

# The impact of crowdfunding on European microfinance

**Abstract:** Crowdfunding has grown spectacularly over the past few years and is likely to revolutionise financial service provision through innovation in delivery and underwriting. This paper discusses the possible impact of crowdfunding on the microfinance sector in the European Union based on an in-depth analysis of the UK crowdfunding market. In particular, the paper asks if crowdfunding will displace or disrupt microfinance provision in the EU as we know it today. The analysis drew on interviews with experts, trade bodies and practitioners. We argue that the impact of crowdfunding on microfinance will depend on the type of crowdfunding and the country context. Equity crowdfunding is likely to have a negligible impact on microfinance, given its emphasis on providing large amounts to scalable businesses and the relatively limited role of equity in business finance. Similarly, although there are no inherent barriers to accessing reward-based crowdfunding, the evidence suggests this form caters to a limited range of businesses (especially creative industries). Peer-to-peer lending, conversely, could potentially have very significant impacts on microfinance institutions (MFIs) by taking their least risky customers, which poses a challenge to their sustainability. The effects of crowdfunding are likely to vary considerably across the EU. Countries where MFIs are largely providing very small loans to socially excluded entrepreneurs, the sector is less likely to be affected, whereas MFIs also lending to established businesses may be more vulnerable. Similarly, the impact may be cushioned where crowdfunding is limited by strict regulation of investment and lending. However, a central argument put forward in this paper is that crowdfunding is a harbinger for a transformation of financial services through technology and innovation, to which MFIs have to respond to remain relevant. There is a lack of research that considers the impact of crowdfunding on financial exclusion. This paper addresses this dearth in research through an in-depth analysis of the UK crowdfunding market.

**Key words:** Crowdfunding, microfinance

## Introduction

Crowdfunding has the potential to completely transform the business finance market with possibly equally profound effects on the role and operation of European Microfinance Institutions (MFIs). The industry has grown from virtually nothing before the financial crisis to a large and expanding sector in less than a decade with little to no state support. In total, the European crowdfunding and P2P lending platforms provided nearly €3,000m in finance to consumers, businesses, organisations and projects in 2014 up from €1,200 in 2013 and €500 in 2012 (Wardrope et al, 2015). The average annual growth of the sector is nearly 150%.

Crowdfunding can be defined as a mechanism whereby members of the public (i.e. retail savers), as opposed to accredited, professional or institutional investors and lenders, invest in or lend directly to households, organisations and businesses rather than through an institution (i.e. pension fund, ISA, managed stock portfolio etc.). These investments or loans are done in exchange for any combination of social, material and financial return or reward and are facilitated to varying degrees by crowdfunding platforms. There are three main types of crowdfunding. First, there is equity crowdfunding in which investors buy a stake in largely early-stage businesses. A not dissimilar type of crowdfunding is revenue or profit-sharing crowdfunding, by which the borrower has an obligation to repay the lender but payments are variable and a function of the profit or revenue of the firm. Second, there is reward-based crowdfunding, whereby rather than receiving a rate of return for an investment, an individual investor may receive a tangible but not financial reward in the form of a product, discounts,

vouchers or an experience (e.g. invitation to launch party etc.). Finally, there is peer-to-peer (P2P) lending, which involves retail investors making loans directly to businesses.

The concept of members of the public investing directly in and lending to individuals or businesses is not new. Rotating Savings and Credit Associations have existed for a long time and the early UK Building Society movement was built on similar principles as crowdfunding. However, the crowdfunding movement has grown exponentially over the last decade or so for a number of reasons. First, the financial crisis has led to a contraction of business credit with the businesses traditionally benefitting from bank finance now unable to access finance at an affordable rate (British Business Bank, 2014; Collins et al, 2013; World Bank, 2013). This has created a window of opportunity for the crowdfunding industry, and especially the P2P sector, by providing a borrower/investee base of creditworthy businesses. This is probably the most important factor underpinning growth in the sector. Second, the long-term restructuring of banking and the abandonment of relationship lending through credit scoring and branch closures has also decreased access to bank finance. Finally, historically low interest rates have also underpinned growth of the P2P sector in particular, as retail savers and investors are searching for better returns. These factors combined with widespread use of social media and web-based financial transactions (Collins et al, 2013), and the competitive advantage offered by low overhead costs due to the absence of a branch network (Moldow, 2010) and few products (many focusing on single product) have enabled crowdfunding platforms to increase their share of the business finance market.

Crowdfunding has grown spectacularly over the past few years and is likely to revolutionise financial service provision through innovation in delivery and underwriting in two ways. First, crowdfunding democratises business finance and grant making by enabling the crowd to decide which organisation and business receive an investment or a loan. This is a departure from having elites deciding funding decisions in arts and economic development. Second, another important reason for the transformative nature of crowdfunding is the inherent efficiency of scaling up using an online platform compared with branches and offices. It is estimated that US P2P lending platforms have a cost advantage of 425 basis points over banks due to the lack of a branch network, online back-office and support, outsourced collection, automated origination and leaner operation (Moldow, 2010).

This paper discusses the possible impact of crowdfunding on the microfinance sector in the European Union based on an in-depth analysis of the UK crowdfunding market. In particular, the paper asks if crowdfunding will displace or disrupt microfinance provision in the EU as we know it today. The analysis drew on interviews with experts, trade bodies and practitioners. We argue that the impact of crowdfunding on microfinance will depend on the type of crowdfunding and the country context. Equity crowdfunding is likely to have a negligible impact on microfinance, given its emphasis on providing large amounts to scalable businesses and the relatively limited role of equity in business finance. Similarly, although there are no inherent barriers to accessing reward-based crowdfunding, the evidence suggests this form caters to a limited range of businesses (especially creative industries). Peer-to-peer lending, conversely, could potentially have very significant impacts on MFIs by taking their least risky customers, which poses a challenge to their sustainability. The effects of crowdfunding are likely to vary considerably across the EU. Countries where MFIs are largely providing very small loans to socially excluded entrepreneurs, the sector is less likely to be affected, whereas MFIs also lending to established businesses may be more vulnerable. Similarly, the impact may be cushioned where crowdfunding is limited by strict regulation of investment and lending. However, a central argument put forward in this paper is that crowdfunding is a harbinger for a transformation of

financial services through technology and innovation, to which MFIs have to respond to remain relevant.

The remainder of this paper is organised into three sections. The second section details the methodology applied, whilst the third presents the findings. The fourth section concludes with a discussion of the implications of the findings for European MFIs.

## Methodology

The methodology applied in the study consisted of four components. First, we conducted an extensive review of secondary sources, including government documents, academic papers, consultancy reports and available statistics. This generated a wealth of useful information on the investors, recipients and intermediaries of crowdfunding. Second, we did a high-level mapping exercise of existing crowdfunding platforms. This review was fairly exhaustive in terms of providers but was high-level in terms of the information covered. A template was developed that focused on year established, services offered, scale, eligibility, rates and fees. We were especially interested in the extent to which the platforms served unbankable businesses. Third, drawing on the supply mapping exercise, we conducted case studies of a selection of platforms, focusing mainly on the market leaders (Table 1).

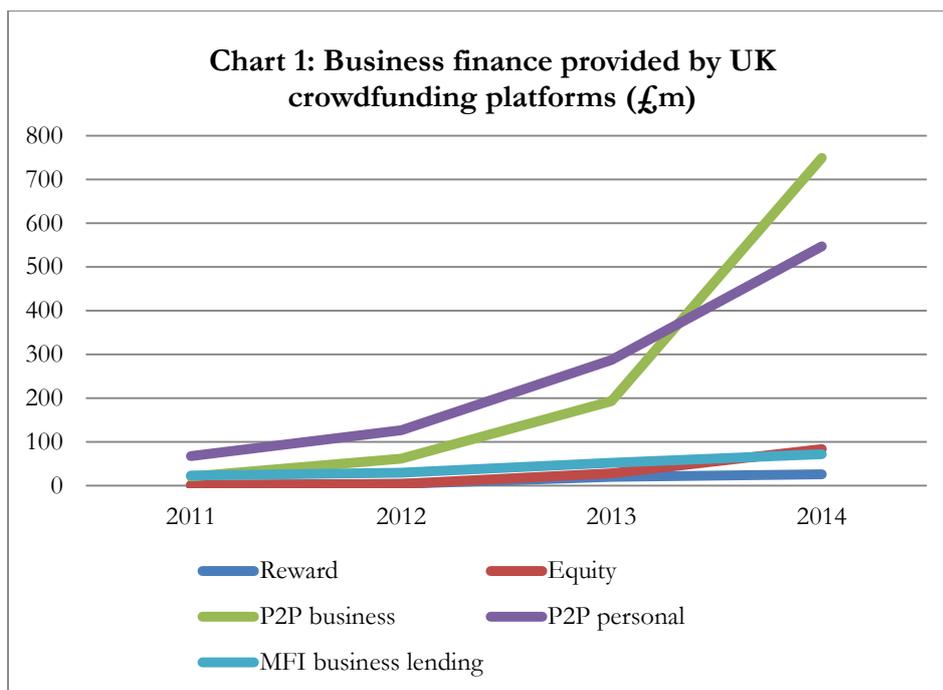
*Table 1: Case study platforms*

<b>Equity crowdfunding</b>	<b>Reward crowdfunding</b>	<b>P2P lending</b>
Crowdcube	Crowdfunder	Funding Circle
Seedrs		Thin Cats
Angel's Den		Market Invoice
		Rate Setter
		Rebuildingsociety.com

The case studies involved review of relevant documentation and interviews with managers and other relevant staff members. Finally, to supplement secondary sources, interviews with key industry experts were conducted. This was especially important to identify the potential future role of crowdfunding.

## Findings

In this section, we present our findings concerning the UK crowdfunding sector drawing on secondary sources and interviews with stakeholders and experts. Specifically we discuss the businesses type of businesses served by the sector, the investors, the platforms and the overlap with microfinance in the UK. Chart 1 shows the amount of finance provided to UK businesses in the last four years. For comparison, it also adds the amount lent to individuals by the P2P personal lending sector and the amount of business lending by UK MFIs.



Source: Baeck et al (2014); Community Development Finance Association data

Reward-based and equity crowdfunding constitute the smallest crowdfunding sectors. UK reward-based crowdfunding raised around £26m in funding for businesses in 2014 but has grown considerably since 2011 when it provided less than £1m in business finance. Similarly, equity crowdfunding in the UK is a small but fast growing. It grew from less than £4m in 2012 to nearly £84m in 2014, equivalent to a growth of over 2000%. Most of the growth in the sector in the UK is driven by two platforms: Crowdcube has raised £40m for 150 businesses since its launch in February 2011 and 81 deals of a value of £7m have been facilitated by Seedrs since it launched in July 2012. P2P business lending has been growing considerably over the last few years and it is estimated to have overtaken P2P consumer lending in 2014 as the largest product segment in the market. According to Collins et al (2013, p. 10), “UK is the undisputable world leader of this alternative financing model.” Yet, the amounts lent or provided by crowdfunding are still dwarfed by their mainstream counterparts. In 2014, UK banks approved £29.2bn in SME lending (British Bankers’ Association, 2014) compared with the around £750m lent by P2P platforms. According to the British Business Bank (2014), P2P lending volume constitutes less than 2% of bank business lending.

### *Platforms*

Generally, each segment is dominated by a handful of pioneering platforms. Being first appears to be a significant competitive advantage as the oldest platforms are generally the market leaders. There are a handful of platforms that dominate the UK P2P market. The most dominant platform was the first to establish (Funding Circle), while the other platforms have focused on a particular niche (i.e. invoice finance, experienced investors wanting to know what they invest in etc.). The platforms generate income by charging fees of businesses that obtain a loan on their platform, usually a percentage (3-5%) of the value of the loan and some charge a separate listing fee (around £500+VAT) or in some cases a fee of lenders. The interest rates charged to businesses range from 4% to 20%. The average for Funding Circle is 8.7% (Pierrakis & Collins, 2013), whilst the average for the sector is 8.8% (Baeck et al, 2014). The platforms tend to be responsible for collecting repayments and for recovering funds to reduce loan losses for lenders. P2P lending came under UK Financial Conduct Authority (FCA) regulation in April 2014. Firms

offering such services have to adhere to FCA principles and core provisions, including conduct of business Rules, capital requirements, money protection rules and dispute resolution rules.

Reward-based crowdfunding was pioneered by the US platforms Indiegogo (2007) and Kickstarter (2009). Kickstarter raised nearly £500m globally in 2013 making it the largest reward-based crowdfunding platform in the world. The largest UK-based platform is Crowdfunder. Fees from people using the site for fundraising generate income. The successful project creators pay an upfront fee (typically 5-10%) of the amount raised. In exchange, most platforms offer direct support to and training of project creators to increase their chance of success and thus increase the income generated for the platform. The average success rate for the sector is 35% and it takes around 28 days to meet their target (Baeck et al, 2014).

To date UK equity crowdfunding has been dominated by a handful of platforms. Crowdcube, the by far largest platform set up, was the first equity crowdfunding platform to be established in the UK, followed by the establishment of Seedrs in 2012. Angel's Den, a vehicle for Angel investors set up in 2007, launched its hybrid Angel investment and crowdfunding website in 2013, and is now the second or third largest equity platform in the country, though crowdfunding makes up less than 20% of funds. Fees paid by businesses that reach their funding target generate income, typically an upfront fee of around 5-7.5% of the amount raised and a set administration fee (around £1,500-2,600). The sector is subject to considerable regulation, especially concerning the protection of investors, the provision of advice and the verification of sophistication of investors. This translates into significant upfront and on-going costs, and there is a long lead-time to get FCA authorisation. Equity crowdfunding is characterised by a high rejection rate (around four out of five applicants) and the fact that only a third of listed businesses are successful in raising funding. Because the platforms only generate income from successful bids, this poses a challenge for the financial sustainability of the platforms.

### *Investors*

The type of investors and their motivations determines the type of business and projects that get funded. A greater orientation towards financial return would cater to businesses that would be more likely to access mainstream finance (including bank finance) as opposed to the businesses served by MFIs. Accordingly the crowdfunding investors or supporters differ considerably with P2P and equity crowdfunding investors displaying a much greater orientation towards financial return, whilst reward-based crowdfunding supporters are driven by nonfinancial motivations.

According to the expert and practitioners interviews, P2P investors tend to be high net-worth individuals that are overwhelmingly focused on financial return. A survey of nearly 1,800 P2P business lenders found that over 80% of lenders stated that making a financial return was very important (Baeck et al, 2014). They are not particularly driven by an interest in a specific project or business, though this depends on the platform. Many allocate funds using auto-bid functions based on certain parameters (risk, return etc.). They often have considerable disposable income and money they need to invest (typically in excess of £250,000). They tend to be in their 50s onwards and are often retired or close to retirement. The average portfolio of an investor is around £8,000 spread across a median of 52 business loans (Baeck et al, 2014). They are well informed about investment opportunities and they have turned to P2P lending because of the low rates offered by banks.

According to the latest industry survey (Baeck et al, 2014), the majority of equity crowdfunding investors are male (78%), based in London, South East and the South West (62%), and have high incomes with over half having annual incomes in excess of £50,000 and 21% in excess of

£100,000. They invest relatively considerable amounts per business. The average amount invested per project is around £1,500, two thirds of investors have invested more than £1,000 and the average investment portfolio is £5,400. Compared with P2P investors, crowdfunding equity investors are younger: 38% are under the age of 35 and 36% are between the ages of 35 and 54. Only a quarter are 55 years and older. The investors are primarily driven by financial returns as obtaining a financial return is very important or important for 96% of investors. However, data from the platform Crowdcube suggests that investors are keen to be involved and help businesses as well as earn a financial return. The top three reasons for investing listed by Crowdcube investors are financial return, enjoyment from investing in small businesses and wanting an active involvement in the business. Over half (52%) of Crowdcube investors are interested in some sort of role in the businesses they invest in.<sup>1</sup>

Conversely, backers or supporters in reward-based crowdfunding tend to provide small amounts in few projects. According to the latest industry survey, 61% contributed less than £50 and only backed one project (Baeck et al, 2014). Investors also tend to invest on the basis of social network links with the entrepreneur. This may take the form of a direct link to the entrepreneur (e.g. family and friends), wider network (friends and acquaintances of friends and relatives), an affinity with the location where the entrepreneur is planning to provide a service or belonging to the same community of interest (e.g. shared worldview, shared interest in gaming, art etc.). Over 70% of backers gave funds to someone they knew, at least by reputation. Around half of backers are women and are fairly spread geographically across the UK. Backers have lower incomes relative to other forms of crowdfunding, as 66% have annual incomes of less than £35,000 and nearly half less than £25,000. They are influenced by the quality of the idea, the team and by knowing that the money will be making a difference (more than 60%). The majority of backers (70%) also gave non-financial support, by usually promoting a campaign.

According to the existing research, reward-based crowdfunding invest in projects for a number of reasons. They are often motivated by a desire to help a specific person and seek to offer support and encouragement to the entrepreneur (e.g. Galuszka & Bystrov, 2014; Ordanini et al, 2011; Zhang, 2012). They are also drawn by getting early access to a particular product and the social kudos (e.g. source of status, sense of pride) associated with supporting the development of a new product or the establishment of a new company (Klaebe & Laycock, 2012). Another important motivation for reward-based crowdfunding is to receive a perk, product or a service. These may include copy of product, acknowledgement (e.g. acknowledgement on website, in credits etc.), experience (e.g. taking part in film/play etc.) or other material or symbolic reward. However, the rewards are generally material. In their investigation of Kickstarter, Bœuf et al (2014) find that symbolic rewards only incentivised investors when no material reward was offered.

### *Businesses*

The fact that crowdfunding platforms are growing rapidly and are already bigger than most MFIs is not in itself an indicator of the impact of crowdfunding on microfinance markets. To understand the potential impact, we need to understand the businesses that crowdfunding platforms serve. Not surprisingly, evidence suggests that the businesses served differ depending on the type of crowdfunding. According to the experts and platforms interviewed, the businesses resorting to P2P loans are well established (at least 2 years but typically 7-8 years), have a turnover in the region of £400,000-£1m and would under normal, pre-crisis circumstances have been able to access finance (i.e. good credit score). According to the latest industry survey, 66%

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<sup>1</sup> Crowdcube website accessed 12.09.2014

and 79% of P2P business borrowers have a turnover in excess of £100,000 and £50,000, respectively (Baeck et al, 2014). They also tend to be growing businesses, though this is not always the case. 41% sought funding for expansion, whilst 34% sought funding for working capital. The businesses funded are concentrated in four sectors: manufacturing (23%), professional and business services (14%), retail (14%) and construction (11%). Many of them found themselves unable to access bank finance following the financial crisis and the partial withdrawal of banks from business finance. Around a third of P2P business borrowers surveyed by Nesta and the University of Cambridge stated that they would be unlikely or very unlikely to get funding elsewhere compared with 44% who thought they would be likely or very likely to get funding from other sources (Baeck et al, 2014). Nearly 80% of P2P borrowers had applied for bank loan and 22% had been offered one. The main reasons for seeking out P2P finance are availability, speed and flexibility. 94% and 90% cite speed and ease of using P2P, respectively, as important or very important for choosing the model. Nine in ten saw P2P lending as easier way to get funded compared with traditional models. P2P lending is generally seen as inappropriate for start-ups due to lack information and credit score. For platforms for which speed is a major competitive advantage, a two-year minimum track record is essential to ensure that they can quickly assess and list businesses. This is especially the case for Funding Circle, Rebuildingsociety and Market Invoice. The average loan is around £73,000 (Baeck et al, 2014).

Typically equity crowdfunding platforms cater to high risk, early stage businesses and, in some cases, businesses needing capital to expand. Of the businesses funded through Crowdcube, 24% have been start-ups, 50% early-stage and 26% growth-businesses. Around 67% of the businesses funded are based in London, South East and the South West (Baeck et al, 2014). In terms of the amount of finance, equity crowdfunding businesses with much smaller amounts than venture capital funds and also likely smaller amounts than Business Angels. The average amount of funding raised was nearly £200,000 from 125 investors (Baeck et al, 2014). The average funded pitch amount at Crowdcube is £230,000, whilst the average for Angel's Den is around £100,000. This is not dissimilar from the average loan amounts on UK P2P business lending platforms, which range from £70,000 to £500,000. In comparison, the average venture capital deal is around £7m (British Private Equity & Venture Capital Association, 2012) and the average angel investment deal is £330,000 (Deloitte, 2013).

Businesses seeking funding from reward-based crowdfunding differ considerably from P2P and equity crowdfunding. On average, businesses raise £3,766 in funding from 77 backers through reward-based crowdfunding (Collins et al, 2013). Around half fundraisers are based in London, South East and the South West. According to the latest sector survey, a little over half of fundraisers said they would be unlikely or very unlikely to get funding elsewhere and a further 21% did not know if they would be able to access other funding (Baeck et al, 2014). In principle, there are no inherent suitability criteria providing the entrepreneur or the business can offer rewards that are attractive for a sufficient number of supporters. Mainly firms in creative, hospitality and high-tech industries that can offer tangible benefits to investors (e.g. early access to product, discounts) use reward-based crowdfunding. They may also involve addressing specific local needs by providing a new service (e.g. broadband etc.). They tend to be entrepreneurs seeking start-up finance or existing businesses seeking to test their products and get feedback from consumers. It enables the businesses to test ideas in market and develop proof of concept, and can also help generate PR and interest. Market testing may make it easier to access mainstream funding further down the line. The survey by Nesta and the University of Cambridge, found that 78% of fundraisers rate control over project as important and very important for choosing reward-based crowdfunding, whilst 66% rate the importance of being able to raise funds on their own terms. 71% of the fundraisers surveyed rated the non-financial

benefits as important and very important, and 68% see the speed of the process as important and very important for choosing crowdfunding.

### *Overlaps between MFI and crowdfunding markets*

We now turn to discussing the overlap between MFIs and crowdfunding markets. In other words, are crowdfunding platforms serving businesses unable to access bank finance or are they serving essentially bankable businesses?

Like other forms of equity, crowdfunding is mainly appropriate for start-ups, young businesses and high growth companies. Although equity finance is a multibillion industry of great importance to high growth businesses and start-ups, the scale of the market among UK SMEs is small. Estimates of the proportion of SMEs using equity ranges from 1-3% compared with 40-50% using loans and overdrafts (The Office for National Statistics, 2011; Breedon, 2012). There are only certain companies likely to benefit from equity funding and there may also be a limited demand among investors. Historically, equity finance has not been a much used source of finance in the UK. Unlike with P2P lending, the practitioners and experts interviewed thought that the growth of the equity-based crowdfunding market would be limited because of high risks, uncertain returns and challenges in scaling up platforms (due to difficulties in screening businesses in an efficient manner). However, the British Business Bank (2014) notes that there is an equity gap, especially at the venture stage. Start-ups and very young businesses are almost by definition not suitable for bank or mainstream loan finance. They lack a track record and data to allow the lender to predict repayment. In the main, the existing platforms are aimed at businesses that may be high risk but has the potential for scaling up and for offering potentially very high financial return to investors. Research by Nesta on Angel Investments found that whilst 56% of exits failed to produce a return, 9% generated more than ten times the capital invested (Wiltbank, 2009). Overall the average return on investment was 22% (Wiltbank, 2009). Although there are platforms that are aimed at achieving social objectives by providing access to equity for businesses that cannot access conventional or commercial equity funding, they have so far, based on our mapping and interviews, had limited to no traction.

As with other forms of crowdfunding, reward-based crowdfunding has been growing considerably. The future growth of the sector may possibly be limited by the relatively small amounts companies can raise. There are also questions about the possibility of raising funding more than once through reward-based crowdfunding as they often rely on small communities (geographical or community of interest). The evidence from research finds diminishing returns with follow-on projects (Bœuf et al, 2014). Reward-based crowdfunding generally caters for start-up firms, which are not really served by banks in the first instance. More established firms use this form of finance for market research and to generate interest. It is difficult to see any specific barriers (e.g. age of business, lack of track record etc.) to access to this type of crowdfunding. In other words, the existing platforms appear to be serving the market efficiently. There are no obvious information asymmetries or high entry costs, though entrepreneurs in deprived communities may be disadvantaged by the lack of potential local investors. That said

This is probably the sector with the greatest potential for growth because: debt finance probably has the largest reach catering for a larger number of businesses than any of the other forms of finance; there is considerable scope for streamlining and automating screening to keep costs down and produce predictable returns for investors; and there is also a great inherent competitive advantage in P2P platforms because of lower costs vis-à-vis banks, which enables them to offer competitive rates to both borrowers and investors. There is an argument to say that there is a market failure in P2P lending. The sector has largely focused on businesses that

would have been able to access bank lending before the recession. These are low to medium risk businesses rather than the businesses that MFIs typically serve. Also, none of the platforms lend to start-ups, unless prime borrowers who can borrow money on one of the consumer lending platforms set these up.

## **Conclusion**

The UK crowdfunding sector has experienced phenomenal growth rates in the past five years. For example, the P2P business lending sector lent over £750m to UK businesses in 2014, despite the fact that none of the platforms existed prior to 2010. Similarly, the first equity crowdfunding platforms were only set up in 2011, yet provided over £80 in business finance by 2014 (Baeck et al, 2014). In both cases, these sectors outgrew the UK MFI sector considerably.

We argue that the potential impact of crowdfunding on MFIs will vary across the EU depending on a number of factors. First, the impact will vary according to the type of crowdfunding. We believed that equity crowdfunding is likely to have a negligible impact on microfinance. Although equity crowdfunding provides smaller amounts of funding than venture capital and angel investments, the emphasis is still on providing large amounts relative to lending and especially microcredits. The focus is also on risky but scalable businesses that can provide potentially enormous returns. Very few if any of the businesses started by microfinance clients in Europe, perhaps with the exception of the UK, the Netherlands and Eastern Europe, fit these characteristics and are more likely to be lifestyle businesses (e.g. businesses providing the entrepreneur with a livelihood but not a return to investors). In fact, very few micro and small enterprises use equity finance, most using loans or another source, though this varies across Europe.

Similarly, although there are no inherent barriers to accessing reward-based crowdfunding, the evidence suggests this form caters to a limited range of businesses (especially creative industries). It is for example not suitable for firms providing services and goods to other businesses. That said this form of crowdfunding is potentially useful for start-up businesses to test the demand for their products so partnerships between reward-based crowdfunding platforms and MFIs would be beneficial for certain microentrepreneurs, especially in hospitality, creative and high-technology industries. Peer-to-peer lending, conversely, could potentially have very significant impacts on microfinance institutions (MFIs) by taking their least risky customers, which poses a challenge to their sustainability.

Second, the effects of crowdfunding are likely to vary considerably across the EU depending on country characteristics. Countries where MFIs are largely providing very small loans to socially excluded entrepreneurs, the sector is less likely to be affected, whereas MFIs also lending to established businesses may be more vulnerable. The microfinance industry in the Netherlands, UK and Eastern Europe may be especially vulnerable to this. The propensity to use different forms of finance is also likely to condition the use of crowdfunding. UK businesses have historically been reluctant to give up equity instead preferring debt finance.

Third, the impact may be cushioned where crowdfunding is limited by strict regulation of investment and lending. In the US, the emergence of a competitive equity crowdfunding industry has been hampered by inappropriate regulation. Conversely, in the UK the early introduction of specific regulation of the crowdfunding sector is seen as a contributory factor to the growth of the sector. In countries where only banks are allowed to lend (e.g. Germany), the scope for capitalising on the efficiencies and competitive edge associated with online P2P lending platforms may be more limited. New platforms would be reliant on partnerships with banks and

possibly also encumbered by the same constraints and inefficiencies as banks. Given that our research suggests that platforms directly compete with banks for customers banks may prove reluctant to partner with such platforms.

However, a central argument put forward in this paper is that crowdfunding is a harbinger for a transformation of financial services through technology and innovation, to which MFIs have to respond to remain relevant. There are two aspects of crowdfunding that signals a change in the delivery of financial services in the future. First, there is the emergence of online-only platforms providing financial services without a single branch. This not only reduces costs but it also potentially facilitates for platforms and institutions to operate across borders by reducing set-up costs. Even if certain client groups require face-to-face interaction, the underwriting and back-office operations could still be under a single online platform. Second, crowdfunding potentially reshapes relationships between investors and investees enables direct investments and loans by individual investors in businesses. This may impact upon MFIs as they can tap into a new source of capital. Indeed, we believe the time is ripe for tapping into this market as in wake of global financial crisis there is an appetite among people to invest in local and tangible activities.

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