governance while offering a combined voice in policy discussion and public opinion building, incorporated as an international not-for-profit organisation in Brussels, Belgium. We aim to increase the understanding of the key roles that crowdfunding can play in supporting entrepreneurship of all types and its role in funding the creation and protection jobs, the enrichment of European society, culture and economy, and the protection of our environment.

In that capacity we help developing professional standards, providing industry research, as well as, professional networking opportunities

foreword

Toniic and the European Crowdfunding Network are delighted to publish this brief on crowdfunding for impact.

Although many research papers focus on crowdfunding or impact investing, very few explore how crowdfunding can scale debt or equity impact investing. Yet there is a strong fit between the two--and there is an undeniable need and significant opportunity for social entrepreneurs to leverage online platforms to access investors, and for investors to access greater dealflow.

This report illustrates the progress of crowdfunding for impact in the EU and the USA, while also highlighting risks and regional regulatory differences. Our brief also highlights case studies of successful online impact investments.

Despite inherent risks, we remain optimistic on the future of crowdfunding for impact.

The sector of impact investing is ripe for technological innovation capable of attracting capital beyond accredited investors and large institutions, and making impact investing for all a reality.

In a world where impact investors often refer to the "lack of investable deals" and where entrepreneurs are frustrated by the hardships of fundraising and the lack of "impact capital," could crowdfunding offer the clearinghouses and marketplaces we have been waiting for?

We hope you will enjoy this brief and look forward to your comments (@ToniicNetwork)!

Stephanie Cohn Rupp
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crowdfunding for impact in europe and the usa

This report has been prepared by the Toniic Institute in partnership with the European Crowdfunding Network. It seeks to frame the opportunity for cooperation between impact investing and the equity and debt crowdfunding sectors in the US and Europe.

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1 introduction

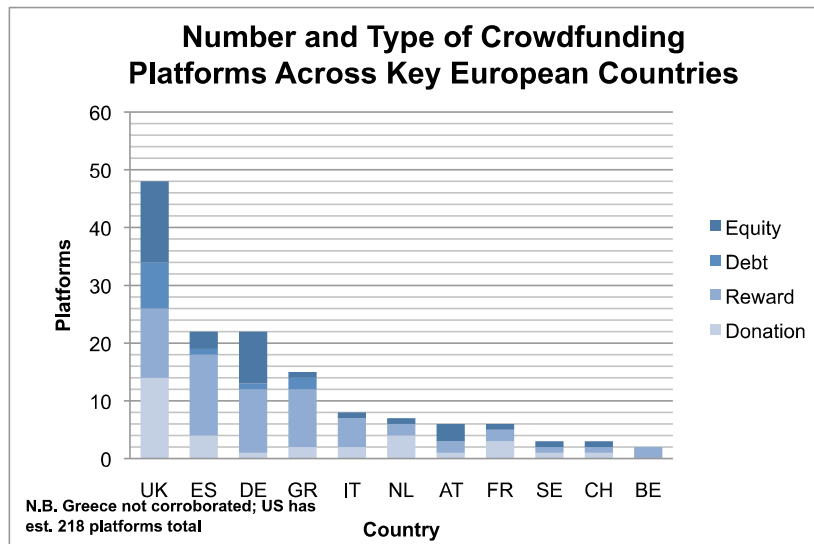
Crowdfunding is a collective resource-pooling practice used to finance individuals, companies, organizations, funds, projects, products or groups. This process operates via online marketplaces and electronic payment. These platforms aggregate rather small amounts of capital in a limited time-frame from many individuals who share a common interest in a specific idea, project or business. There are four main models of crowdfunding: equity, debt, reward and donation-based (see Table 1 below). The sector has experienced incredible growth since 2010, though national crowdfunding markets vary considerably in size (Chart 1).

TABLE 1 – MARKET OVERVIEW

Total Crowdfunding Market (2012)					
Type	Description	Size (\$m)	Mkt Share	Growth (p.a.)	≈ Size (\$m) 2013
Equity	Investors receive a stake in the company	116	4%	30%	166
Debt	Investors are repaid with interest over a given time period	1,170	44%	111%	2,100
Reward	Investors receive a tangible item/service in return for their funds	380	14%	524%	1,400
Donation	Contributions go towards charitable causes	980	37%	43%	1,400
TOTAL		2646			5066

Source: Crowdsourcing.org and GoGetFunding

CHART 1 – GEOGRAPHIC OVERVIEW



Source: Crowdfund Insider and Ikosom

More than one million campaigns are estimated to have raised \$2.7 billion worldwide across all types of crowdfunding platforms in 2012. This figure is expected to reach \$5.1 billion in 2013, almost double the 2012 figure. To date, the most active segments of this market worldwide are Arts (all types) (27.7%), Social Causes (27.4%), Business and Entrepreneurship (16.9%), and Energy and Environment (5.9%) (Massolutions 2013).

Given these trends, the impact investing community is showing interest in equity and/or debt-based crowdfunding as a tool for harvesting more impact opportunities. Impact investments are “made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside financial return” (GIIN). The J.P.Morgan and GIIN report, Impact Investor Survey – Perspectives on Progress (2013), estimates that the impact investment industry almost doubled in size between 2007 and 2012, going from \$4.3 billion to \$8 billion; it is estimated to advance to \$400-1000 billion by 2020. Of the 99 firms surveyed for the above data, 83% reported using private equity investment instruments and 66% use private debt. Fifty-six percent are based in the USA while 27% are based in Europe (J.P.Morgan & GIIN, 2013). Given these broad trends in geographic location and choice of investment instruments, there are strong signs of compatibility between equity or debt-based crowdfunding and impact investing.

2 crowdfunding: framing the opportunity

2.1 crowdfunding and the democratization of capital

One of the many perceived outcomes of equity or debt-based crowdfunding is the democratization of capital. The phrase was originally used with reference to the microfinance revolution. Now, with the JOBS Act in the USA enabling unaccredited investors (individuals with annual income less than \$200k per year or net worth less than \$1 million) to participate in equity or debt crowdfunding in the USA, the phrase has been re-branded. In a presentation to the European Commission in June 2013, Christian Saublens, Director of EURADA, listed several advantages to this democratizing process in crowdfunding. The benefits of crowdfunding can be summarized as follows.

1. Entrepreneurs using crowdfunding can benefit from any of the following advantages, depending on the platform they use, the type of crowdfunding they engage in and the way the structure their campaign:
 - Favorable funding terms thanks to an open, market-driven valuation of their project-contrasting with traditional investment negotiations usually marked by information asymmetries and exclusivity.
 - Lower transaction costs thanks to platforms using business models based on margins from a high number of transactions, compared to traditional investors who seek out

only a small number of potential out-performing investments.

- Product, price and market validation through open customer feedback and peer review systems on platforms promoting interactive exchange of knowledge.
- A dedicated consumer and word-of-mouth marketing base obtained by engaging early on with potential customers and supporters of the project.

2. Private investors can use crowdfunding to access benefits such as:

- Emotional connection and close identification with the enterprise, its team and goals, both prior to investment and during the investment period.
- Low-cost portfolio diversification across sectors or even multiple platforms.
- Due diligence and quick background checks on entrepreneurs and projects using public data available through social media and elsewhere, as well as commentary and feedback on the project on crowdfunding platforms.
- Opportunities to be an active investor by providing and reviewing comments and other input at all stages of the funding progress.

3. Professional investors can use crowdfunding to extend their existing portfolio, enjoying the following advantages:

- Social proof of an investment opportunity, product validation and measurable market reaction without additional cost.
- Built-in due diligence process by the crowd, verifying the background of projects and teams.
- Financial resources from crowd co-investment and sharing of financial risk.
- Expertise and advice from the crowd or individual co-investors benefiting project management during the investment period.

In keeping with the principle of democratization of capital through crowdfunding, Toniic is pioneering the notion that equity or debt-based crowdfunding can be a tool to democratize impact investing. We will discuss this in greater detail in Section 3 of this paper.

2.2 investor challenges

Despite its numerous perceived advantages, equity or debt crowdfunding also presents a number of challenges for investors:

Fraud—critics assert that the crowdfunding space may become an easy target for fraudsters after the advent of more liberal financial regulatory frameworks. However, since liberal changes to the financial regulatory frameworks have not yet materialized, this point is difficult to verify. For now, the European Crowdfunding Network points out that social media can be used by investors to run background checks on prospective teams and investments, and that a solid vetting process is becoming an expected component on every competitive crowdfunding platform.

Valuations—setting valuations enables an entrepreneur to decide how much equity to offer for the amount of capital required. If this is done prior to the campaign it can lead to under- or over-valuations due to false assumptions about intellectual property and market size and scale. In order to allow for a market-based valuation, some platforms allow flexible equity offerings, while others operate bidding systems on equity or shares.

Follow-up—communicating with a large group of disparate stakeholders is difficult, particularly if they all have equal voting powers. This can be problematic during price negotiations regarding follow-on investments or exit. While some crowdfunding platforms mitigate this problem through the use of special-purpose vehicles to pool the crowdfunders, others apply proportional voting rights. In general, good managers should be able to manage a large and disparate group of investors.

Investor risk—the protection of retail investors from excessive risks is a potential problem. One answer to this is the introduction of reliable standards for controlling data in investment pitches and metrics for the risk carried by investors. The notion of acceptable risk in crowdfunding will be difficult to monitor with crowdfunders. However, investor protection is likely to be applied across all geographies, and information and education guidelines are already included within those regulations.

Business impact—achieving transparency over the allocation of invested funds may be difficult, since crowdfunding addresses private markets without standardized reporting systems. Investors should demand guarantees that the companies they invest in are doing their best to ensure that there are no negative social and/or environmental externalities from their product/service across the entire supply chain. Crowdfunding platforms can include relevant criteria in their own due diligence.

In view of these challenges, a healthy degree of self-regulation and transparency will be crucial to the future of crowdfunding.

2.3 entrepreneur challenges

The protection of entrepreneurs in equity and debt-based crowdfunding has been a subject of some concern, and it seems this aspect of crowdfunding requires more attention. In an interview, Deborah Burand, Director of the University of Michigan's International Transactions Clinic, draws on extensive experience in the microfinance industry to articulate this issue. She states that regulators, commentators and platforms alike have not devoted sufficient efforts to protecting financially inexperienced entrepreneurs from debt traps and exposure to unknown liabilities. Burand's concerns pertain to the following areas:

Financial Management—can entrepreneurs manage the different types of financing available through crowdfunding platforms? Are they offering too much equity for the

capital they are soliciting? Are they subjecting themselves to prohibitively high interest rates? Do they have the resources to manage debt repayment in the first place? To preempt these problems, entrepreneurs could undergo protective screening by crowdfunding platforms, including an interview and an integrity analysis.

Reputation Management—are entrepreneurs capable of managing their reputation online? A real concern for entrepreneurs is the possibility that an individual client, shareholder or competitor could smear their reputation through social media and other web channels. Protecting entrepreneurs against undue reputation damage should be one of the value propositions of competitive equity and/or debt-based crowdfunding platforms.

Business impact—do entrepreneurs have full supply-chain oversight and can they guarantee the social and environmental neutrality or positivity of their product/service? Both achieving this and reporting on it can be resource-intensive. Competitive, impact-oriented crowdinvesting platforms should establish a minimum standard of social and environment responsibility. This would serve as a value proposition for investors and quality endorsement for entrepreneurs.

2.4 crowdfunding models

Crowdfunding platforms generate revenue by charging a fee to the company raising capital or to those investing in that company. In addition, most equity-based crowdfunding platforms have a vested interest in the business in the form of shares. For this paper we will focus on equity and debt crowdfunding only. This is not to say that reward crowdfunding, especially pre-sales, or donation crowdfunding have no potential use for impact investing, but they do not allow the allocation of funds against a financial return.

2.4.1 equity

Equity crowdfunding is similar in structure to traditional private investments. Equity crowdfunding (or crowdinvesting) is used when an entrepreneur or business sets out to attract investment from a group of people instead of a business angel or other private investor. Equity crowdfunding is usually subject to capital markets and banking regulations and is therefore restricted in terms of funding amounts, geography and marketing possibilities – potentially limiting the possibility of impact initiatives being funded via equity crowdfunding.

Some funders are primarily interested in investing in projects that share their own values, that are locally engaging, and that achieve a certain impact or create jobs in their community. Others have a real knowledge of the market and seek to bring funds and expertise to the success of the project. Equity crowdfunding generally includes equity-like arrangements.

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The most widely adopted model is to charge the company raising capital transaction fees averaging 5% if their target is successfully reached. In addition, most platforms also charge a listing fee of up to 5% as well as a fixed annual, monthly or one-time sum labeled as compensation for due diligence, legal and/or compliance costs.

Many equity crowdfunding platforms operate a performance-based carried interest model, either alongside transaction fees and fixed costs, or independently of them. Typically, carried interest is charged at 3-10% for platforms prioritizing deal quantity over quality, and up to 20 or 30% for models with an imperative on deal quality. Table 2 displays overview information on a small selection of players in the equity crowdfunding market.

TABLE 2 – SAMPLE OF EQUITY CROWDFUNDING MARKET IN THE USA AND EUROPE

Name	Country	Key Metrics				Fees		Sectors
		Members	Ø Size (€k)	Biz Funded	€k Funded	Business	Investor	
Crowdfunder*	USA	19,000	1,320	6	n/a	10% of raise	n/a	Impact
Seeds.nl	NL	n/a	28	3	85	n/a	n/a	Impact
Impact Crowd	NL	350	n/a	2	n/a	n/a	n/a	Impact
GrowVC	USA	n/a	n/a	n/a	35,000	2.5% of raise	n/a	Cross-sector
CrowdCube	UK	40,000	213	58	12,250	€2k fixed rate plus 5% of raise	n/a	Cross-sector
WSeed	France	16,400	208	26	5,410	10% of raise	5% of investment	Cross-sector
FundedByMe	Sweden	4000+	228	11	2,514	5% of raise	n/a	Cross-sector
Companisto	Germany	6,968	116	16	1,970	n/a	n/a	Consumer & Services

*does not allow equity crowdfunding but operates as a market place for accredited investors for equity

Source: Organization websites

2.4.2 lending/debt

With debt crowdfunding, a company will borrow money from a group of people instead of a bank. Crowdfunding platforms with this model can function in a variety of ways. The main motivation for the funder is a (higher) financial return. The interest rates are usually based on the risk factor, which is calculated based on financial data and personal securities.

Debt crowdfunding is similar in structure to traditional private market lending schemes. Lenders offer a principal with an expectation of financial gain. Risk is mitigated according to portfolio theory by providing very small amounts of finance to any given project and therefore distributing the total crowdfunding allocation over a large number of projects.

Debt crowdfunding platforms tend to charge lenders a fee of 1-7.5% per loan. Annual percentage rates can vary hugely, but generally speaking, lenders receive interest of 5-12% per year (see Table 3 below for information on a number of selected lending platforms).

TABLE 3 – SAMPLE OF BUSINESS AND PROJECT DEBT-BASED CROWDFUNDING MARKET IN THE USA AND EUROPE

Name	Country	Key Metrics			Fee	APR	Ø Inv. Int. Rate	Sectors
		Members	€k Funded	€k Range				
FundingCircle	UK	49592	150000	up to 1150	2-5% closing	7-9%	0.058	Cross-sector
ThinCats	UK	1819	36160	from 50-1000	n/a	11%	6.5-16.8%	Cross-sector
isePankur	Estonia	24492	3990	from 0.1-10	2.9-4.9%	26%	0.2	Cross-sector
Mosaic	USA	n/a	3870	n/a	1% per year	n/a	4-8%	Solar Energy

Source: Organization websites

2.5 crowdfunding and the liquidity crisis

Small and Medium Enterprises (SMEs) were among the first to rush into the credit vacuum following the collapse of the subprime market in the USA in 2008. In Europe, SMEs account for 99% of businesses and 67% of all employment, according to the European Commission. According to the European Central Bank, the availability of bank loans and the banks' willingness to lend to SMEs declined sharply after 2008 by 23% and 29% respectively. Over the same period, the value of required collateral increased by 34% and interest rates increased by 54% for SMEs. Bank lending may not return to 2008 levels for another four years. In wealthier economies such as France, Germany, Italy, Spain and the UK, the funding gap is expected to increase to EUR 2.5 trillion by 2020, while most economies with less developed financial markets suffer from even greater gaps.

As a result, the entrepreneurial infrastructure has been eroded. Under these circumstances SMEs are falling back onto local communities, family and friends for a supply of credit. Loyalty networks have become intrinsic to businesses' survival. In addition, the squeeze on credit has been mirrored by a consequent squeeze on innovation. This should be, and has increasingly become, an urgent concern for the European and American public and policymakers.

Crowdfunding is not the sole solution for the current global economic decline, but it is a vital and valid source of optimism for entrepreneurs and investors alike. In Europe, \$945 million were raised through all crowdfunding platforms in 2012, while in the USA this figure was \$1.6 billion – with an estimated total market of over \$5 billion for 2013, according to Massolution (2013). Crucially, the median size for equity crowdfunded deals in 2012 was \$190,000 and for debt-crowdfunded deals, this figure was \$4,700 per deal. In the USA, however, the overdue SEC-JOBS Act ruling is delaying the anticipated watershed in retail investor and entrepreneurial activity through crowdfunding. Similarly, in Europe, where equity crowdfunding is mostly legal and practiced, regulatory barriers restrict the sector's further development. Doubts remain especially regarding the standing of equity and debt crowdfunding in relation to new national interpretations of the Alternative Investment Fund Managers Directive (AIFMD), which was implemented by European Member states in mid-2013. Additional hurdles include national interpretations of the Prospectus Directive

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and the Markets in Financial Instrument Directive (MiFID II), since crowdfunding platforms generally do not comply with European rules at this time but use national regulations to reduce costs and efforts required for compliance.

Regardless of the regulatory framework, however, the theoretical advantages of equity and debt crowdfunding for our current economic system are far-reaching and fundamentally stabilizing. This reality was highlighted in A Framework for European Crowdfunding (European Crowdfunding Network 2012) which proposes solutions applicable to the global financial sector.

- System resilience – the opportunity to create a diversified financial system has already been demonstrated in Europe and the USA, with an estimate of more than 500 crowdfunding platforms between the two regions. By expanding the concentration of wealth from traditional financial services to inter-connected crowdfunding networks, any future financial shocks may be dissipated thanks to a larger, more defensible footprint.
- Real rates and prices – Rates and prices on equity and debt crowdfunding platforms fluctuate according to crowd demand rather than the perceived interest of a few financial experts, whose assumptions are not necessarily reflective of economic reality.
- Funding diversification – SMEs and investors are able to diversify their respective funding sources and destinations in terms of both sector and geography. Risk is reduced, value is spread, credit shortages are avoided and disruptive SMEs have a greater chance of achieving growth.
- Financial stability – crowdfunding generates the possibility for investors to receive a tangible return. This makes it less likely that funding flows will stop since tangible returns from investment opportunities have been shown to motivate the crowd.
- Big data – crowdfunding platforms are capable of developing real-time Big Data (wide-reaching market information) for socio-economic trends and patterns, according to Sherwood Neiss. Therefore, cooperation with the public sector could lead to a more efficient allocation of public funds and incentives based on crowd activities. This has already come to pass in certain contexts. For example, the allocation of £85 million by the UK Government’s Business Finance Partnership scheme to fund SMEs is largely proceeding alongside the crowd’s actions via platforms such as Funding Circle, Market Invoice, Urica and Zopa (UK Department for Business, Innovation & Skills, 2013). In addition, there are great possibilities for increasing social mobility and business productivity through the democratization of Big Data which will underpin “new waves of productivity growth, innovation, and consumer surplus” (McKinsey Global Institute, 2011).

2.6 regulatory barriers and possible solutions

Regulation and legislation should aim to protect investors while stimulating market efficiency and transparency. Today, such markets cannot emerge in the field of equity and debt crowdfunding in the USA or Europe, because incumbent investor protection regimes exclude a large number of potential investors. Of course, these investor protections are in place for good reason and generally result from market failures. However, crowdfunding provides new and different opportunities to ensure transparency and protect investors, and widespread recognition of this potential has elicited discussion on both sides of the Atlantic about adequate crowdfunding regulation. However, the estimated size of the market has not yet motivated regulators to focus on crowdfunding as such.

There are two facets to this discussion. On one hand, efficient growth in equity and debt crowdfunding continues to be constrained by inadequate and/or incomplete regulatory environments in the USA and Europe. On the other hand, some commentators consider that there is also a market-side problem—namely, the unwillingness of crowdfunding platforms to engage complex regulatory proceedings. Both of these concerns are valid and constitute obstacles. The existing regulatory framework does not allow innovative startups with a small budget to scale their business in the crowdfunding sector. At the same time, large financial institutions possessing the financial and administrative resources to deal with existing, complex regulatory frameworks see little attraction in managing the low-margin, small-value and high-volume activities characteristic of crowdfunding, and their reticence is likely to continue until the business model has been proven by scaling up those small startups.

In the USA, the SEC has yet to finalize the long-awaited Title III (crowdfunding) component of the JOBS Act. This has kept the market at a relative standstill as crowdinvesting platforms function more like Angel Networks as long as they can only accept accredited investors. In the meantime, the volume and diversity of pre-launch US crowdinvesting platforms is blossoming. Key areas of interest in relation to the SEC rules are:

1. SEC and FINRA registration and disclosure requirements for the platform
2. Terms and conditions for unaccredited investors
3. Registration and disclosure requirements for the company seeking to raise
4. Offering threshold for SEC registration
5. Tax audit requirements for raises of more than \$500k
6. Investor verification processes and privacy issues under Title II of the JOBS Act

In Europe, crowdfunding is largely regulated by national law, as most platforms circumnavigate pan-European legislation due to the high administrative and financial costs involved. Thus, in practice, 28 different legal frameworks for crowdfunding coexist in a single market. This fragmentation of the European Union, a result of failed European harmonization in favor of national and member state interests, is the key hurdle for crowdfunding. As long as this situation persists, cross-border transactions will remain impossible or prohibitively expensive for SMEs, and the real value of the common market will be unavailable to them, as well as to crowdfunding. Potential investors are currently excluded from crowdfunding opportunities solely based on their geographic location within the Union. The main areas of interest in the European economic space are:

1. Regulation around the marketing of private equities and the promotion of crowdfunding campaigns
2. Corporate law restrictions regarding the ability to offer equity to crowd investors at a reasonable cost
3. Regulation of reclaimable funds, i.e. of credit institutions
4. Collective investment undertakings as dealt with in UCITS and AIFM directives
5. Regulation of business practices and transaction structures as dealt with in MiFID and MiFID II

Most commentators have noted the prohibitive compliance costs and legal fees involved in international regulations and many are urging the European Commission to produce a pan-European regulatory framework in order to allow the sector to grow. For others, however, including ImpactCrowd CEO Enrique Aparicio, expectations of a centralized framework are unrealistic in the context of the plethora of national regulatory bodies. Mr. Aparicio sees these complexities as an “opportunity for quality platforms to distinguish themselves from the competition.” In other words, only the best platforms will find the investor backing and management proficiency required to operate within the various national frameworks. This, in turn, could lead to an all-round reduction of the risks discussed above in section 2.1.

Again, there is a measure of truth in both positions. For a single market to enable pan-European investment through crowdfunding, leading to globally competitive crowdfunding platforms, a pan-European approach and harmonization are necessary (indeed, the same is needed in the USA, as is envisioned under the JOBS Act). But due to the political realities, this must remain a mid-term goal. The European Commission has been gathering data and launched a public consultation in the third quarter of 2013 to establish a more reliable knowledge base for its own work. The European Commission has announced that it will make a public statement in early 2014 and is likely to issue soft measures in order to motivate member states and industry to exploit existing frameworks. It is therefore likely

that in the short term, platforms will have to exploit existing national regulation to establish themselves as leaders within their national market and industry sector or to make the relevant investments to become compliant with European or multi-national regulatory hurdles.

It should be noted, though, that some European countries have already moved forward in order to better enable crowdfunding. Italy's financial regulation authority, CONSOB, has introduced specific equity crowdfunding laws. The Austrian Parliament has raised the ceiling for the marketing of private equities and the promotion of crowdfunding campaigns. In fact, additional adjustments are expected in Austria, after the national elections in the fall of 2013, due to pressure from a citizens' initiative and the Austrian Chambers of Commerce. Further national regulation is being discussed and crowdfunding has entered the political programme following the elections in autumn 2013. The same is true for Germany, where crowdfunding has been included in the coalition agreement of the ruling parties, with further action to be developed. For example, in France and the UK a public consultation was launched in the third quarter 2013 with a final proposal for regulation to be made in early 2014. In the Netherlands the government has indicated that it will make funds available in order to further the crowdfunding industry. Still, overall this shows an officially unsupportive environment in both the USA and Europe, with developments that spell great improvements to come in the future.

As Table 4 demonstrates below, the SEC is expected to be broadly supportive of equity and debt crowdfunding while protecting retail investors against excessive risks. In Europe, although the regulatory framework is fragmented along national lines, there is still a competitive environment for equity or debt crowdfunding platforms.

TABLE 4 – REGULATORY FRAMEWORK FOR EQUITY AND DEBT-BASED CROWDFUNDING IN EUROPE AND THE USA

Country	Legal	Investor Limits	Prospectus Requirements	FA Registration Requirements	Inv. Fund/Trading System Dfn.	Payment Services Regulation	Consumer Credit Regulation
USA	No	≤\$2000 or 5% annual income if <\$100,000 10% annual income if >\$100,000 Max. \$100,000	Exemption for offers <\$50m per 12 months. Disclosures to be avail min. 21 days before offering.	Intermediaries, 'funding portals' must register with SEC and FINRA. Shareholder threshold increased to 2000.	Weekly report of volume info using MPID to FINRA	FINRA authorisation is likely to be required	Consumer credit license required if borrowers permitted.
UK	Yes	Platforms must conduct 'professional investor' appraisals	Exemption for offers <€5m per 12 months	Registration with FCA, regulated if exemption limit is exceeded. No Collective Investment Schemes for retail investors.	€100m exemption from AIFMD	Exemption of 'Commercial Agents' likely to apply to operators.	Consumer credit license required if borrowers permitted.
Germany	Yes	Anyone can invest	Unlicensed platforms offer silent partnerships. Exemption for offers ≤€100,000/ per 12 months	Financial services with commercial scale require registration with BaFin.	Startups and subordinated loans do not fall under AIFMD, project finance might.	BaFin authorisation required, 'Commercial Agent' exemption not applicable	Consumer credit license required if borrowers permitted.
Netherlands	Yes	Anyone can invest	Exemption for offers below €2.5m/12 months	Platforms must register with AFM	Crowdfunding platforms not AIFMD. Subordinated loans not AIFMD.	AFM authorisation required.	Consumer credit license required if borrowers permitted.
Italy	Yes	Anyone can invest. Professional investors take min. 5% of share offering.	Exemption for offers <€5m per 12 months	Operators with financial back-grounds are exempt but must register with CONSOB.	Crowdfunding platforms not AIFMD. Subordinated loans not AIFMD.	CONSOB authorisation required.	Consumer credit license required if borrowers permitted.

Source: European Crowdfunding Network (October 2013): Review of Crowdfunding Regulation 2013.

3 crowdfunding for impact

A functional relationship has existed between crowdfunding and impact for years. All over the world, financial collectives use centuries-old collective management techniques to increase the security of participants. Similarly, although microfinance, as founded in the 1980s, was financed by foundations, financial institutions and high-net worth individuals (rather than “the crowd”), the principles of democratizing credit were at the root of the industry’s philosophy. The ensuing years have seen a synergy between fair interest rates, community or collective responsibility and an impetus on finance for women, proving the creditworthiness of the world’s poor and marginalized people. In the modern context, we see a rise in demand for the democratization of capital, since public faith in traditional finance, and banking in particular, has disintegrated. Indeed, this may well be the reason that crowdfunding platforms have gained rapid traction in economically unstable regions such as Eastern and Southern Europe.

The microfinance concept’s adaptation to the crowdfunding model has exceeded expectations. Kiva, the pioneering crowdlending platform, has facilitated the loan of \$456.5 million to over 1 million people, who uphold an unprecedented repayment rate of 99.01% (Kiva 2013). Furthermore, donation- and reward-based crowdfunding for impact have also shown astonishing results; an estimated \$960 million was raised for social causes, energy and the environment in 2012 (Crowdfunding Market Grew 81%, in 2012, finds Massolution Report, 2013). JustGiving, a leading global donation-based crowdfunding platform, has facilitated the donation of around \$2.3 billion from 21 million people to 13,000 charities since its 2001 launch (JustGiving 2013). While we are hesitant to assume that these large sums are indicative of a large social or environmental impact, we acknowledge the social proof in favor of the concept of crowdfunding for impact.

A positive pattern is also emerging for the workability of equity and debt crowdfunding for impact. Commenting on the pros and cons of different types of funding, Aparicio believes that “the expertise and network of impact angel investors is highly complementary to the enthusiasm and virtually unlimited resources of the crowd” (2013). The crowd, for example, may be called upon to complete rounds of investment led by impact investors—a practice that is already commonplace among certain European equity crowdfunding platforms, such as WiSEED, MyMicroInvest or Angel.me. The championing of deals by professional investors gives retail investors greater confidence in the opportunity. Such phenomena offer insight into desirable developments for this variety of crowdfunding. However, there are a number of key challenges for the future of equity and debt crowdfunding for impact:

1. **Impact measurement:** Impact investors and crowdfunding observers are concerned that equity and debt crowdfunding platforms will lack the capacity and/or willingness to support comprehensive impact measurement and reporting among their communities.

Indeed, today crowdfunding platforms have limited or nonexistent monitoring and evaluation activities, and none for impact. According to Deborah Burand, a key challenge facing companies within this context is the need to prove that their product/service is not the cause of “bads” in society. Just as Kiva requires borrowers to subscribe to Consumer Protection Principles, investors will have to ensure that their issuers allocate funds raised in a socially and environmentally responsible manner. While this is a key challenge for any platform which plans to support equity and debt crowdfunding for impact, an acceptable solution may lie within due diligence and a light monitoring process following investment, rather than longitudinal impact or social return on investment studies.

2. **Ticket size:** Some argue that the risks involved in impact investing are greater than those in typical venture capital investments. As a result, there is concern that the market for equity and debt crowdfunding for impact will be constrained by low average ticket sizes, especially for frontier market investing. This, again, is a key challenge for platforms offering equity and/or debt crowdfunding for impact. With the growth of the market and the acceptance of crowdfunding by consumers, this will no longer be a problem. As of today multi-million-dollar fundraising campaigns are already being successfully funded through the crowd, and we are seeing an upward trend in this regard.
3. **Education:** The lack of financial and technological know-how in the social sector is indicative of an education-related challenge in the crowdfundering space. Social entrepreneurs must find the right balance between social goals and business realities. In addition, they will need internet and social-media fluency to support a successful equity or debt crowdfunding campaign. Lack of financial literacy among potential investors is an additional challenge. While the solution lies partly on the side of political responsibility, additional efforts must be made by crowdfunding platforms to ensure that both entrepreneurs and investors are satisfactorily educated about the risks and opportunities crowdfunding can offer them.
4. **Social entrepreneur protection:** As mentioned above, equity and debt crowdfunding platforms will need to establish mechanisms to protect entrepreneurs from excessive financial and reputational risks. Such protection cannot be greater than it is for other forms of investment, but it must take into consideration crowdfunding’s unique features in terms of accessing the crowd for potential investment. Of course, this is also one of the unique anti-fraud features of crowdfunding: the public, open process and data behind a crowdfunding campaign provide opportunities for the crowd to review the credibility of people and project ideas.

3.1 case studies

The market for equity and debt crowdfunding is growing in the USA and Europe. Numerous examples of successful crowdfunding campaigns bear testament to the popularity of enterprises addressing social and/or environmental problems. In the USA, these examples continue to be limited by the ongoing delays to the SEC JOBS Act rulings. →

1. Company: Brighter Schools

Project: Solar power for schools

Product: Solar PV installation for schools

Project Location: Various locations across the UK

Crowdfunding Platform: Abundance Generation

Type: Equity

Total Funding: £216,000

Number of Investors: 158

Website: <http://www.bnrg.ie>

Brighter Schools was set up by the Wunderenergy company to provide solar PV systems to UK schools. The target of £216k was achieved within two weeks of launching the campaign. Brighter Schools have a total goal of raising £735k to fund 570kWp at 10 schools. Interest from other schools presents strong possibilities of scale. The rate of return to investors is estimated to be 7.2-8.3% over the 20 year life of the investment. Meanwhile, the schools pay nothing for the installation, but buy the electricity produced at a cost less than the current price of electricity. Money raised from the crowd pays for these initial installations. The Feed-in Tariff and school payments repay investors and supply the investment return. In addition, the panels are an in-house educational tool, teaching children about sustainability and climate change and allowing youngsters to be involved in the management of the project.

2. Company: Oakapple One

Project: Solar power

Product: Built-in solar panels for housing

Project Location: Various locations across the UK

Crowdfunding Platform: Abundance Generation

Type: Equity

Total Funding: £480,000

Number of Investors: 313

Website: <http://www.oakapple-energy.co.uk>

Oakapple One was set up as part of the Oakapple group of companies in order to develop a portfolio of rooftop PV systems on new residential properties. Panels are installed during the construction process and begin generating electricity immediately. The raise of £480k paid for 435kWp of solar PV installations, which will provide an estimated effective rate of

return of 7.35-8.60% over the 20-year life of the investment. Meanwhile, the homeowners are able to use the electricity produced for free, and the remaining supply is injected into the national grid. The homes are designed to be highly energy-efficient and thus have a low environmental impact.

3. Company: LSTN (pronounced LISTEN)

Project: Reused materials for headphones sold to raise funds for deaf children

Product: Vintage headphones made from reclaimed wood

Project Location: Los Angeles, California, USA

Crowdfunding Platform: Crowdfunder

Type: Equity (until SEC rulings on the JOBS Act, these projects are reward-based)

Total Funding: £6340

Number of Investors: 95

Website: <http://www.lstnheadphones.com>

LSTN makes high-quality, vintage-style headphones using reclaimed wood. For each pair of headphones sold, they are able to provide a hearing aid to a deaf child in a developing country. This campaign was run as a rewards-based campaign but could, following the SEC's JOBS Act rulings, qualify for the equity-based crowdfunding envisioned by Crowdfunder.

4. Company: 2050 Magazine

Project: Bridge information gap about climate change and renewable energy

Product: Free online interactive magazine

Project Location: Barcelona, London, New York, Tokyo

Crowdfunding Platform: ImpactCrowd

Type: Equity

Total Funding: €25,000

Number of Investors: 120

Website: <http://www.2050publications.com>

2050 Magazine aims to bridge the information gap between scientists and the public concerning climate change and renewable energy. With an established viewership of 10,000, the €25,000 raised through ImpactCrowd has enabled 2050 Magazine to increase production, distribution and revenue creation. They aim to save 30 million kWh of electricity (€3-6 million) through lifestyle changes adopted by their readers.

5. Company: Pinnacle Charter School

Project: 662kW Solar Panels to serve 2,000+ students

Product: Solar Panels

Project Location: North Denver, Colorado USA

Crowdfunding Platform: Mosaic

Type: Debt

Total Funding: \$450,000

Number of Investors: 169

Website: <https://joinmosaic.com/browse-investments/pinnacle-charter-school-24>

The 662kW solar system powers a Pinnacle Charter School, one of the largest in Colorado. The \$450,000 investment is expected to earn the 169 investors a 5.4% yield over a 120-month term. Meanwhile, the solar project is expected to save Pinnacle Charter School up to \$1.6 million in electricity costs over the lifetime of the project. In addition, tens of thousands of students will receive case-proven education about the importance of clean energy.

4 conclusion

Despite the challenges ahead, this report offers an optimistic outlook for the equity and debt crowdfunding sector, and about the possibilities for impact investors to operate successfully within this sector. In addition to broad compatibility in terms of geographic location and choice of financial instruments, the opportunity for investors is framed by certain key investment indicators which can be derived from the crowd: social proofing/proof of concept, product validation and market size. Of course, the risks and challenges for investors and social entrepreneurs are significant, as highlighted above. However, we expect these risks to be largely, although not entirely, mitigated through solid regulatory frameworks and a competitive environment for crowdfunding platforms enforcing principles of transparency, self-regulation and social and environmental responsibility.

The adopted regulatory frameworks will decide the future of equity and debt crowdfunding in the USA, Europe and worldwide. We are particularly eager to discover the crucial registration, disclosure and tax audit requirements demanded by the SEC and FINRA in the USA. Meanwhile, we are cautiously optimistic about the possibility of European countries generating favorable regulatory environments for equity and debt crowdfunding; in turn, this will facilitate efforts at pan-European crowdfunding while maintaining a healthy competitive environment. Within the existing European market, however, we acknowledge that the variety of national corporate and financial regulatory frameworks demands financial and legal proficiency, as well as strong financial backing, from competitive international crowdfunding platforms. In a number of European Member States, questions remain as to the extent of the AIFMD and MIFID II regimes' applicability for equity and debt crowdfunding platforms. However, we are convinced that the industry has already reached relevant size and has been successful in fostering innovation and job creation, and that opportunities will continue to develop rapidly.

Setting aside regulatory concerns in advance of official publication, the outlook on equity and debt crowdfunding for impact is positive. Almost a decade of successful crowdfunding

for impact, through donation, reward and debt-based platforms, gives us considerable social proof in favor of the concept. In addition, industry experts interviewed for this report are optimistic about equity and debt crowdfunding for impact. Nonetheless, we have identified certain key hurdles which, until they are overcome, call for circumspection as to the future of equity and debt crowdfunding for impact investors. Concerted cooperation is needed between crowdfunding platforms, impact investors and social entrepreneurs in order to overcome challenges related to impact measurement and reporting, low average ticket sizes and the investment-readiness of social entrepreneurs.

Toniic and the European Crowdfunding Network are excited about the prospect of engaging the action-oriented investment community with crowdfunding for impact.

We welcome collaboration with any relevant parties as we pursue this goal.

bios

Oliver Gajda

Oliver is the co-founder and Chairman of the European Crowdfunding Network and Executive Board member of CF50 Inc., the global Think Tank on crowdfunding. He works as a hands-on operational and strategic consultant on sustainable, innovative businesses and non-profits. The past decade, he has worked with venture capital, microfinance, technology and social entrepreneurship in both commercial and non-profit settings in Europe and the USA. A former journalist, Oliver started his career in the early 1990s in the publishing and business information industries. He holds Masters Degrees from Solvay Business School and from the University of Hamburg and studied at SEESS (UCL) in London.

Nick Mason

Nick is a former consultant to Toniic, currently acting as impact evaluation consultant for Young Philanthropy in London. He is a co-founder of the Conscious Leadership Community and continues to be involved with We Yone Child Foundation, an NGO based in Freetown, Sierra Leone. He is passionate in his ambition to work with innovative solutions to global development issues – now concentrating his energy towards the African impact investing sector. He holds a Bachelor's Degree in Natural Sciences from Trinity College Dublin and spent an Erasmus year at La Sorbonne, Paris.

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