Case Study of the Equity Crowdfunding Landscape in London: An Entrepreneurial and Regulatory Perspective

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Content

Acronyms

CFTC: Commodities and Futures Trading Commission

eCF: Equity Crowdfunding

EIS: Enterprise Investment Scheme

FCA: Financial Conduct Authority

FSA: Financial Services Authority

GDP: Gross Domestic Product

IPO: Initial Public Offering

PRA: Prudential Regulatory Authority

SEC: Securities and Exchange Commission

SEIS: Seed Enterprise Investment Scheme

SME: Small-Medium Enterprises

VC: Venture Capital

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1. Executive summary

This case study takes an entrepreneurial and regulatory perspective on the potential of ***equity crowdfunding***, an entirely novel internet based mechanism for raising financial capital, to address the entrepreneurial equity gap. The context for our study is the rapidly growing UK equity crowdfunding cluster, which is prominent especially in and around London. We explore the factors driving the rapid growth of the industry and use interviews and empirical evidence to consider its effects. Drivers of equity crowdfunding include the regulatory and tax regime as well as the broader London entrepreneurial ecosystem. The equity crowdfunding marketplace is still developing, with numerous competing business models, which leads us to compare the current three market leaders. We show the importance of equity crowdfunding to investors, entrepreneurs, platforms, regulators and stakeholders in the wider national economy. We argue that key contributory factors in the success of equity crowdfunding in the UK have been the London ecosystem for entrepreneurial finance and the emergence of a sympathetic tax and regulatory regime encouraged by policy makers keen to nurture innovation.

We offer five main lessons for researchers and policy-makers from the London experience.

- The experience of London's equity crowdfunding cluster suggests that policy-makers and regulators would do well to look and listen to the market if they are to understand the early dynamics of how equity crowdfunding takes root and diffuses.

- Equity crowdfunding is a long-term commitment. Policy-makers and regulators are critical in helping to maintain a steady environment, which facilitates a long-term focus and confidence on the part of the investor community.

- The emergence of the post-recession London equity crowdfunding cluster sends a clear message: national and local governments should work together to create an ecosystem capable of sustaining robust entrepreneurial and financial communities.

- Regulators should cautiously embrace the eCF phenomenon because the potential benefits to society may outweigh the risks to eCF investors. However, such policies should be exploratory because the full effects of eCF on investments and entrepreneurs will not be revealed for some time, until the impact on firm performance and investor risks can be properly evaluated. In line with this recommendation, we advocate continuous financial education for investors, entrepreneurs, and platform operators.

- Platform providers should utilise their already strong social media capabilities to develop functionality, which ensures that entrepreneurs keep their investment community informed of developments. We suggest platform providers and regulators collectively address the issue of increased transparency around the investor- entrepreneur relationship.

2. Introduction

Entrepreneurship is recognised as essential for innovation, economic growth and employment creation. The 5.4 million small and medium-sized enterprises (SMEs) in the UK employ a combined workforce of more than 10 million people and account for almost two thirds of the jobs created since 2008. Notwithstanding, their key role in the innovation and growth process, entrepreneurs find it hard to access the finance they need to survive and scale. The existence of an equity gap – the inability of small firms to access the finance they need to grow – has been a long-term challenge for UK governments (HMSO, 1971; 1991; Parker 2009).

In this case study, we focus on the potential of ***equity crowdfunding***, an entirely novel mechanism for raising financial capital, to address the entrepreneurial equity gap. We define equity crowdfunding as "an open marketplace for entrepreneurial finance that takes place on a two-sided online platform and operates within a social media environment" (Estrin and Khavul, 2016a). It has been suggested that equity crowdfunding will allow entrepreneurs and small businesses to raise money quickly and relatively cheaply (Mollick, 2014). On the other hand, there are arguments that equity crowdfunding exposes investors to unwarranted risks (Agrawal, Catalini, & Goldfarb, 2013).

We anchor our study in the rapidly growing UK equity crowdfunding cluster, which is prominent especially in and around London. We consider the main business models adopted by the equity crowdfunding platforms, characterise the current London marketplace, including the London entrepreneurial ecosystem into which they fit. Our study demonstrates how the evolution of equity crowdfunding, regulatory institutions, and the entrepreneurial ecosystems in London affected the supply of capital to entrepreneurs. We show the importance of equity crowdfunding to investors, entrepreneurs, platforms, regulators and stakeholders in the wider national economy. We argue that key contributory factors in the success of equity crowdfunding in the UK are the London ecosystem for entrepreneurial finance and the emergence of a sympathetic tax and regulatory regime encouraged by policy makers keen to nurture innovation.

2.1 Entrepreneurs and the funding gap

Lack of funding remains a major constraint on new venture growth and this is thought to be to a significant extent caused by the high risks inherent in entrepreneurial new ventures (Smith & Smith, 2003). The resulting capital market deficiencies affect both local small businesses and high-tech entrepreneurs. The Greater London Authority, for example, identifies a serious equity gap for both start-ups and early stage companies. In less capital-intensive sectors such as social media software, the sums are smaller (between £250,000 and £1 million) than for capital-intensive high-tech start-ups, where the gap can be as much as £10 million (Wilson and Wright, 2015). Moreover, in those private investment markets for new ventures which do exist, primarily venture capital and angel investors, the suppliers of capital have come under criticism for lack of regional, gender and ethnic inclusiveness (Bates and Bradford, 1992; Mollick and Robb, 2015). In addition, the minimum investment requirements in venture capital and angel investments are often well beyond the scope of many small businesses, their growth prospects notwithstanding. Moreover, many entrepreneurs are unwilling to cede the share of equity and degree of involvement that these investors seek (Fraser, et al., 2015).

The global financial crisis of 2008 threw into sharp relief, the urgent need for new models in the capital market. The high levels of risk taking within the financial sector precipitated the crisis and led to widespread bankruptcies and state sponsored bailouts of financial institutions. As a result, traditional suppliers of credit to entrepreneurial ventures became even more cautious than hitherto, which for new and early stage ventures exacerbated their funding problems (Fraser, et al., 2012). At the same time, the world recession caused significant declines in employment prospects and increased unemployment. This pushed many people to create new entrepreneurial firms rather than chase elusive employment. Likewise, the increasing desire, especially of young people, to have flexible careers and independence generated the social pull factors into entrepreneurship (Bentley University, 2014). Consequently, the number of self-employed workers in the UK was 700,000 greater in 2015 than 2008 (Economist, 2015). With increasing numbers of entrepreneurs entering the UK economy, the past few years have been a propitious time for capital market innovations that are designed to address the new venture equity gap.

2.2 Crowdfunding

Indeed, the UK has been amongst the leaders in fostering equity crowdfunding and other novel mechanism for raising capital for entrepreneurs. As an idea, crowdfunding has been around for a long time. Crowdfunding was used to finance the base for the Statue of Liberty in the late 1880s, but its significance for contemporary entrepreneurs was hugely increased with the recent growth of the internet, which brought cheaper storage, secure networks, and connectivity through social media. Crowdfunding now implies the use of social media to harness investor and entrepreneur networks. It is a financial innovation that builds on new technological platforms that are breaking down traditional barriers of geography, access and asymmetric information (Mollick, 2014; Bellaflame, Lambert, Schienbacker, 2014; Estrin and Khavul, 2016b). According to Massolution (2012, 2015) crowdfunding has grown worldwide from around $1 billion in 2011 to $34.4 billion in 2015 (prediction). The World Bank estimates that the overall world crowdfunding market will expand to $93 billion by 2025 (Kshetri, 2015).

Crowdfunding falls into distinct categories. One is rewards based where access to different forms of media (e.g. music or film) or new products are provided in return for investments. A second is donation based where individuals donate to fund interesting projects. Another is debt based, where investors receive interest on collective loans to businesses. However, of much greater significance for capital starved entrepreneurs is *equity crowdfunding (eCF)*, which offers founders of new ventures an on-line social media marketplace where they can access a large number of investors who, in turn, each supply funds to finance initiatives that they find attractive (Estrin & Khavul, 2016a; Bruton, Khavul, Siegel, & Wright, 2015). Globally reward and donation crowdfunding have traditionally represented around 90% of the market but equity crowdfunding is now increasing rapidly, expanding by 184% between 2014 and 2015 (Massolution 2015). This is the focus of our study.

The UK has been a leader in fostering equity crowdfunding as a novel mechanism for raising capital for entrepreneurs. Since around 2010, the UK was an early mover into the field exploiting existing regulations to permit and support equity crowdfunding. The UK regulatory environment has been more open to this innovation than have regulators in much of continental Europe and the US, though differences have now narrowed. We argue that UK's early leadership came as a consequence of London's traditional role as a financial centre and partly because of the benign gaze of a sympathetic regulator. UK equity crowdfunding platforms have for the moment a global advantage and the local ecosystem has a sufficient number of firms and investors to provide a basis for a Case Study about this new financial sector.

2.3 Outline of the case

The study is organised in three further sections. In the subsequent part, we outline in greater depth the opportunities opened up by equity crowdfunding (eCF) as well as various forms of crowdfunding, which have emerged, and the architecture of equity crowdfunding platforms and operations. These developments will also be placed into a broader international context. The following section sets the context for equity crowdfunding in the London ecosystem for finance, technology and entrepreneurship. We then go on to summarise the key opinions of stakeholders including regulators, entrepreneurs, investors and the platforms themselves drawing on both published materials and our own interviews. Finally, we consider the implications of our analysis for practice before drawing conclusions.

3. Crowdfunding: the innovation

The modern origins of crowdfunding are usually argued to derive from crowdsourcing, a term defined by the Wired journalist, Jeff Howe, as "the act of taking a job traditionally performed by a designated agent (usually an employee) and outsourcing it to an undefined generally large group of people in the form of an open call" (Unterberg, 2010, p 122). Bellaflame et al., (2014) draw on this notion to define crowdfunding as raising funds by tapping the general public. They go on to propose crowdfunding to be an "open call through the internet for the provision of financial resources either in the form of a donation or in exchange for some form of reward and/or voting rights in order to support initiatives for specific purposes". Mollick (2014) finds this definition simultaneously too general and too narrow; because it leaves out some important phenomena such as peer to peer lending but does not mention explicitly the role of the internet. Thus his definition is "the efforts by entrepreneurial individuals and groups – cultural, social and for-profit – to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries". The EU defines it as: "open calls to the public, generally via internet, to finance a project through either a donation, a monetary contribution in exchange for a reward, product pre-ordering, lending, or investment" *(European Commission).* Crowdfunding is therefore a relatively new phenomenon, and to set the context it is helpful to present the main historical events, which have occurred since crowdfunding platforms began to appear. Figure 1 depicts a timeline, which highlights major crowdfunding milestones since 2009. However, this case study is solely concerned with a particular form of crowdfunding; equity crowdfunding. While all varieties of crowdfunding started from the same original concept, the various forms have now largely separated as phenomena. This case contributes to our understanding of how equity crowdfunding operates and the ways in which it can help or hinder investment into early stage entrepreneurial ventures.

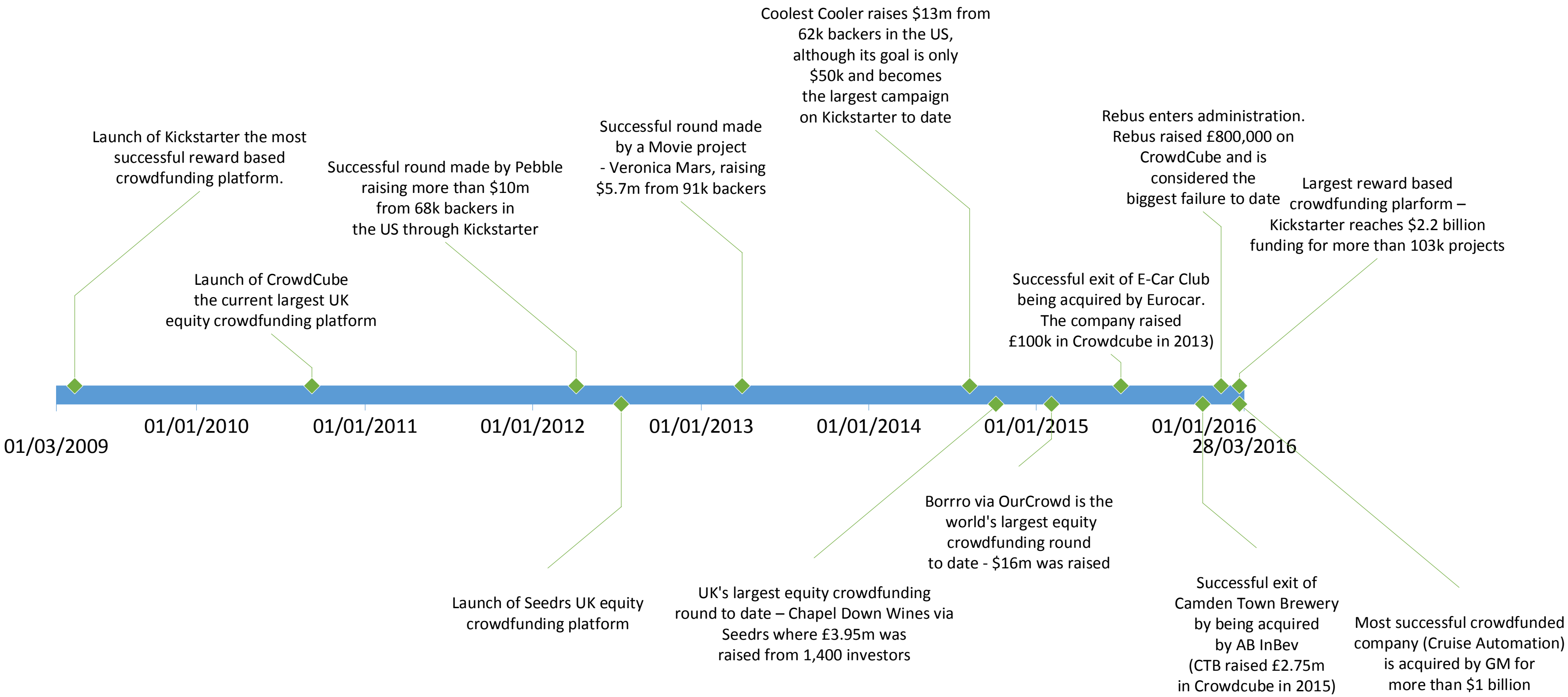

Figure 1 Crowdfunding Milestones. Source: Firm Websites and National Press

3.1 The global environment for equity crowdfunding

Several countries including the UK, Australia and Netherlands permitted eCF platforms to operate from around 2010 (Kshetri, 2015), followed by the United States formalised federally through the JOBS (Jumpstart Our Business Startups) Act 2012. Albeit to varying degrees, equity crowdfunding is a regulated activity in most countries. Regulators require that eCF platforms, the companies that bring together potential investors with capital starved entrepreneurs on the basis of a social media model, carry out due diligence on each pitch. They also mandate written warnings reminding potential investors about the risks involved in early stage investing.

Figure 2 highlights key global regulatory changes post-2011. A key issue for financial regulators is the protection of investors because they may be unaware of the high risks involved in investing in new ventures and SMEs. Further complications arise if the eCF platforms are attracting investors who do not have the expertise fully to understand the nature of the investments in relation to their own risk appetite and attitude to losing their investment. Risk levels are increased in eCF where it is not possible for investors to simply trade their shares on a stock exchange when they want to sell them, in the same way investors can with liquid shares such as Coca-Cola or IBM. Regulators have responded to these challenges in a number of ways: including limiting the types of investors eCF platforms are able to attract, as well as how they are solicited to, by limiting the amount investors can invest in one period or by limiting the total value sort by entrepreneurs at one time. Exemptions may exist for investors deemed more sophisticated and knowledgeable, so called "accredited investors"[1] .

Equity crowdfunding is an international phenomenon (Massolution, 2015, Kshetri, 2015; Terry et al., 2015) especially with the issuance of final SEC rules, which facilitate smaller companies' access to capital in the USA (SEC, 2015); the Jobs Act came into force 16th May 2016. EU countries have implemented regulations nationally with the limits set by EU legislation. Regulations have so far been implemented in: Austria, France, Germany, Italy,

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[1] The definition of accredited investor varies between countries but usually include institutional investors, and high net worth individuals. In the UK, this is defined as having an annual income in access of £100,000, and net assets in excess of £250,000 (excluding primary residence, insurance, and pension policies).

Portugal, Spain and the UK, with regulations being developed Belgium, Finland, Lithuania and the Netherlands. Our further examples are from the UK, where the Regulator, the Financial Conduct Authority (FCA), initially adapted existing regulations to allow equity crowdfunding and then introduced formal rules in 2014. The details of these are reproduced in the Appendix A1. This pro-innovation approach has arguably helped to put the UK at the forefront of equity crowdfunding globally for the last five years, and the UK now has the most companies funded and the most financing being raised through eCF.

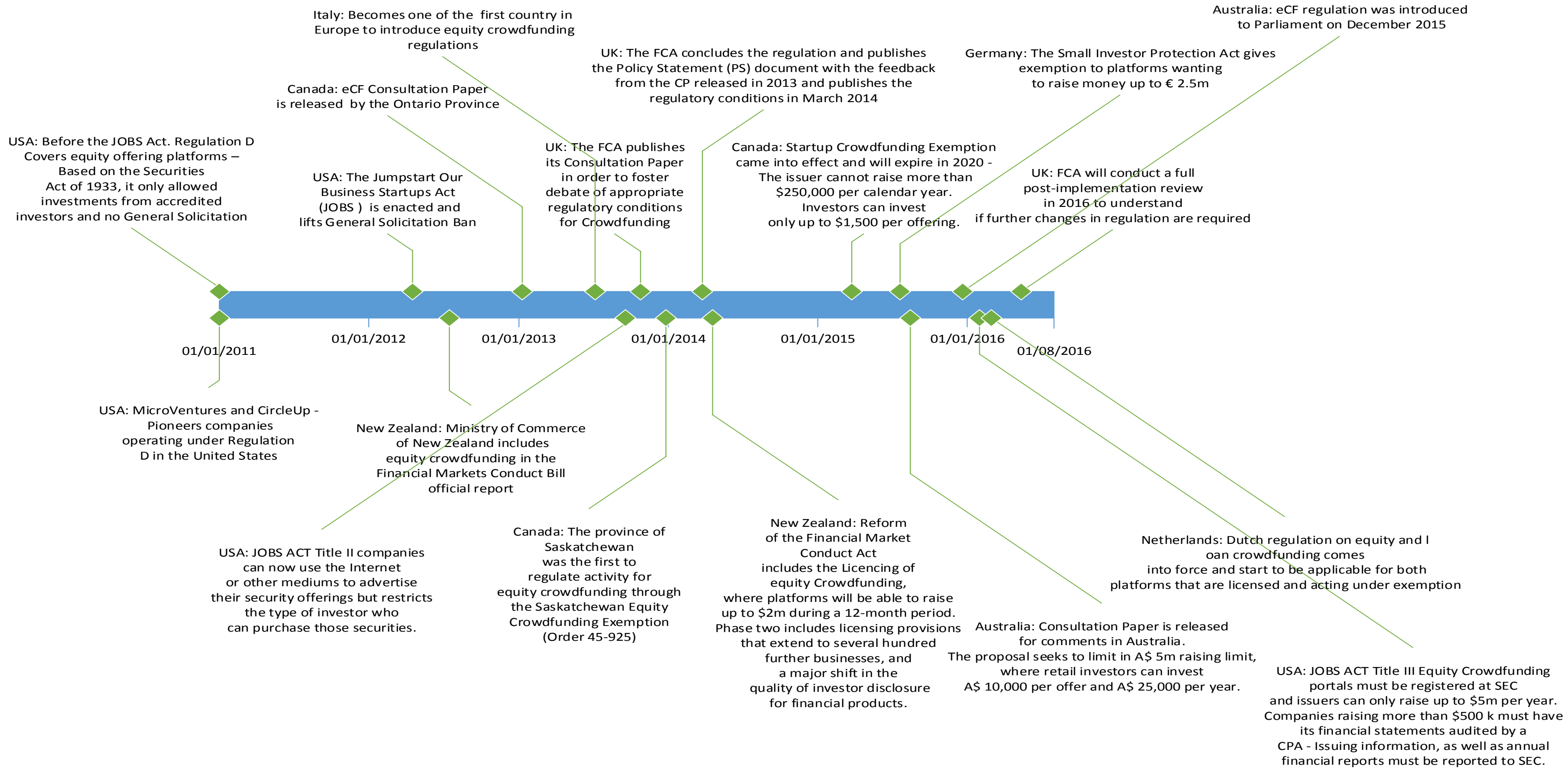

Figure 2 eCF Global Regulatory Milestones. Source: National Regulatory Authorities

3.2 Different models of crowdfunding

Table 1, which is derived from the 2012 Nesta Report, The Venture Crowd, summarises the UK crowdfunding landscape. As we have seen, crowdfunding is usually categorized into four predominant forms. The most common types, represented by huge, mainly US based organisations like Kickstarter and Indigogo, raise potentially large sums for their participants either as donations, or in return for small rewards and other intangible benefits. For example artists receive money from the social network either as support for their creative endeavours, or in exchange for rewards associated with the product itself, such as free tickets and meetings with the artists in return for funding say albums or films. Donation and reward crowdfunding have also been used to finance research, including at universities, and innovation, and hence have been used to help in directly or indirectly financing entrepreneurial ventures. They have also been used to gauge the market interest in new products (Belleflamme, Omrani, and Peitz, 2015). However, their primary purpose is not to finance new ventures, and their activities typically take the form of large numbers of contributors each putting in very small amounts of money. They therefore are not easily scalable to meet the financing needs, especially equity financing needs, of new ventures, and their funding model might imply considerable problems of governance for entrepreneurial firms further down the line. The third form of crowdfunding concern debt rather than equity, and is clearly of great interest to entrepreneurs. Crowdfunded lending is a major new financial market developed out of the well-established peer to peer lending sector. This is available for existing as well as new ventures, and provides loans to firms (PWC, 2015). The fourth form is equity crowdfunding, which is the subject of this study.

	Form of contribution	Form of return	Motivation of funder
Donation Crowdfunding	Donation	Intangible benefits	Intrinsic and social motivation.
Reward Crowdfunding	Donation/ Pre-purchase	Rewards but also intangible benefits.	Combination of intrinsic and social motivation and desire for reward.
Crowdfunded Lending	Loan	Repayment of loan with interest. Some socially motivated lending is interest free.	Combination of intrinsic, social and financial motivation.
Equity Crowdfunding	Investment	Return on investment in time if the business does well. Rewards also offered sometimes. Intangible benefits another factor for many investors.	Combination of intrinsic, social and financial motivation.

Table 1 Crowdfunding Models Source: NESTA July 2012

The UK Alternative Finance sector did £3.2 billion of business in 2015 year, up 84% on 2014; business lending represented 12% (Nesta, 2016). The equity crowdfunding sector has been growing very rapidly, recently by 295%, so £84 million was raised in 2014 and £332 million in 2015. To quote the Nesta Report (2016), "Excluding real estate crowdfunding (£87 million), equity-based crowdfunding contributed £245 million worth of venture financing in 2015, which we estimate is equivalent to 15.6% of total UK seed and venture-stage equity investment, based on Beauhurst's data during the same period (i.e. £1.57 billion in 2015). In addition to this, 2015 saw the equity-based crowdfunding market report its first two exits." Market volumes in the main categories of crowdfunding in 2015 are reported in Figure 3. However, for some perspective, equity crowdfunding in the UK is not yet at the same scale of the venture capital market, which raised \$3.6 billion in 2015 (FT January 6th 2016).

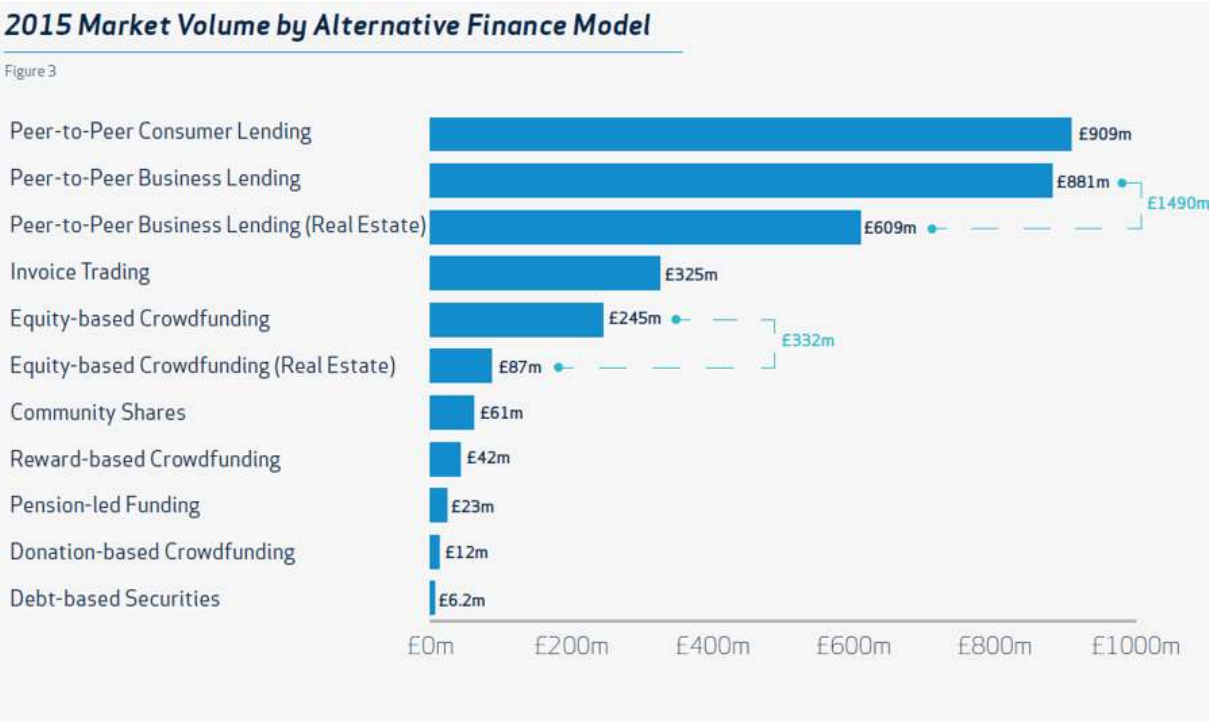

Figure 3 Structure of Crowdfunding Market in 2015 Source: Nesta, 2016

3.3 Equity crowdfunding: How the process works

We have noted that equity crowdfunding provides a virtual market through a two sided social media platform linking individuals who require financing for their new ventures, both commercial and social, with individuals willing to supply that funding in return for equity in the business organisation (Estrin and Khavul, 2016). Though the precise market clearing mechanisms differ from platform to platform, equity crowdfunding always involves supply of funds, demand for funds and a price. Thus eCF has the same the “open call” format as other forms of crowdfunding. However, in the motivation of and incentives for entrepreneurs and investors, it is distinct from donation-based, reward-based, and peer-to-peer lending forms of crowdfunding.

Figure 4 describes a generalized process model of the equity crowdfunding cycle. To begin, entrepreneurs seeking funding either approach the platform independently or are recruited to the platform through business development managers. In compliance with regulatory due diligence requirements, platforms screen potential pitches for accuracy of representation. The vast majority of entrepreneurs who approach the platforms to pitch are turned down at this stage. Entrepreneurial ventures that make it through the screening process are required to prepare videos and briefing materials to publically post on the platforms. Such material is increasingly standardized to allow investors an opportunity to compare across pitches. Next, entrepreneurs, who pitch to the network, state a sum that they seek to raise, the amount requested, and the number (proportion) of shares that they will offer in return for the investment. An offer to supply funds is only taken up if the pitch itself is successful.

It is therefore useful to distinguish three concepts in the behaviour of the players on the two sides of the platform. Investors can indicate their intentions to invest, but these become actual investments if the pitch is funded. Thus, the completion of the investment is not under control of any individual investor unless they fund the entire round or bridge the gap in the closing of the pitch. Investors include professional early stage investors, sector specialists, angels and venture capitalists, as well as potential small investors (Ahlers et al., 2012). Entrepreneurs who pitch on the platforms can also be investors. They participate on the platforms because they often have particular sector experience and wish to learn about the process from the supply as well as demand side (Bellaflame et al., 2015).

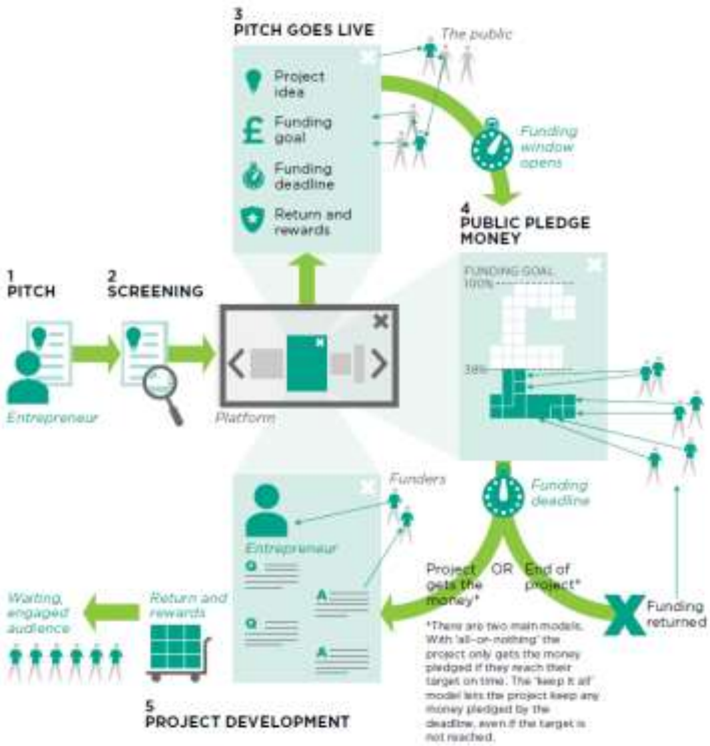

Figure 4 The eCF process. Source: NESTA Dec 2012

The pitch is usually live on the platform for a fixed period. During the pitch there is an exchange of information and data around the network, including between the entrepreneur and potential investors and between bidding investors. This is the process whereby the knowledge within the network is disseminated. There are three possible outcomes to a pitch. It fails to accumulate, via the bids (actions) of individual investors, the amount requested by the entrepreneur. In this case, potential investors in this pitch as a group are not able to make an investment and the entrepreneur does not receive funding; this occurs in the majority of cases on most platforms. Second, the cumulated amount invested exactly equals the amount requested, in which case the pitch is exactly funded and the entrepreneur receives what he or she requested and distributes the pre-agreed number of shares according to the proportions of money received. In the final case, the cumulative sum available for investment exceeds the amount requested: the pitch is therefore overfunding. Different platforms have different rules for overfunding with respect to equity offered and dilution.

The pitch period is therefore best seen as a market clearing process whereby the supply of funds is or is not equated to the demand by an entrepreneur at a given offer of shares and valuation of the firm. It is not clear whether the process described above is entrepreneur or investor led. At first sight, it would seem to be the former because the entrepreneur sets the terms for the investment. However, on some platforms the process can allow for renegotiation during the pitch, whereby particular investors can state to the entrepreneur that they will only provide funds at particular terms, which alter the shareholding offered, or the valuation.

Finally, platforms differ the way that they handle the raised amounts and the post-investment interactions between entrepreneurs and investors. Some platforms do not take custody of the funds and act only as process intermediaries, while others pool the investor funds and act as nominees and representatives of investors. Regardless of the model, all platforms seek to stimulate active post-investment environments through which entrepreneurs report back to investors and investors stay engaged with the platform. Achieving a robust post investment environment is a challenge. We next examine some of the theoretical idea underlying equity crowdfunding.

3.4 Why might equity crowdfunding help to solve entrepreneurs' funding gap?

Traditionally, entrepreneurs fund new ventures in stages that often start with personal savings, investments from friends and family, private angel investors, and at times professional investors (Parker, 2009). The funding escalator is summarized in Figure 5 below.

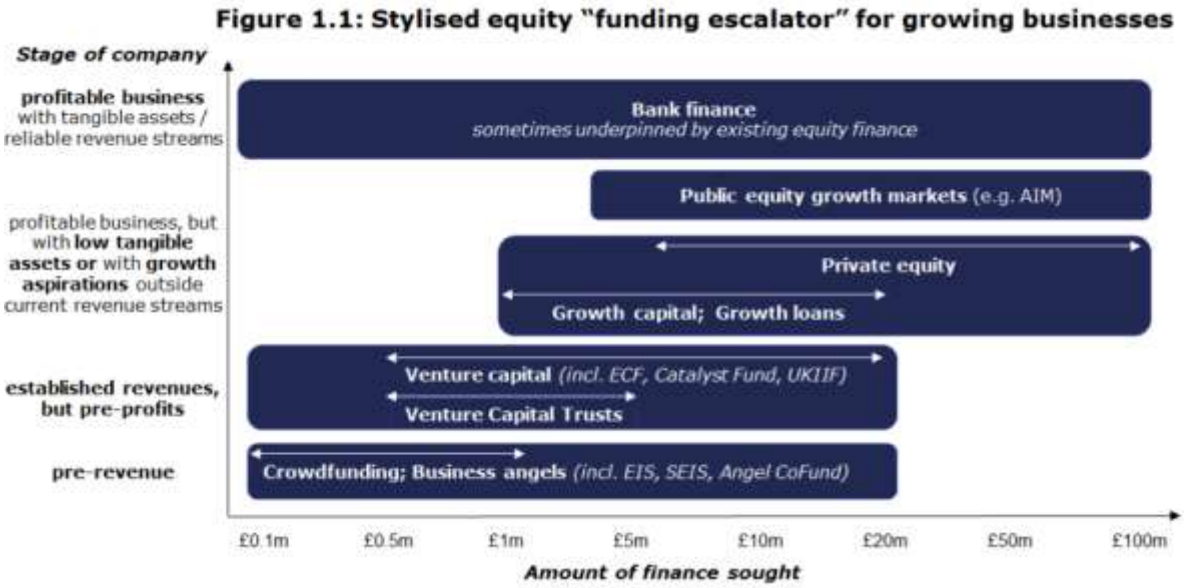

Figure 5 Funding escalator. Source: British Business Bank 2015, Figure1.1

Successful funding strategies for entrepreneurs often depend on the potential to build strong ties based on interpersonal connections between a small numbers of participants. Entrepreneurs rarely go or succeed on capital markets in the early stages to raise funds. This is partly because it is difficult for them to raise external finance via either equity or debt because of market failure leading to problems of asymmetric information between borrowers and lenders leading to adverse selection (Bruton, Khavul, Siegel, Wright, 2015).

The key asymmetries of information behind the market failure arise between the entrepreneurs who seek equity finance and the investors who might be able to supply it (Estrin and Khavul, 2016). The relevant information to make judgements about investments such as the ability to judge the level of risks are rarely available in an early stage venture, because the business model is typically not yet proven and the characteristics of the competition in the market place are not yet established. Thus investors, and indeed the entrepreneur, cannot know for certain what consumers will want to buy and what other entrepreneurs are considering moving into this space. Moreover, such information as there is not distributed symmetrically; the entrepreneur will typically have a much better understanding of the upside and the dangers than an external investor. The dangers of adverse selection resulting from this raise the cost of capital (and especially equity capital) to new ventures, possibly restricting supply altogether (Wilson and Wright, 2015). Moreover, the transactions costs involved in investors gathering such information as might be available in order to construct contracts which address the underlying risks are extremely high; traditional early stage finance capital markets rely primarily on face to face interactions and personal relationships which are hard to scale and expensive to create.

The promise of equity crowdfunding is that the costs of transactions may be reduced through the use of the social media via the Internet; the eCF platforms introduce new mechanisms for entrepreneurs to establish their reputations to investors, as well as for investors to pool their information. An important example of this is how equity crowdfunding seems to have allowed the matching of demand and supply of early stage finance across a wider geographical area (Agrawal et al, 2011); because traditional early stage financing tends to be relational, its range and impact may be quite narrow and contain hidden biases (Mollick and Robb, 2015)

There are three ways in which equity crowdfunding might be able to provide information to improve the matching between investors and entrepreneurs (Estrin and Khavul, 2016). First there is *a priori* information provided by the entrepreneur as part of the pitch process. As we have seen, this includes a valuation of their business and financial information about the company, usually following a standard format, including data about themselves and their business experience and an explanation of their business idea. Entrepreneurs often provide a video of themselves outlining their pitch to potential investors. These messages are provided within a fairly standard format, and the investor has the knowledge that the proposal has faced a screening by experts within the platform that weeds out many of the original investment proposals. Perhaps most importantly, all this information is freely available to the entire social network, which is to say to all potential investors. The open access characteristics of the platform provide entrepreneurs with an interesting balancing act. They are incentivised to reveal as much information as they can and as accurately as they can in order to improve their chances of reaching their investment target without giving away core information to potential competitors. In general, the provision of this information is likely to affect the willingness to pay of the investor, and thereby improve matching between investors and entrepreneurial projects.

However, a priori information also raises the danger of disclosure risk. This arises when entrepreneurs are led through the demands of the platform, and behind that the potential investors, to reveal details of their plans to competitors. This danger is clearly present in equity crowdfunding and probably means that entrepreneurs whose business models are easily open to imitation or face strong barriers to entry would be less likely to choose equity crowdfunding. They would likely prefer a mechanism for funding based on lower levels or more private provision of information, for example through some relational form of financing such a venture capital or angel investment. In less serious cases of disclosure risk, the IPR and imitation problems may be counterbalanced by the opportunity for the entrepreneur to develop their business model and product offering on the basis of comment and reaction from investors, other entrepreneurs and potential customers.

Second, information flows are generated through the *dynamics of the pitch process* because the platform pools together the knowledge of a network of investors with skills, and experience about particular sectors, technologies and financing arrangement. During the period of the pitch, potential investors receive additional information from the network itself, which generates an enormous amount of discussion and exchanges concerning each pitch. From the opening of the pitch, potential investors are invited to comment on any and every aspect of the pitch – the valuation, the product, the business plan, the market, the entrepreneur and the management team, financial forecasts and the entire business model. The investor network is an informed group, which includes people who are entrepreneurs themselves, as well as potential consumers, specialists in finance and marketing and business angels. The eCF platforms are structured to facilitate the posting of comments from investors and responses from entrepreneurs, in an accessible and easy to manipulate format. Hence the platforms allow the enhancement of knowledge about the pitch through the open exchange of information between investors and entrepreneurs with the possibility for all members of the network to freely participate.

Finally, network participants can watch the investment decisions of other investors. Investors reveal to others on the network their willingness to pay for equity in the business by publicly pledging sums towards the target. The entire network is informed about the amount invested and the timing of the investment (early in the process, late, in a large single sum or in a number of smaller amounts). This may encourage others also to invest, in the knowledge that some investors have already taken the plunge. One might argue that this brings a disincentive because, when one person makes a financial pledge, it reduces the incentives for others to do so. However the "target or nothing" character of the bidding process means that free riding is not possible until the target is reached.

To understand in details the variety of ways that online funding platforms have tried to narrow the entrepreneurial funding gap, we next turn to a description of the London equity crowdfunding ecosystem. It is important to note that there is as yet no single dominant business model of equity crowdfunding and a variety of firms operating rather different approaches currently co-exist. For example some firms, such as *Crowdcube*, use a direct shareholding model in which investors hold their own shares directly while others, such as *Seedrs*, use a nominee model in which the platform holds the shares on behalf of investor. *SyndicateRoom*, in particular, offers the possibility for both investor and company led processes.

3.5 The emergence of London equity crowdfunding platforms

Over the past five years, the UK equity crowdfunding market has seen the number of platforms increase from four in 2010 to around 40 in 2015. Including debt, equity, and donation platforms the number is closer to 39. A portion of this growth can be attributed to the entry of international platforms, such as *AngelList* from the US and *Invesdor* from Finland, as well as to the proliferation of niche industry specialists such as *Abundance Generation*. However, today, the equity crowdfunding market in and around London has three clearly acknowledged homegrown, UK leaders: Crowdcube, Seedrs, and SyndicateRoom. Although they compete head-to-head for entrepreneurs and investors, each platform has carved out a unique approach to equity crowdfunding, which we highlight in this section[2].

New platforms have been created each year at a fairly steady rate (Dushnitsky, Guerini, Piva, Rossi-Lamastra (2016). There is a significant and rapidly growing contribution to the needs for early stage finance, representing in 2015 more than 15% of all funding to entrepreneurial ventures (Nesta, 2016). Some of these firms are now quite large; in terms of projects funded, Crowdcube and Seedrs have funded more than 350 and more than 200 projects respectively and both have raised more than £130 million. Crowdcube have a very large number of investors, with more than quarter of a million people signed up to the platform by May 2016. In contrast to others forms of crowdfunding, which are built around the model of large numbers of investors, each providing small amounts (Mollick, 2014), the average number of investors in each successful pitch is small in equity crowdfunding. Thus, in Crowdcube some £145.3 million had been raised for 372 successful projects (out of more than a thousand campaigns) by March 2016. Seedrs had 214 successful pitches in 2014 and 2015, out of 576 campaigns.

3.5.1 Crowdcube

Crowdcube is the oldest and historically the largest operating equity crowdfunding platform in the UK. It was started in 2010 and began operations in 2011 when it funded 22 firms raising £2.5m. That increased to £12m in its second year and more than £20m in its third[3]. Nearly five years after it began, the company has now passed the £150 million investment mark with nearly 400 entrepreneurial ventures financed (Crowdcube; 16/4/2016).[4] In addition, Crowdcube has a network of more than 274,000 users, of whom 200,000 registered since June of 2014. Between 2011 and the end of 2015, more than 1,000 ventures pitched for funding on Crowdcube suggesting a success rate than is approximately

[2] A note about geography is in order. Each of the major UK equity crowdfunding platforms has roots outside of London (Crowdcube headquartered in Exeter, Seedrs conceived in Oxford, and SyndicateRoom, operating in Cambridge), but as its technology sector expanded, the gravitational pull of London became palpable. Seedrs launched its platform in London; Crowdcube opened a London office four years after it started operating; whereas, SyndicateRoom's activities span the Cambridge and London clusters.

3 Source: Crowdcube direct communication February, 2016

4 Where we refer to on-going operational statistics, they are offered by the company websites. We indicate the date of retrieval since these data change rapidly.

30% over the entire period but closer to 50% for the calendar year of 2015. Moreover, only about 10% of the entrepreneurs seeking to make pitches are allowed to do so by the platform. The average investment on the platform is approximately £1,900 and the average number of investments per pitch is 185. Crowdcube has offices in London, Exeter, Manchester, and Edinburgh and has expanded internationally through joint ventures in Canada, Poland, Sweden, Spain, and New Zealand, Brazil, and Saudi Arabia.

Crowdcube is an FCA registered platform, which does not advise investors on specific pitches nor act as a custodian of the funds invested. Crowdcube takes 5% of the raised investment amount and passes through an additional fee for legal services from a third party. Crowdcube arranged its investment model in such a way that investors are direct shareholders in the company. Shares on Crowdcube are differentiated based on investment amounts. That is, entrepreneurs provide a level of investment whereby successful investors will receive A shares (voting rights), rather than B shares. Pitches on Crowdcube run for 30 days, a shorter duration than the original 60 days with which Crowdcube started. As on other platforms (i.e. Seedrs), the average successful and unsuccessful pitches on Crowdcube can usually be differentiated within a couple of days of commencing (Estrin and Khavul, 2016a). Furthermore, for successful pitches overfunding events are frequent and investor shares are diluted in the process. Crowdcube has had several successful exits and the overwhelming majority of the businesses funded on its platform are still operating (Estrin, Khavul, and Wright, 2016). Crowdcube itself has received three rounds of investment from the crowd on the platform and form venture capital, angel, and institutional investors.

3.5.2 Seedrs

Seedrs is Crowdcube's nearest competitor. Seedrs started operations in 2012 and was the first platform to receive formal FCA authorization to operate in equity crowdfunding. Much as Crowdcube, Seedrs grew rapidly, particularly between 2014 and 2015. Since its launch in 2012, Seedrs has seen over £130 million invested in campaigns of which 214 were funded in 2014 and 2015. The number of deals funded rose from 91 in 2014 to 123 in 2015, and to total amount invested from £29 to 67 million over the same period. The number of investors also rose sharply, from almost 25,000 to more than 38,000 in those two years with average number of investors increasing from 187 to 206 and average investments from £1,160 to almost £1,750. Thus the average number of investors per successful pitch was 197 and the average investment was more than £1,450 (Seedrs, May 20, 2015: direct communication). The average investment in a pitch is therefore fairly similar to Crowdcube as is the reported number of investors per successful pitch. Seedrs charges a sliding fee based on the total amount raised (starting with 6% on the first £150,000; then 4% on the amount between £150,000-£500,000 and 2% on anything above £500,000) to the ventures raising funds and 7.5% to the investors on any profits that the investors make (Seedrs.com).

The Seedrs model is different from Crowdcube; its investors are offered a nominee structure, which means that Seedrs aggregates investments, takes custody of the funds, and represents the investors as one block on the venture's capitalization table. The nominee structure allows Seedrs to negotiate contracts with the ventures on behalf of the investors after the campaigns are completed. Investors within the Seedrs model all receive the same ordinary shares, which are held in common by the platform. Overfunding events on the Seedrs platform are treated differently to those on Crowdcube. If the entrepreneur chooses to accept overfunding investments, the venture will need to offer additional equity in proportion to the investment received. Unlike Crowdcube, Seedrs is authorized to take investments from those outside the UK, in particular from investors in the EU. In 2015, Seedrs entered the US with a purchase of an existing platform and anticipates an integrated launch in 2016.

3.5.3 SyndicateRoom

SyndicateRoom represents yet a third model for investing in equity crowdfunding. It was started later than Seedrs and Crowdcube. Since 2013, SyndicateRoom has funded 71 ventures and raised £55 million. At £13,500, the average investment on SyndicateRoom is six times higher than on either Seedrs or Crowdcube and at 80% completion; the proportion of deals funded is more than double the average 30% on Crowdcube.

In designing its platform, SyndicateRoom adopted a model that combines the traditional syndication arrangements of angels and venture capitalists with the online networks that equity crowdfunding offers. Angel investors lead all pitches on SyndicateRoom. They negotiate the terms of the raise with the entrepreneurs in advance and are bringing those exact terms to the network of online investors. The pitch is offered to the public only after the angel investor has committed her own funds to the firm. The platform screens all investment opportunities and conducts its own analysis of the terms of the deal. Unlike Seedrs or Crowdcube, which offer investments as low as £10, SyndicateRoom sets the lower bound for investments at £1,000 and raises that to £5,000 for overfunding events[5].

Much like Seedrs and Crowdcube, SyndicateRoom has raised investment capital on its own platform. In addition, in March of 2016, SyndicateRoom announced a partnership with the London Stock Exchange to be able to offer IPO shares directly to its network. The robustness of the offerings is yet to be confirmed. Although SyndicateRoom operates out of Cambridge, its proximity to London and many London links place it firmly within the London equity crowdfunding orbit.

3.5.4 Comparing and Contrasting

The equity crowdfunding platforms upon which we have concentrated are far from the only players in this market. On the basis of industry trade associations, we have identified an extensive list (see Appendix Table A2), and the market is still rapidly evolving. It is important to note that most figures associated with eCF in the UK and elsewhere are subject to constant change. However, the three upon which we have focused are currently the largest and each believes that their business model and platform enhances access and mitigates the risks of equity crowdfunding investments. From the perspective of the investors, Seedrs and SyndicateRoom manage the investor experience and create long-term contractual affiliation between investors and platform. Crowdcube, on the other hand, leaves the investors and entrepreneurs to contract directly and does not try to mitigate the post-contractual risks through managed investor governance.

All platforms seek to bind the investors and entrepreneurs to their environment with online and offline engagement. Increasingly, platforms offer events to not only meet entrepreneurs and scrutinize their pitches, but also meetings to update investors on the progress of funded pitches. Consistently, the platforms raise the post-investment engagement of entrepreneurs and investors as serious challenge. Moreover, although the

5 Source: SyndicateRoom.com last retrieved May 23, 2016.

funding mechanisms on the platform may vary, each of the three market leaders has retained a generalist approach eschewing an industry focus.

However, with the entry of multiple niche platforms, some focusing on clean-tech, energy, technology, while others still on property, the generalist platforms have had to make the case for the wide reach of their network and to offer specialized investment products. There is little doubt that competition between the three major London equity crowdfunding platforms is fierce. Yet with increased competition from foreign and niche platforms, the major players realize that cooperation especially with respect to the codes of conduct for the industry has to become institutionalised if investor protection is to remain within the context of "light touch regulation".

4. Contextualising equity crowdfunding: The London ecosystem

As the previous sections have shown, while other countries have also acted to encourage eCF, platforms operating in the UK and London specifically have thrived. This case study argues that this is can be related to the unique nature of the eCF ecosystem in London. Key elements of this ecosystem include the resilience of the UK economic environment following the financial crisis and the critical mass of entrepreneurs and technologists who have been attracted to London. An important additional factor is the development of a taxation regime and regulatory environment, which seeks to encourage and nurture eCF. We address each of these elements within this section.

4.1 The London technology and finance sectors

According to McWilliams (2015 p.49), 'London accounts for 8.9% of world technology finance – a long way short of the 30% contributed from Silicon Valley but nevertheless a figure which indicates an emerging growth.' In the five years from the financial crisis to 2013, the growth rate of financing financial technology businesses (fintech) in London was increasing faster than that of Silicon Valley (McWilliams 2015). This begs an important question regarding why London has become such an important hub for entrepreneurship? The answer may be found in the historical contingencies of the financial crisis. Following the

Big Bang[6] London's economic growth has been compared to the mega-growth of Far East economies. Douglas McWilliams (2015 p.23) (Executive Chair of Cebr, an economic consultancy) suggests that, 'London growth continued until 2007; indeed, for the entire period from 1997-2007, London's economy grew at an annual rate of 6.2% in cash terms. With inflation averaging perhaps 2% over the period this meant that real GDP growth grew at an annual rate of 4% - fast enough to rival Far East economies.' He suggests that this growth was underpinned by the financial district of London where 'City jobs' rose from a plateau of 170,000 in the mid-1980s to 230,000 in 1989 and 350,000 by 2007. Correspondingly, city bonuses also increased from ~£1 billion in 1990 to ~£14 billion by 2008, with the number of individuals receiving bonuses over £1 million totalling ~30 in 2000 to ~1500 in 2007.

The financial crisis provided an opportunity to rebalance the UK economy away from financial services and the property market towards other industries concentrated outside London, but this does not occur. In 2009, London's GDP declined by 6% compared with the UK's decline, as a whole, of 4.3%. The fact that London's GDP had declined by an additional 1.7% compared to the rest of the UK is sometimes pointed as indicating resilience because a steeper decline did not take place. In 2012 London's employment increased by 2.3%, leading the UK economic recovery, in contrast to those who had predicted that the financial crisis would precipitate a regional rebalancing. The signal was clear; London is a highly resilient place to do business. In a single East London Postcode (EC1V) 32,000 new business were created in just two years to 2014, as many as were created in Manchester and Newcastle together (McWilliams, 2015). This area has become an epicentre for technology start-ups due to its proximity to London's traditional business centres and comparatively low rents for office space and excellent transport links,

McWilliams's findings are mirrored in other reports. In 2014, research underwritten by Bloomberg Philanthropies titled: London: Digital City on the Rise, (Mandel and Liebenau, 2014) found that, 'There are 382,000 workers in London's tech/info sector—an increase of 11 percent since 2009.' and that the, 'growth of London's tech/info sector from 2009 to

6 The Big Bang is shorthand for a number of measures taken to deregulate the UK Securities industry in 1986 in order to allow London to compete with other foreign financial centres, such as New York, Tokyo and Zurich

2013 was more than triple the previous four years.' These scholars suggest that the tech sectors' consist of two interrelated areas; fintech and big data. Fintech, of which Crowdfunding is an important element, has been described as, 'The magical combination of geeks in t-shirts and venture capital that has disrupted other industries has put financial services in its sights. From payments to wealth management, from peer-to-peer lending to crowdfunding, a new generation of start-ups is taking aim at the heart of the industry—and a pot of revenues that Goldman Sachs estimates is worth $4.7 trillion. Like other disrupters from Silicon Valley, fintech firms are growing fast. They attracted $12 billion of investment in 2014, up from $4 billion the year before.' (Economist, 2015).

As London's position as a hub for entrepreneurship, technology and finance phenomenon has developed, the UK Government's interest has also increased. In 2015, at the Bank of England's Open Forum, UK Chancellor (George Osborne) stated that London was, 'good at both fin and tech' He stated, 'We will go out of our way to do that. The race is on but we are determined to win it to become 'the global centre for fintech' (FT, 2015). A government sponsored report (EY, 2014) found, in accordance with the Centre for Retail Research (2015), that the UK is an early adopter of innovative business models, including crowdfunding, particularly where those models increase levels of convenience, reduce upfront costs and rely on internet delivery. See Figure 6.

Figure 6 Consumer e-commerce spending per capita Source: EY 2014

The EY report also outlines how UK is a market leader in Europe for crowdfunding and peer-to-peer lending. It is estimated that in 2013 £1bn of funding was committed through such platforms. EY estimated correctly that the sector would grow significantly in the coming years.

In summary, a key element of the thriving crowdfunding ecosystem in London is the entrepreneurial and technology community, which, like London's tech and finance sectors, has changed considerably since the financial crisis. EY (2016) outlines how, 'The UK has always benefitted from a large FS (financial services) industry. However, much of the recent success of the UK's fintech sector should be attributed to a well-served and well-functioning ecosystem.' A key component of this ecosystem is the institutional environment, which regulates the use of eCF.

4.2 The UK Regulatory Environment

In addition to the entrepreneurial, finance and technology players, eCF in the UK also benefits from a sympathetic regulatory regime, which has particular benefit in a hub like London. Following the financial crisis, the phrase often touted by the press was that the Regulator was 'asleep at the wheel', that the regulations in place were inadequate and that firms had been inappropriately supervised and allowed to get away with far too much (Sants 2010b). Figure 7 shows how confidence in banks diminished following the financial crisis (EY 2016).

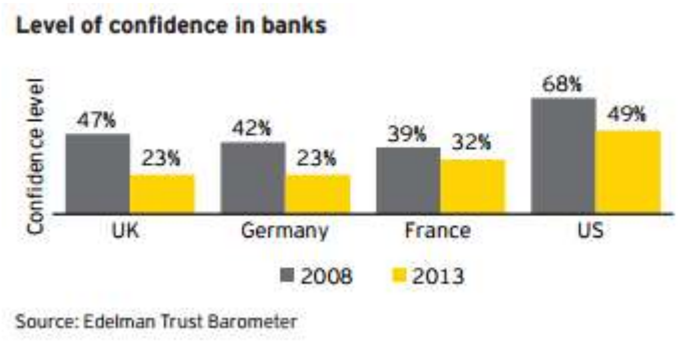

Figure 7 Level of Confidence in Banks Source: EY 2016

Traditionally the approach of US, European and UK regulators has been quite different. Prior to the financial crisis within the UK, the regulator, the FSA (predecessor to the FCA), adopted a principles based or 'light-touch' approach to regulation. This approach was contrary to a prescriptive or detailed rule driven approach to regulation and allowed firms to

> *'…have increased flexibility in how they deliver the outcomes [the Regulator] require' and focused on, '…moving away from dictating through detailed, prescriptive rules and supervisory actions how firms should operate their business.'* (FSA 2007).

The FSA repositioned itself to focus its activity towards setting desirable regulatory outcomes in principles and out-come focused rules. The principles set the high-level desired outcomes and were underpinned by fewer rules, which were also often outcome focused.

The FSA suggested that a highly complex rulebook with many thousands of detailed rules was a barrier to smaller firms without legal or compliance expertise. In contrast, two key US regulators, the SEC and CFTC, have always been predominately rules-focused. In 2009, the FSA's 'principles-based' approaches to regulation were replaced in the wake of the financial crisis. The Regulator's Chief Executive commented that:

> *'…the limitations of a pure principles-based regime have to be recognized. I continue to believe the majority of market participants are decent people; however, a principles-based approach does not work with individuals who have no principles'*- Speech at the Reuters Newsmakers' event March 12th 2009 (Sants 2009).

In 2012, Lord Turner, Chairman of the FSA, observed that prior to the crisis,

> *'debates about regulation [were] more focused on fostering London's competitiveness through 'light touch' regulation, than on any concern that poor regulation might be creating the conditions for future crisis. In retrospect, it was a fool's paradise – the band playing on oblivious to the dangers ahead.'* – Speech at FSA City Banquet at the Mansion House, London, 11th Oct 2012, (Turner 2012).

Turner highlighted the need to move towards a new approach of 'intense supervision' (Ashby and Waite, 2009; Financial Services Research Forum 2009; International Securities Association for Institutional Trade Communication 2011; Turner, 2009). The new approach required a far more proactive approach by the regulator, seeking to actively influence outcomes as opposed to merely reacting to events (Pain, 2010).

In addition to introducing new rules and obligations, the financial crisis also changed the regulatory landscape by altering the way in which the UK Regulator supervised firms (Sants, 2009; Sants, 2010a). In 2009, the Regulator's Chief Executive directly threatened the banking establishment, Hector Sants outlined:

> *…a fundamental change. It is moving from regulation based only on observable facts to regulation based on judgments about the future… This more 'intrusive' and 'direct' style of supervision we call 'the intensive Supervisory Model'… There is a view that people are not frightened of the* [Regulator]. *I can assure you that this is a view I am determined to correct. People should be very frightened of the* [Regulator].*'* - Speech at Reuters Newsmakers' event March 12th 2009 (Sants, 2009).

However, despite increased sanctions and heightened supervision the FCA has also acknowledged the need to foster innovation in accordance with government policy.

Christopher Woolard (2015a; Woolard 2015b), director of strategy and competition at the FCA commented that,

> *'Disruption - particularly disruptive new entry – is a key part of promoting competition. But financial regulation can be complex, and deeply traditional in its approach… Whilst regulators rightly focus on the risk of bad things happening in the system, we have to be conscious this can be at the cost of stifling the chance of good things emerging. We run the risk of seeing the problems and challenges of technology and innovation without valuing sufficiently the benefits they can bring. We may be potentially too risk averse.* [A further] *danger is we ignore the needs of consumers and those firms that could bring the disruptive innovation we need in markets.'*

Mandel and Liebenau (2014) concur, 'Good policy has helped as well. Since taking office in 2008, the local and national governments have used a variety of policy measures to attract existing tech businesses and encourage start-ups, building on London's world-class strengths in finance, advertising, and media.' Figure 8 contrasts the UK, US and German regulatory environments in relation to their ability to facilitate fintech and correspondingly eCF.

UK **Regulator:** FCA	**Notable initiatives** **Project Innovate (2014):** developed by the FCA to support authorisation for innovative businesses. Proposed to include a Regulatory Sandbox, which will enable businesses to test out new products and services, in an environment that is exempt from standard regulations	**Interviewee sentiment:** "The FCA's Innovation Hub was outstanding and made the authorisation process so much more manageable." **FinTech, UK** "The FCA is well educated in FinTech, meaning you can have a useful conversation." **FinTech, UK** "The cost of compliance isn't a UK pain point, but there is always room for improvement." **FinTech, UK** "Due to the complex nature of the UK financial market, it is sometimes difficult for FinTechs to understand which elements of the regulatory framework apply to them." **Investor, UK**
FCA invaluable in complex market | Easy to engage | Well-informed | High-impact programmes		
US **Regulator:** CA: The Department of Business Oversight NY: Department of Financial Services	**Notable initiatives** Limited regulatory initiatives specifically aimed at engagement with, and support of, FinTechs	**Interviewee sentiment:** "Engagement with the regulator is mainly from a legal standpoint; FinTechs would benefit from a more collaborative approach." **FinTech, US** "A well-established long-standing regulatory environment which is fit for purpose but lacks support for new innovative business models." **Investor, US** "Fragmentation of policy schemes creates a more complex, time-consuming process." **FinTech, US**
Limited collaboration | Fragmented | Complex		
Germany **Regulator:** Federal Financial Supervisory Authority (BaFin)	**Notable initiatives** Limited regulatory initiatives specifically aimed at engagement with, and support of, FinTechs	**Interviewee sentiment:** "The regulatory landscape in Germany is very complex, with a lengthy and expensive application process." **FinTech, Germany** "The regulatory environment is positive, but the process can be long and costly." **FinTech, Germany** "BaFin provides a more open regulatory environment than reputation indicates; however, there is room for improvement to support FinTechs with opportunities to grow." **FinTech, Germany** "BaFin should consider introducing FCA-like sandboxes and regulatory projects." **FinTech, Germany**
Active, but could be more collaborative and transparent | Complex | Time-consuming		

Figure 8 Comparisons of Fintech Regulatory environments. Source: EY 2016

In conjunction with toned down rhetoric from the regulator and the government's focus on supporting fintech, the FCA also developed and introduced an 'Innovation Hub'. The purpose of this initiative was to help fintech firms, including crowdfunding firms, to become compliant and where appropriate receive the required authorizations to conduct business. However, the initiative also allows the regulator to learn more about the nature and risks associated with the disruptive fintech firms emerging post-crisis, which operate non-traditional business models. The FCA website states the Innovation Hub,

> *'…aim[s]* to *offer support to innovator businesses that are looking to introduce ground-breaking or significantly different financial products or services to the market, including when they need assistance with an application for authorisation or a variation of permission. This helps new or non-regulated businesses understand more about our regulatory framework and what it means for them, as well as firms that are already regulated. We are also looking to add more flexibility to our regulatory framework and remove barriers to entry, to encourage and support innovation where it will not erode consumer protection or the integrity of the financial system.'*

A key element of the Project Innovate Hub is the 'Regulatory Sandbox,' the purpose of which is to provide an environment where firms are exempt from the usual regulatory consequences of engaging with new innovative products, services or business models.

The FCA (FCA, 2014) undertook a specific analysis of crowdfunding; the proposed regulations are contained in Appendix A1. Their approach can be summarised as being designed to trade-off between factors; to secure an appropriate degree of protection for consumers, and to promote effective competition in the interests of consumers.

UK policymakers have also supported tax regimes, which facilitate eCF. Two tax incentives apply to eCF activities. The first is the 'The Enterprise Investment Scheme (EIS) which is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax relief to investors who purchase new shares in those companies' (HM Revenue and Customs, 2013a). This scheme was not specifically designed for eCF platforms, it was introduced in 1993, but its rules have been recently updated. The purpose of EIS is to help small, yet high risk companies raise capital and so is highly relevant to eCF entrepreneurs and investors. Announcing the EIS scheme, the then Chief Secretary to the Treasury commented, 'The purpose of Enterprise Investment Schemes is to recognise that unquoted trading companies can often face considerable difficulties in realising relatively small amounts of share capital. The new scheme is intended to provide a well targeted means for some of those problems to be overcome' (Voinovich, 2013). Firms must qualify and the income tax relief 'is available to individuals only, who subscribe for (although this can be through a nominee), shares in an EIS[7].

The second scheme, introduced in 2012, is the Seed Enterprise Investment Scheme (SEIS). It is, 'designed to help small, early-stage companies raise equity finance by offering tax relief to individual investors who purchase new shares in those companies. It complements the existing Enterprise Investment Scheme (EIS), which offers tax reliefs to investors in higher-risk small companies. SEIS is intended to recognise the particular difficulties which very early stage companies face in attracting investment, by offering tax

7 Relief is at 30% of the cost of the shares, to be set against the individual's Income Tax liability for the tax year in which the investment was made. Relief can be claimed up to £1,000,000 invested

relief at a higher rate' (HM Revenue and Customs, 2013b). To qualify for tax relief at 50% of the cost of the shares, SEIS requires that investors hold shares for 3 years from the date of issue. These developments have been welcomed by eCF platforms with for example Seedrs providing investors and entrepreneurs clear instructions on how the schemes operate with their platform (Voinovich, 2013)[8].

In summary, new tax and regulatory approaches have led London to be recognised as being particularly friendly to fintech firms and align with HM Treasury and the UK Chancellor's goals of developing a fintech friendly ecosystem. However, it may be suggested that the regulator's approach of allowing a lighter touch of regulations for some firms and industries comes at the expense of the incumbent firms who are not exposed to these benefits yet are funding them. From an ECF perspective, the UK government and regulators approach to fostering innovation has led to a regulatory regime which has allowed eCF to develop and expand resulting in the UK becoming a global leader in crowdfunding.

4.3. Stakeholder perspectives

This section outlines perspectives held by various stakeholders engaged in the London eCF community. We delineate three important sets of stakeholders who provide different and sometimes contradictory perspectives. The first are senior executives working within two of the leading eCF platforms; Crowdcube and Seedrs. The second set outlines the opinions of investors in the platforms. The third set explores the perspectives of those seeking to raise capital through the platforms; the entrepreneurs. Table 2 outlines the interview participants. . These comments were drawn as representative from a larger pool of interviews conducted from 2014-2016. For more details on the method employed, see Appendix A3.

Platform/eCF Model	ID	Job Title/Professional Background
Set 1: eCF Platform Providers		
Seedrs	1.A	CEO of Seedrs (Interview)
Crowdcube	1.B	CEO of Crowdcube (LSE Lecture)

8 In 2016, the UK government also introduced the Innovative Finance Individual Savings Account (ISA) which allows for peer-to-peer loan agreements to be included within the tax-free ISA tax wrapper (Nesta, 2016).

Set 2: Investors' Views		
Crowdcube Investor	2.A	Business Owner/Consultant
Crowdcube Investor	2.B	Consulting Professional
Crowdcube Investor	2.C	Information Technology Professional
Crowdcube Investor	2.D	Business Owner/Banking
Crowdcube Investor	2.E	Risk Management Professional
Crowdcube Investor	2.F	Investment Banking Professional
SyndicateRoom Investor	2.G	Asset Management Professional
SyndicateRoom Investor	2.H	Business Owner/Internet Company
SyndicateRoom Investor	2.I	IT Management Professional
SyndicateRoom Investor	2.J	Business Owner/Consultant
Crowdcube Investor	2.K	Business Owner/Internet Company
Crowdcube Investor	2.L	Private Equity Professional
Crowdcube Investor	2.M	Information Tech Professional
Set 3: Entrepreneurs' Views		
Crowdcube Entrepreneur	3.A	CEO - Locator app
Crowdcube Entrepreneur	3.B	CEO – Software and technology consultancy company
Crowdcube Entrepreneur	3.C	COO – Mobile payment app
Crowdcube Entrepreneur	3.D	CEO - Chemicals
SyndicateRoom Entrepreneur	3.F	CEO – Healthcare

Table 2 eCF Interviewees

4.3.1 Platform providers' views

We have argued that eCF may be a significant innovation in providing individuals with investment opportunities they might otherwise not have had and correspondingly providing entrepreneurs with access to new investors. The consequence of this is has been to provide capital on a fairly significant scale to new ventures and SMEs, which are a major source of UK job creation. The CEO of Crowdcube (1.B) described how such platforms create social networks, which are open to a wide range of investors and entrepreneurs,

> *'Crowdcube's aim is to improve the process of angel investment, which means to democratise investment and to allow ordinary people to invest in start-ups, meaning not necessarily extremely wealthy and well connected. Angel investment usually means 5-6 wealthy people invest in a start-up together. The ethos of our company is to focus more on the entrepreneur, so they can find access to funds. The idea is that lots of people raise small amounts of money for a much larger amount of businesses. We focus on early-stage companies, on democratising funding (people can invest as little as 10 pounds) and simplifying the process. It only takes 1-2 minutes to do. Our website connects two important parts, one side are small or early-stage companies and on the other is the crowd.'*

Similarly the CEO of (1.A) Seedrs commented on how his platform also aimed to democratise the process of investment,

'We started working on Seedrs back in 2009 as a new way to enable people to invest in start-ups and growth businesses that they care about. And provide those businesses access to a broader range of capital and to make the whole process simple and straightforward. This is very much for self-directed people who want to take control over where their money goes. And that's a big part of what crowdfunding is. It's about democratising element of it, it's about taking out the middle man to some degree, just saying to people you invest in the businesses that you care about.'

We suggested in section 2 that eCF platforms might reduce the information asymmetries inherent to traditional investment vehicles because entrepreneurs usually have more or better quality information about their ventures than their investors. The informational disadvantages of investors may lead to a 'moral hazard', whereby incomplete or inaccurate information is used to mislead a party as to the true nature of risk involved in a transaction. From the regulators' perspective, information asymmetries may lead to investors being misled and sold financial products, which are inappropriate to their risk appetite. Consequently, eCF platforms must be clear about the risks involved and avoid providing investment advice for which they would be held accountable and subject to further regulation. 1.A described how eCF platforms influence the knowledge people have regarding potential investments,

'I think when you invest in person you're doing it much more in isolation. In the sense that you're making your own judgement of the business and you have much less to go on in terms of what other investors are thinking. And, that works two ways. What often happens when you invest offline – someone is giving no information about what other investors are doing? Someone's got bad information in the sense that you have this perception this company is really hot, but every entrepreneur knows how to go to an angel and say we're just about to get a term sheet from Index but we'll let you in if you sign now. Who knows if any of that's true. There's a harsh reality online in the sense that you only see what's actually happening. So I think from an investor experience you just have a lot less information about other investor behaviour offline than online. You're just making your own decision based on what you are told. That's one sided. And we don't take any liability as we are not giving any advice to investors. We check that people understand the risks that are involved. We have disclaimers all over our website.'

Fraud or the misleading of investors, where benefits accrue at the expense of the investors, may cause loss of trust and confidence in the platforms, which may reduce the number of potential individuals available to invest in entrepreneurs' projects. 1.B commented,

> *'We do background checks into individuals, look at their history with Companies House UK, check their IDs, do money laundering checks on the entrepreneurs and investors, etc. The majority of companies that come on Crowdcube have been around for a while. They have a track record. So, if you are going to try and fake a company and run it for two years—that's a lot of effort to go through. There's also a forum where people can catch you out, which helps to deal with the problem of information asymmetries.'*

The platforms are clear that although they do all the checks listed above, it is investors who make the decisions. Moreover, improvements in procedures and processes to weed out potential fraud are a continuous endeavour for all platforms.

Seedrs CEO (1.A) commented on how his platform seeks to mitigate the risk of fraud and increase trust in his platform not least through being regulated and encouraging high levels of engagement between entrepreneurs and investors,

> *'I think that trust in the platforms, that regulation is part of it. But early on there were a number of platforms on an unregulated basis. And one of the reasons that I think we had grown so strongly and really hit the ground running was that we came to the market regulated. We were able to provide the level of trust that came with that. One fear people fairly have about CF is that if they invest and that companies then kind of go off and I'm not sure it's going to happen. Seedrs, compared to other platforms, mitigates that to some extent, we access the nominee and we provide a certain level of required engagement. But there's only so much you can force an entrepreneur to do in terms of keeping people updated. If you see an entrepreneur who seems to naturally want to engage with his or her investors I think that creates a huge amount of trust.'*

In summary, a key benefit of eCF espoused by the platforms providers' is that it democratizes investment opportunities and reduces reliance on intermediaries. The platforms also aim to prevent moral hazards created through information asymmetries. Reduction of asymmetry of information between investors and entrepreneurs is viewed as a key benefit though fraud is often quoted as a concern amongst potential eCF investors. However, from the perspective of the platform providers, they have due diligence processes in place to limit or prevent fraud and money laundering practices. The platforms have less control over how frequently entrepreneurs update their investor community. This means that while asymmetric information is reduced during the funding stage, when compared with more traditional investment vehicles, it persists and is perhaps more prevalent following a successful funding round as large groups of investors have less power to require frequent updates than small groups of angel or VC investors.

4.3.2 Investors' views

Clearly for eCF to bring societal benefits, through the funding of new entrepreneurial activities, investors must be found who are willing to participate and who understand the risks involved. This is the key regulatory challenge; to protect investors and ensure they are appropriately informed regarding the risk of their investments while at the same time encouraging platforms which direct funding to entrepreneurs and SMEs. The investors interviewed highlighted several reasons for choosing to invest through crowdfunding platforms. An important reason for many was the return on investment. A prevailing theme was that crowdfunded investments appeared to offer an attractive return when compared with extremely low interest rates in banks. Investors were also keen to be associated with what they viewed as exciting or technologically advanced ventures. Allaying some regulatory concerns (see 2.1), many investors commented that they understood that such investments came with additional risk. One investor (2.A) commented,

> *'Essentially the money I've put in I am assuming am not going to get it back. So if I do get anything back that's a bonus or if I do get my principal sum back that's fine. But I had a small amount of money that I wasn't doing anything with. I have never done anything with saving previously and interest rates are ridiculously low it's not really much profit in stuffing cash into a savings fund. And because its small amounts of money and I have worked on the assumptions if I lost it, its fine.'*

Often investor's highlighted how they recognised that the investments were high risk and that they may lose their capital. Yet this is ascribed to the nature of investing in smaller start-ups rather than any additional risk created by the platforms themselves. An investor (2.B) commented,

> *'When you are talking about smaller start-up companies, at the end of the day there are a number of volatile factors you need to take into consideration. Through the crowdfunding platform, should the company go bust, it's going to be very difficult or expensive for an international investor to get all the money back. So more or less the risk profile is the same.'*

The high-risk nature of investing in start-ups should be balanced by a high level of reward compared with low risk investments such as accruing interest in the bank. In addition participant investors recognised that their investment was at risk and often invested spare funds they felt they could afford to lose or as part of a more balanced portfolio where the eCF investment represented the higher risk element of the portfolio. Table 3 highlights views of several interviewees regarding their financial motivations for investing through equity based crowdfunded platforms.

Table 3: Importance of financial returns and high risk alternative investments			
'I had some expendable income and decided that it would be a good idea to diversify what I am putting my money into rather than just sticking it into a mutual fund. Instead I could take a small portion of my savings and put them into something higher risk and more exciting.' (2.C)	*'I have a considerable amount of spare cash in the bank. My* interest [in equity based crowdfunding] *was how I could invest and receive a good rate of return.'* (2.D)	*'I am interested in the potential benefit* [of equity based crowdfunding] *if you find the right company, of the gains from that but at the same time I am pretty aware of the fact there are high risks with small companies.'* (2.E)	*'I was attracted by the higher potential returns from crowdfunding in comparison to listed investment opportunities.'* (2.F)
'Because of my age and the capital I have built over time, my ability to take risks with that money is greatly enhanced, so a portion of my wealth is allocated towards more risk taking ventures. Because of my background I am inherently more comfortable considering this type of investment and taking that risk' (2.G)		*'I have capital to put to work. There aren't a lot of opportunities to invest that money by more traditional routes to get a return and certainly you can't sit on the money in the bank, it just doesn't feel very comfortable doing that.'* (2.G)	*'Interest rates are really low. At the moment leaving the money in the bank doesn't really do you much good.'* (2.H)

Table 3 Importance of financial returns and high-risk alternative investments

In addition to the potential rate of return, several of the investors interviewed highlighted how brand recognition and product familiarity were also important factors in deciding to invest. Investors familiar with the brand may be proximate to the firm and know the company. Alternatively, they may use its products or services or have watched others do so. All in all, familiarity with the company pitching reduces the information asymmetries and increases the available information investors have at their disposal to make decisions. It is also possible that some investors would participate out of solidarity with the entrepreneur and not necessarily because they see profit potential. Table 4 consolidates and highlights related comments from investors,

Table 4: Importance of brand and product recognition			
'I didn't just do it because it was actually crowdfunding. I did it because I've used Sugru's products in the past, I bought a pack maybe 9 months ago and it's very, very good and I thought that at the moment in the market, it's not very well-known about... Once they start going more mass market, I think the products is strong enough that it will sell very well. I only put in a small amount of money.' (2.K)	*'I like the product. It's something that I'm very interested in. I used it and I like. When it became available to be invested in and they want my money as an investor, I'm very happy to be part of them. So it's more about the personal interest in the company and into the product itself. The product is fantastic. I did look at their financials, they look pretty decent.'* (2.J)	*'I've always been fond of Camden Town Brewery. So, I think these guys are very distinctive. I think they seem to have a very good acceptance from both, a mainstream consumer and from more, sophisticated beer connoisseurs. You know, the owner is the founder. And I also think that the brand, you know, is an important asset and of course Camden Town Brewery, it's one of the most synchronized places in London.'* (2.B)	*'Just Park... I am driving a lot for work it means I am frequently parking in the NPC carpark and I am thinking this is ridiculous it's very expensive. I've got the app on my phone and I actually use this and it felt like it's a good idea. I think they were about 30% funded when I put my funding in and they were oversubscribed by another like 150% something like that. It was quite bonkers.'* (2.A)

Table 4 Importance of brand and product recognition

The interviews also revealed important secondary non-financial reasons for investing through equity-based crowdfunding. Many eCF investors enjoyed the eCF experience. Investors commented on how participating in innovative products and services and experiencing crowdfunding were all important motivating factors. Table 5 highlights these perspectives.

Table 5: Importance of participating and experiencing				
'I can make a very very small amount of	*'I put in money because I*	*'In the end, I only put in a small amount of*	*'I wasn't really thinking that I would set out to*	*I don't invest very much. I am not a massive*

investment feel like I am being part of something and potentially make some money back on it.' (2.A)	*enjoy the idea and I want just to follow it or their success other I take financially more seriously.'* (2.M)	*money. I'm not going to become rich out of it. But I did it to personally see what the experience* [of equity based crowdfunding] *was like.'* (2.K)	*make some money. I liked the idea of some of the things that were there and I thought I want to invest in this. It's a good thing that should be invested in'* (2.A)	*investor in so it's kind of away for me to learn. It's a form of self-improvement in terms of being to become a better investor in the future.'* (2.K)

Table 5 Importance of participating and experiencing

However, despite the potential rewards and non-financial benefits, eCF has not convinced some entrepreneurs who already have experience of investing in start-ups and SMEs. Investing through a crowdfunding platform instead of through more conventional routes creates a new dynamic to the process and in some ways is counter intuitive. Public sharing of a 'good' investment goes against traditional practices as does ceding significant equity control rights while investing. An experienced investor[9] who chooses not to invest through crowdfunding outlines how this approach goes against traditional practices,

> *'No. A good investment is something you discover, keep from others and you try to get the best deal. It's not in your interest to attract others because it makes everything more expensive. The best time to invest when everyone thinks it's a bad investment. I don't believe in the crowd. They're always wrong. Getting in is more expensive, when you're invested online you have no influence. Offline you can be involved with the board, have management influence. As part of the crowd you have zero control, being one out of 250 other people is not interesting. These are donations more than investments.'*

Another experienced investor[10] who also refrained from investing through crowdfunding platforms highlighted the importance he attached to the product, market potential and meeting investors,

> *'I think the most important thing is a beta* [product] *when you invest, after that growth and the* [market] *potential. Then, if you meet the founders and the team it'll be a lot better because you know the direction, their life, what their interests are, whether the thing they're doing is their passion. I think*

[9] Not included in Table 2 as not engaged in eCF but invests through more traditional funding vehicles

[10] Not included in Table 2 as not engaged in eCF but invests through more traditional funding vehicles

when you meet the team and you know the founders it'll be a lot more "pleasable" or it makes you more confident about the thing.'

In contrast, a platform provider (1.A) highlighted how the previously outlined perspective that it was not possible to interact with the entrepreneur was, in his view, a misconception particularly where larger sums were involved,

'Although one of the misperceptions of crowdfunding and other platforms like us is that you can't have any contact with the entrepreneur. The truth is that anybody who's investing a meaningful amount or you're looking to invest a meaningful amount, they call you or e-mail and say 'can we get together for coffee?' They have that in personal interchange it may be offline that may be the first time they interact with them, [with crowdfunding] *they only do it after they've learned about the deal. You have the opportunity to interact offline even though the deal is ultimately online.'*

Despite views held by some experienced investors that the eCF platforms reduce the opportunities for social interaction with entrepreneurs, the success and remarkable growth of these platforms demonstrates that others see considerable benefits in this form of investment. The convenience and ease by which the platforms allow individuals to invest permits them to engage in investments in a more transparent and convenient way, thereby reducing important barriers to investing in SMEs; for example investors no longer need to be able to understand and manage large volumes of legal paperwork. A platform CEO (1.A) who also invests through the platform he runs highlighted how he found the convenience of investing an important benefit particularly when investing relatively smaller amounts of money,

'I find it a tremendous amount more efficient among other things. I think that the hassle of dealing with individualised documentation and paper work and (…) and everything that goes with it just isn't particularly well worth it for me. Look, I'll be the first to say and I'm sure that's the truth for many more investors that if I were looking to invest 50,000 or 100-250.000 pounds per deal than it might matter a little less, if I invest smaller amounts, I'm trying to build a portfolio then to me online is the only efficient way to do that. I tend to invest anywhere between 100 to 1,000 pounds per deal. But I think that if you're investing under about 10,000 pounds it's very hard to do that in any efficient way offline and really you got to get into to 25,000-50,000 pounds before offline investment starts to make sense.'

Furthermore, the use of the platforms allows some investors, both experienced and inexperienced, entrance to networks and correspondingly investments opportunities to which they previously did not have access. Thus, eCF platforms overcome challenges that investors faced regarding visibility of networks and accessing different types of more flexible investments. Consequently, here too, the eCF platforms are able to narrow funding gaps by overcoming barriers to investing easily and efficiently in SMEs. Table 6 highlights two such perspectives,

Table 6: Importance of accessing new investments and networks	
'Compared to venture capital fund [crowdfunding] *is more flexible in the selection and choice of the type and size of company that one could invest in, whilst providing similar tax relief and governance.'* (2.I)	'[The crowdfunding platforms] *allow me to see more opportunities, seeing sectors where I don't have networks.'* (2.J)

Table 6 Importance of accessing new investments and networks

In summary, our interviewees naturally cited potential return on investment to be an important motivating factor for eCF investors; not least as traditional methods of saving were drawing low returns due to the extended period of low interest rates. However, it was understood by investors that additional returns would create higher levels of risk. Equity based crowdfunding platforms were, therefore, seen as a vehicle by which to access better returns through riskier investments. For many, the platforms were not seen so much as increasing or mitigating the risk of investing with start-ups, but rather as allowing investors to access investments that were previously inaccessible. The platforms were seen as reducing transaction costs, due diligence and paper work and thus made the process of investing easier and more efficient while at the same time reducing asymmetric information risks. However, some felt that such convenience came at the price of control and being able to dig deeper into the nature of the investments by meeting or interacting with the entrepreneur more directly. For some experienced investors, eCF platforms' potential to reduce information asymmetries for other investors was disadvantageous. eCF can make investments more transparent and therefore lead more people to the investment, when some investors prefer to invest on their own or with only a few others. At the same time eCF platforms' capabilities were deemed, by some experienced investors, as being unable to reduce asymmetric information sufficiently when compared with direct physical contact with the entrepreneurs. In selecting investments, risk, rate of return as well as brand and product recognition were all felt to be of importance. In addition, the interviews revealed important non-financial motivations for engaging with these platforms. The learning more about innovative types of product and experiencing the role of being an investor were also highlighted as key factors by the interviewees. From the regulators' perspective, it is reassuring to understand that most individuals engaging with eCF are doing so while being aware of the risks and so are not investing money they cannot afford to lose.

4.3.3 Entrepreneurs' views

The ability of eCF to channel capital towards entrepreneurs creates potential social benefits including job creation, enhanced innovative capabilities, economic growth and increased tax revenues. Consequently, it is important to consider the reasons entrepreneurs may choose to seek capital through eCF rather than through more traditional means. The entrepreneurs interviewed highlighted several reasons for selecting equity based crowdfunding as an appropriate vehicle to raise capital. A key reason given by entrepreneurs was that it allowed them access to a large pool of potential investor's conveniently. Table 7 highlights related perspectives from the entrepreneurs interviewed,

Table 7: Importance of accessing large pool of potential investors		
'It was a commercial decision. We felt that Crowdcube had a large investor pool more quickly and easily available.' (3.A)	*'Number one? Larger audience. Fundraising is a sales exercise… you want to increase the numbers at any stage of the sales cycle and Crowdcube, I believe has around 180,000 people registered on its database* (interviewed in: 2014), *so when we launch on Crowdcube we get our message in front of 180,000 people.'* (3.B)	*'We didn't want to alienate too many people wanting to invest, even if they are at the smaller end.'* (3.C)

Table 7 Importance of accessing large pool of potential investors

As the crowdfunding platforms matured and attracted larger numbers of investors their appeal to entrepreneurs also increased. As the number of investors within the platforms became larger (see 2.5), for some firms, the platforms were perceived as being more attractive than angel investor firms. An entrepreneur (3.B) commented, *'There aren't many professional angel investors. There's a very wide range of angel investor organizations around the UK and of course in America and elsewhere. They range from a very small and informal to very large and national and some of them are international. So Crowdcube's been going for about five years* (interviewed in: 2014) *and its already, I don't know, 5 or 10 or 100 times bigger than any other angel organization in Europe.'*

An additional factor cited by the interviewees was the opportunity to leverage their existing community of users and transition their user base into investors. This has the added benefit of turning user-investors into more vocal advocates of the firm. This finding suggests that established firms may have an added advantage over start-ups and supports our earlier finding that brand recognition and product recognition are important factors in the investment decision making process. Table 8 highlights these perspectives,

Table 8: Opportunity to leverage existing user community		
'We could see that there was a huge demand from our customers – there are three quarters of a million of them, - to own some of the business and to profit from our success and so once we realised that it was better than plan B.' (3.A)	*'So we at a certain stage where we've built up this incredible community, very vibrant and engaged community.'* (3.D)	[Through crowdfunding] *we could see when our customers became investors and shareholders. It almost supercharges* [customers] *advocacy on behalf of the product and the company'* (3.D)

Table 8 Opportunity to leverage existing user community

A related reason for selecting equity based crowdfunding, highlighted by the interviewees, was that crowdfunding allowed them access to capital without relinquishing the same levels of control than they would through venture capital investment. From the perspective of a manager, crowdfunding provides an opportunity to raise capital without having a relatively small number of powerful investors to answer too; instead there are a large number of investors with relatively little individual influence. An entrepreneur[11] commented,

'From the view of someone who is looking for funding [crowdfunding] *is a very positive thing. You don't have to worry about funders, as they don't really have influence. If the money is gone, it's gone. If you're with a VC, they might kick you out* [as the manager of a venture] *and get involved, as they really want to see returns on their investment.'*

[11] Not included in Table 2 as not engaged in eCF but invests through more traditional funding vehicles

As equity based crowdfunding has matured (see 2.5) the amounts of money raised has increased. Correspondingly, entrepreneurs' perspectives on the capability of such platforms to raise larger sums have changed as have their views on whether equity based crowdfunding is an appropriate vehicle to raise capital for more mature firms. An entrepreneur (3.D) suggested,

> *'When you see that it's possible to raise a significant amount of money then it becomes a viable option for a growth stage company like ours whereas I think it really started with seed stage companies which would need to raise a quarter of a million or something like that but once we became comfortable that it was possible to raise one million so it became more viable for us.'*

Similar to the investors, the interviews revealed important secondary reasons for entrepreneurs to engage with eCF besides raising capital. Such platforms also allowed businesses to spread awareness of their products and services. Thus using eCF platforms to raise capital had an added secondary benefit for SMEs. An entrepreneur (3.C) commented,

> *'While we were looking to fundraise as well, it was relatively significant that we wanted to raise awareness with the restaurants in London. We wanted to gain credibility among the restaurants.* [Crowdfunding] *allowed us to do that.'*

A further non-financial reason for adopting a specific eCF platform (Syndicate Room) contrasted with the views of investor who felt negatively about eCF due to the lack of direct physical interaction (see 3.3.2.). Entrepreneur (3.D) felt that,

> *"And Syndicate Room is attractive to the investor and investee because it's a virtual meeting rather than a physical meeting and you don't have to go and sit in a hot room somewhere and look and watch six or seven other companies presenting, so it's very attractive from that point of view"*

In summary, a key reason for entrepreneurs to select eCF as their preferred method of raising capital is the access that such platforms facilitate to a large pool of investors. Some entrepreneurs see this process as primarily a numbers game in that the more potential investors the more likely their fund raising initiative is to succeed. As the platforms have matured and related success stories become widespread, their pools of investors have increased. This in turn has resulted in eCF being seen as a viable alternative to angel and VC investment, increasingly so as eCF firms have grown much larger. Correspondingly, as the size of the platforms has increased so has the potential sums that can be raised by capital seeking firms. SMEs can now potentially access larger sums and larger volumes of investors than prior to the development of such platforms depending on local regulation. Consequently, eCF has attracted not only start-ups but also more mature SMEs looking to raise developmental capital. However, engaging with eCF platforms has additional secondary benefits for entrepreneurs including raising awareness and credibility. In addition, entrepreneurs, like investors, find that engaging with eCF is more convenient and effective than more traditional routes.

5. Conclusions

In the final analysis, what lessons to can we draw from the emergence of equity crowdfunding in and around London? We offer the top five points of relevance to policy-makers and regulators as well as investors and entrepreneurs.

1. Equity crowdfunding has the potential to become a driving force in closing the gap in the financing of entrepreneurial ventures and creating access for entrepreneurs and investors. It may allow investors access to networks and investments with which they would not ordinarily be able to interact whilst at the same time reducing transactions costs and the burden of legal paperwork. UK's light-touch regulatory approach coupled with a generous tax incentive policy has allowed multiple equity crowdfunding platforms to launch, experiment, and gain scale. This has meant that tens of thousands of investors and entrepreneurs had an opportunity to engage with the process without facing extensive barriers to entry. *Thus, the first lesson from UK's equity crowdfunding London cluster suggests that policy-makers and regulators would do well to look and listen to the market if they are to understand the early dynamics of how equity crowdfunding takes root and diffuses.*

2. Equity crowdfunding can generate numerous societal benefits, including higher levels of innovation and hubs of expertise, job creation and increased taxable revenues. After half a decade of multiple platforms operating in and around the London cluster, evidence is starting to accumulate which suggests that many firms that attract capital through equity crowdfunding are able to start and scale their businesses. In addition, the influx of capital may bolster local investment and employment, and such effects reach far beyond the boundaries of London. However, equity investments are long-term commitments, and equity raised through crowdfunding is no exception. Economic and societal benefits accrue over time and may take years to become apparent. With few exits from equity crowdfunding, the UK industry is yet to see the full fruits of its labour. *In view of this, we suggest that policy-makers and regulators are critical in helping to maintain a steady environment, which facilitates a long-term focus and confidence on the part of the investor community.*

3. Equity crowdfunding as a financial innovation has antecedents in the financial crisis, which precipitated new models for allocating capital when traditional debt and equity markets became less helpful for the majority of entrepreneurial and growth ventures. Our case study highlights that London's financial ecosystem helped to establish the City as a particularity fertile location for crowdfunding activities. Yet, this did not happen immediately. In fact, it is clear that the equity crowdfunding, as a financial innovation, emerged not from the ashes of London banks but as an alternative and an increment to the traditional providers of capital. Over time, London saw the development of the key elements of its ecosystem: the local hubs of entrepreneurship that have sprung up around London since the crisis. In tandem, the UK government has also clearly signalled its support for technology, innovation and entrepreneurial activities in the capital**.** *We suggest that this implies national and local governments should work together to create an ecosystem capable of sustaining robust entrepreneurial and financial communities.*

4. Equity crowdfunding raises common concerns held by regulators worldwide regarding the risk profiles of investors and the degree to which investors understand the high risk and illiquid nature of these investments. The investors we interviewed, albeit a modest sample, appeared to engage with eCF platforms with a clear knowledge that their investments were at risk and that they could lose their capital. Some investors also highlighted that they engaged with the platform for non-financial reasons such as understanding more about an interesting innovation or the investment process. Some investors therefore see their investment as entertainment, part of their disposable income. *Consequently, we recommend regulators cautiously embrace the eCF phenomenon as the potential benefits to society seem to outweigh the risks to individual investors. However, policies should be exploratory because the full effects of eCF on investments and entrepreneurs will not be revealed for some time, until the impact on firm performance and* *investor risks can be properly evaluated. In line with this recommendation, we strongly advocate continuous financial education of entrepreneurs, investors, and platform operators.*

5. ***The use of eCF platforms is viewed by many as going some way to mitigating information asymmetries between entrepreneurs and investors. These have also long been a regulatory concern. However, for others, such information asymmetries can only be adequately reduced through direct interaction with the entrepreneurs.*** We offer that equity crowdfunding platforms seem to reduce information asymmetry but post-investment, information asymmetries may still arise if entrepreneurs do not keep their investment community informed of developments. Efforts to keep entrepreneurs and investors connected are therefore very important. Indeed, for investors who are participating in order to learn more about an innovation, industry, entrepreneurship or the process of investment, the level of engagement between entrepreneurs and investors is critical. Yet, our research also shows that entrepreneurs also have reasons for engaging with the eCF model that does not relate exclusively to raising capital. Entrepreneurs may also choose eCF due to perceived secondary benefits regarding raising awareness and credibility of their product or service. *Thus, we recommend that platform providers utilise their already strong social media capabilities to develop functionality, which fosters these additional elements of added value for entrepreneurs. We suggest platform providers and regulators collectively address this issue.*

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Appendices

Appendix A1: The relevant rules

The FCA's regulatory approach to crowdfunding over the Internet, and the promotion of non-readily realisable securities by other media - March 2014

Given the significant risks investors face when investing in unlisted securities that are hard to value independently or sell on a secondary market, we proposed that firms offering such investments on crowdfunding platforms (or using other media) promote only to certain types of investor. These are:

- *professional clients,*
- *retail clients who are advised,*
- *retail clients classified as corporate finance contacts or venture capital contacts,*
- *retail clients certified as sophisticated or high net worth, or*
- *retail clients who confirm that they will not invest more than 10% of their net investible assets in these products.*

Where no advice has been provided to retail clients we also proposed to apply the appropriateness test, so all firms (both MiFID and non-MiFID) would need to check that clients have the knowledge or experience to understand the risks involved.

We proposed rules that would apply to 'unlisted shares' and 'unlisted debt securities', intending to identify difficult-to-value, illiquid securities. Some respondents asked for clarification of what was meant by these terms and, in particular, whether they applied to securities traded, or soon to be traded, on a recognised investment exchange or designated investment exchange5 such as the Alternative Investment Market. As explained in the CP, we did not intend that liquid, traded securities are affected – only those securities for which there is no acceptable secondary market. After considering respondents' comments, we propose to replace the terms 'unlisted share' and 'unlisted debt security' with a new defined term, 'non-readily realisable security', to more clearly describe the intended scope of the proposed rules.

Appendix A2: List of crowdfunding platforms

Name	Brief Description	Website
Abundance Generation	Platform offering equity for UK renewable projects (Debentures)	www.abundancegeneration.com
AngelList	Platform offering equity	www.anegellist.co
Angels Den	Platform offering equity	www.angelsden.com
CoFunder (NI) Ltd	Platform offering debt	www.cofunder.co.uk
Crowd2Fund	Platform offering debt and equity	www.crowd2fund.com
Crowd for Angels	Platform offering debt and equity	crowdforangels.com
CrowdBnk	Platform offering equity	www.crowdbnk.com
Crowdcube	Platform offering equity	www.crowdcube.com
CrowdFunder	Platform offering equity	www.crowdfunder.co.uk
CrowdPatch	Platform offering funding and volunteering with social purposes	www.crowdpatch.co.uk
CrowdProperty	Platform offering debt	www.crowdproperty.com
CrowdShed	Platform offering debt for not-for-profit businesses	www.crowdshed.com
Emerging Crowd	Platform offering debt and equity in emerging markets	www.emergingcrowd.com
Ethex	Platform offering Not-for-profit investment intermediary	www.ethex.org.uk
Funding Empire	Platform offering debt	https://www.fundingempire.com/
FundingKnight	Platform offering debt	https://www.fundingknight.com/
FundingSecure	Platform offering debt	https://www.fundingsecure.com/
Funding Tree	Platform offering debt and equity	https://www.fundingtree.co.uk/
Fundsurfer	Platform offering debt and equity and donation	https://www.fundsurfer.com/
FutSci	Platform offering donation for science research projects	https://www.FutSci.com/
Gambitious	Platform offering equity for gaming projects	www.gambitious.com
GrowthFunders	Platform offering equity	www.growthfunders.com
Hubbub	Platform offering	https://hubbub.net

	donation	
Invesdor	Platform offering debt and equity	www.invesdor.com
InvestUP	Platform offering debt	www.investup.co
JustGiving Crowdfunding	Platform offering donation	http://crowdfunding.justgiving.com
Lending Crowd	Platform offering debt	https://www.lendingcrowd.com
Microgenius	Platform offering donation and equity for community projects	http://www.microgenius.org.uk
Money & Co	Platform offering debt	http://moneyandco.com/
Property Crowd	Platform offering debt and equity for property investments	https://www.propertycrowd.com
Property Moose	Platform offering debt and equity for property investments	http://www.propertymoose.co.uk
Property Partner	Platform offering debt and equity for property investments	http://www.propertypartner.co
QuidCycle	Platform offering debt	https://www.quidcycle.com/
Rebuilding Society	Platform offering debt	https://www.rebuildingsociety.com/
Seedrs	Platform offering equity	www.seedrs.com
ShareIn	Platform offering equity	www.sharein.com
Simple Backing	Platform offering debt for property and businesses	www.simplebacking.co.uk
Trillion Fund	Platform offering debt and equity for clean energy	www.trillionfund.com
VentureFounders	Platform offering equity	www.venturefounders.co.uk

Table 9 Crowdfunding Platforms

Note: that not all are based in London and some do not cover equity CF

Appendix A3: Research design

A multiple case (Yin 2009) or collective case (Stake, 2013) method was adopted. Such an approach allows for inductive building of theory through the selection of various cases which provide rich empirical descriptions of the phenomena under consideration (Eisenhardt, 1989). As Yin (2009 p. 4 and p. 23) notes, a case study approach is appropriate where researchers wish to 'retain the holistic and meaningful characteristics of real-life events,' This approach is also appropriate where investigators are exploring a phenomenon, such as eCF, which has novelty and where related scholarly literature is sparse (Ordanini et al., 2011).

The method employed for primary data collection, through interviews, was a semi-structured approach. This technique allows flexibility to explore new and contemporary issues whilst ensuring important topics were covered (Kvale and Brinkmann, 2009). Emphasis, however, remained on the researcher to frame what was important in understanding the behaviours, events and patterns related to the research topic (Bryman, 2008). In total twenty-nine semi-structured interviews were conducted between 2014 – 2016. Pilot interviews were intially conducted to ensure all questions were clear and followed a logical flow. Minor changes were made accordingly. Table 10 outlines a sample of the questions in the interview protocols employed.

Investor Questions	Company Questions	Objective
1. Did you have any experience investing in unlisted companies online or offline before using the platform?	1. What is the growth and funding situation of the company before the eCf campaign?	Investigate: eCf, Investor, experience/company stage
1. What motivated you to use Ecf?	2. What motivated you to raise money online?	Investigate eCF
3. Why did you choose to invest via the platform?	3. Why did you choose to raise funding via the platform?	Uncover the merits of each model unmentioned by existing literature
4. What's your impression of the offering curation?	4. What's your experience with the pre-selection process of the platform?	Investigate the pre-screening process of each model
5. How would you go about doing due diligence?	5. How did you facilitate potential investors' due diligence process?	Investigate each model's influence on the investors' due diligence process
6. Do you consider the valuation to be satisfactory?	6. How was the valuation agreed upon?	Investigate each model's influences on the valuation

Did you negotiate on it?		negotiation process
7. Were there expectations as in how you would communicate with the company after the campaign? How did they do so far?	7. How do you communicate with the crowd investors?	Investigate each model's influences communication and investor management after the campaign
8. Have you or your co-investor provided nonfinancial support to the companies you invested in?	8. Have you so far received any value-added support from any of the crowd investors?	Investigate how each model influences the likelihood of crowd investor providing value-added

Table 10 Sample of Interview guiding questions and objectives for investors and entrepreneurs.

External validity was constructed through investigation of multiple cases, across different eCF platforms, thereby allowing 'literal replication' across cases (Stake, 2013; Yin, 2009). The multi-case research design also allowed for internal validity by allowing close inspection of the context and causes of changes in eCF practices (Leonard-Barton, 1990). Internal validity was achieved by considering different empirical data sources. Scope, depth and consistency was ensured by discussing key concepts, constructs and terminology with each of the informants and triangulating the findings across primary and secondary data sources (Flick, 1998; Seale, 1999). Secondary data sources included, research publications from eCF websites, regulatory authorities business angel associations and press reports. These resources aided the development and refinement of interview questions and to provide context for interpreting interview responses.

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