ENTRENCHING INNOVATION

The 4th UK Alternative Finance Industry Report

December 2017

Cambridge
Centre
for Alternative
Finance

UNIVERSITY OF CAMBRIDGE
Judge Business School

With the support of:

CME GROUP FOUNDATION

CONTENTS

RESEARCH TEAM

BRYAN ZHANG

Bryan is a Co-Founder and Executive Director of the Cambridge Centre for Alternative Finance and a Research Fellow in Finance at the Cambridge Judge Business School. Bryan has led and co-authored many of the most influential industry reports on the alternative finance industry since 2013.

KIERAN GARVEY

Kieran is the Lead on Regulation & Policy at the Cambridge Centre for Alternative Finance, Cambridge Judge Business School. His research interests include the application of alternative finance with respect to financial inclusion, early stage ventures, regulatory & policy evolution and technology.

JOHN BURTON

Dr. John Burton is a Skills and Capability lead for the Civil Service and has been using his years of astronomy data analysis expertise to introduce new techniques and methodologies across government departments. He has worked for a number of world-renowned research institutions, including most recently the CCAF, and was honoured for his work by NASA in October 2017.

TANIA ZIEGLER

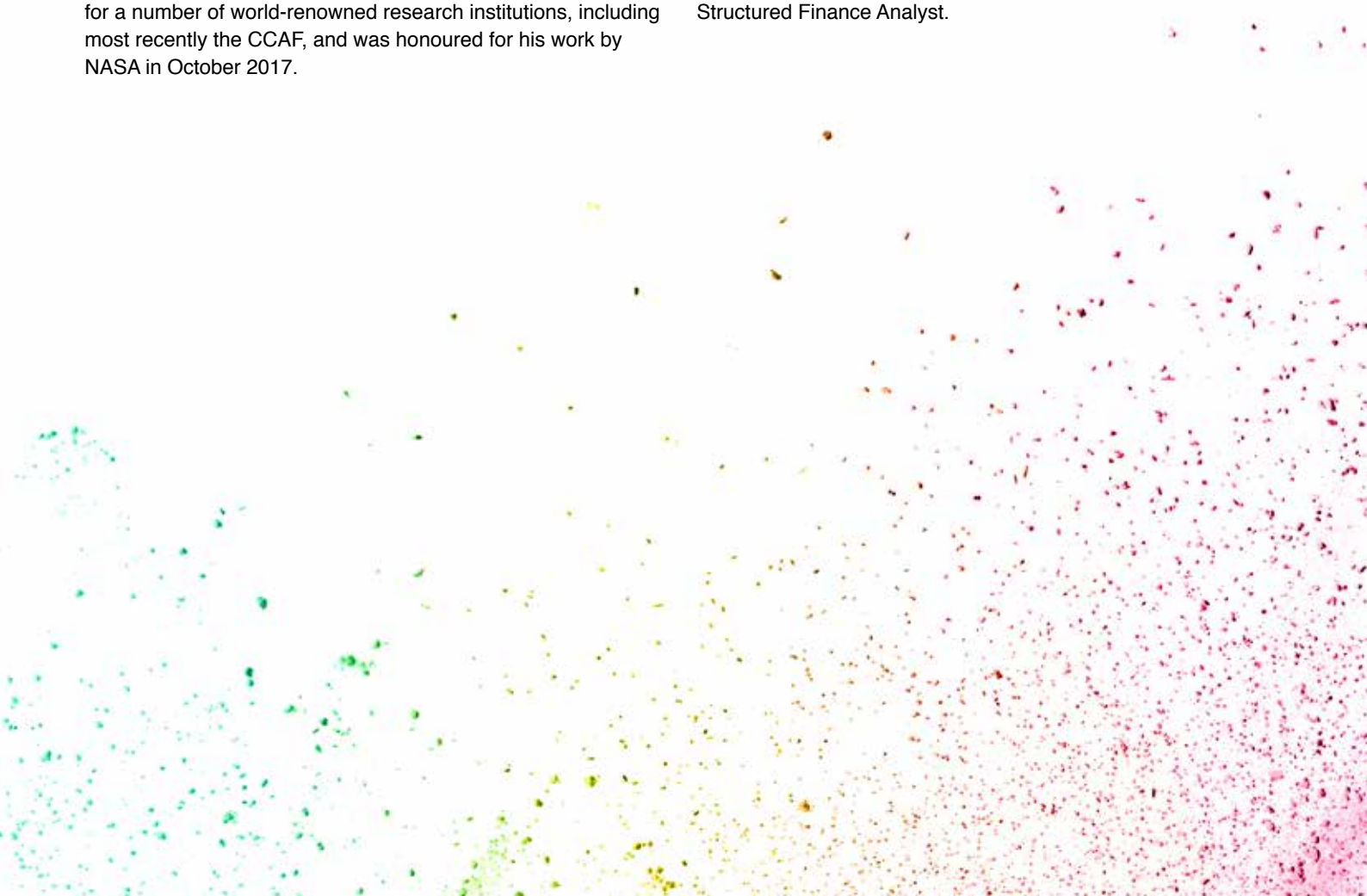
Tania is the Senior Research Manager at the Cambridge Centre for Alternative Finance, Cambridge Judge Business School. Her research interests include small business economics and SME utilization of alternative funding models.

SAMANTHA RIDLER

Sam is a Senior Industry and Policy Researcher at the Cambridge Centre for Alternative Finance. Previously, Sam was Manager of the P2P Finance Association (P2PFA), co-ordinating the industry's response to key policy issues and liaising with key stakeholders such as HMT, HMRC, FCA and BoE.

NIKOS YEROLEMOU

Nikos is a Research Assistant, Cambridge Centre for Alternative Finance focusing on data and analytics before starting his career in commercial real estate at Lloyds Banking Group. He has since moved to Fortwell Capital as a Leveraged Debt & Structured Finance Analyst.



ACKNOWLEDGEMENTS

We would like to thank CME Group Foundation for their financial support of this research programme and report.

This report would not have been possible without the participation of 77 UK-based platforms, and the support of the United Kingdom Crowdfunding Association (UKCFA) and the Peer to the Peer-to-Peer Finance Association (P2PFA). In particular, we would like to thank Karen Kerrigan, Julia Groves and Bruce Davis from the UKCFA and Christine Farnish and Robert Pettigrew from P2PFA for all their support.

We are grateful to the Financial Conduct Authority for the opportunity to provide research inputs into the ongoing post-implementation review of crowdfunding regulation and for their feedback regarding the design and conduct of field research.

We are extremely grateful to the wider CCAF research team, including Louise Westerlind and Dr. Jonathan Anderson for their role in data collection, research, analysis and feedback throughout the research process. The research team at the CCAF would also like to thank Robert Wardrop, Raghavendra Rau and Mia Gray for their counsel, guidance and feedback throughout the study. We would also like to thank Mint Garvey for her work on designing the publication, and Charles Goldsmith, Kate Belger, Ruth Newman and Philippa Coney for their continued support in producing and publishing this report.

FOREWORDS

Cambridge Centre for Alternative Finance

UNIVERSITY OF CAMBRIDGE Judge Business School

Bryan Zhang
Co-Founder and Executive Director
Cambridge Centre for Alternative Finance

This report is titled 'Entrenching Innovation', which is a reflection upon both the historical development and the current state of the UK online alternative finance industry.

Online alternative finance has become an ever more established component of the UK financial landscape. Since 2011, more than £10 billion worth of funding has now been intermediated through various online alternative finance platforms in the UK. Online funding channels, such as crowdfunding and peer-to-peer lending, have not only entered common discourse, but have also become embedded in the everyday infrastructure of finance; in many instances, they are now one of the default fundraising and investments channels for businesses, retail investors and institutions. With equity-based crowdfunding now accounting for 17% of all seed and venture stage equity investment in the UK and peer-to-peer business lending providing an equivalent of 15% of all new loans lent to small businesses by UK banks, alternative finance has entered the mainstream and is likely here to stay.

Progress in financial innovation is, nevertheless, not linear within such a dynamic landscape, and is made more difficult as competitors, technology and markets evolve. In 2016, a number of alternative finance platforms either suspended operations or exited the market completely. As market consolidation accelerates there is greater pressure on alternative finance platforms to distinguish themselves through better services and more innovative products, whilst simultaneously responding to emerging regulatory and supervisory demands. Consequently, the industry has witnessed a considerable level of product and business-model innovation over the last year. Some of these innovative changes have driven the growth of the alternative finance market to £4.58 billion in 2016 whereas others, such as the controversial 'wholesale lending', have not been conducive to the development of industry.

Funder research shows that the compositions of the retail investor and lender market have been relatively stable over the last two years since the implementation of the FCA regulations. The alternative finance retail market has exhibited stability across demographic metrics, including age, gender, education, income and geographical distribution, as well as within motivational and behavioural patterns. One of the prevailing trends over the last year has been the institutionalisation of the funding, with many alternative finance models reporting over 25-30% of funding coming from mutual funds, pension funds, asset managers, family offices, broker-dealers and banks among others. In the longer-term, the bifurcation of the supply side of alternative finance is likely to continue with institutional funders co-investing alongside retail investors.

From the CCAF's parallel and comparative studies conducted in the Americas, the Asia-Pacific region, Europe, Middle East and Africa, similar patterns of development, challenges to keep innovating and opportunities to reshape the existing financial landscape have been identified. Good financial innovation not only improves the efficiency of capital allocation and reduces information asymmetry, but also can achieve a greater degree of financial inclusion, increase welfare and benefit communities. In that sense, perhaps this report marks just the 'end of beginning' for the UK alternative finance industry.

Kim Taylor
President Clearing and Post-Trade Services
CME Group

The world of banking and financial services continues to change swiftly and dramatically, with alternatives to traditional products and services being introduced daily, significantly impacting the way people and institutions use money.

Previously, financial technology could be regarded as applications of traditional financial services upon existing technologies, but today, we are witnessing truly novel inventions with participation from previously untapped markets. Crowdfunding and peer-to-peer lending are just a few examples where new participants are accessing technological innovations to create new marketplaces. The size and growth of the online alternative finance market, new entrants and partnerships, and the impacts on regulation and tax incentives, have the potential to transform the global economy. But this transformation can be best achieved only with thoughtful analysis and a thorough understanding of the alternative finance landscape.

CME Group, as the world's leading and most diverse derivatives marketplace, is proud to support the publication of this series of reports through its Foundation.

We believe that it is with informed view of the possible future, we can work to achieve new opportunities and economic prosperity through financial innovation.

We thank the alternative finance platforms defining this industry for their contribution and input to this research:


CrowdPatch


CROWDSTACKER


Wellesley & Co.


Downing


fleximize


FOLK 2 FOLK
Local Secured Lending


GROWTH STREET


GrowthFunders


growthdeck


JustGiving
Crowdfunding


lendwithcare


LIQUID
FINANCE
Funding growth


MADISTON
LendLoanInvest


MARKETINVOICE


Mayfair&Morgan


Rate%Setter


SME CAPITAL


SEEDRS


SIMPLE
CROWDFUNDING


unbound


VENTURE
FOUNDERS


YesGrowth
Funding for business


ArchOver


assetz
capital


FutSci


INVESTED


invest&fund
alternative finance


Just
Cashflow
Your alternative bank overdraft


JustUs


rebuildingsociety.com


sancus
straightforward financing


the
house
crowd


ThinCats


UpEffect


crowdahouse


ZOPA

EXECUTIVE SUMMARY

Since 2013 researchers at the University of Cambridge have been tracking and analysing the development of the online alternative finance market in the United Kingdom. This is the fourth annual industry study, which includes data collected from 77 alternative finance platforms, as well as over 8,300 retail investors within the UK. Our data revealed that the UK online alternative finance market grew from the £3.2 billion in 2015 to £4.6 billion in 2016, representing an annual growth of 43%. Over the six years between 2011 and 2016, a total of £11 billion worth of market volume has been facilitated through online alternative finance channels in the UK.

SUSTAINED INDUSTRY GROWTH ALONGSIDE CONTINUED DIVERSIFICATION AND DEVELOPMENT OF KEY MODELS

Peer-to-peer business lending became the largest market segment, growing by 36% to reach £1.23 billion in 2016. Peer-to-peer consumer lending contributed £1.17 billion with a 47% year-on-year growth rate, whilst peer-to-peer property lending recorded £1.15 billion with an 88% growth rate between 2015-2016. Invoice trading accrued a total of £452m in 2016 with a 39% annual growth. Equity-based crowdfunding reached £272m in 2016 with an 11% annual increase whilst the real estate crowdfunding dropped by 18% to £71 million 2016 from the £87m in 2015. Reward-based crowdfunding accounted for £48m in 2016, a 14% annual increase from 2015. Donation-based crowdfunding reached £40m with a 233% year-on-year growth. Community shares model recorded £35m in 2016 whilst debt-based securities registered considerable year-on-year growth rate to achieve £79m in 2016, in comparison to the £6.2m in 2015.

MARKET CONSOLIDATION AND CONTINUED INNOVATION

The UK market continued to consolidate in 2016, with the top five largest alternative finance platforms accounting for 64% of total market volume. Compared to 2014, when new entries to the market were their peak, there are considerably fewer new entrants into the market. By our account, more than 35 UK online alternative finance platforms have become become inactive in 2016. Some platforms have merged, whilst others have either suspended their operations or closed all together. Despite market consolidation, those platforms which remain have maintained, or in many cases accelerated, the growth rate of their business by innovating both their business model and the financial products on offer. Over 59% of surveyed platforms reported that they either significantly or slightly altered their business models in 2016, whilst 67% stated that they either have ‘introduced significantly new products’ or ‘slightly altered products’.

INCREASINGLY IMPORTANT SOURCE OF ALTERNATIVE BUSINESS FUNDING

In 2016, business funding transacted for start-ups and SMEs grew by 50%, from £2.2 billion to £3.3billion. In total, it is estimated that 33,000 firms utilised various debt, equity or non-investment based (e.g. reward-based crowdfunding) alternative finance channels and instruments to raise funding, which represents around 2.5% of the UK’s 1.3 million employers. The annual British Banking Association data implies that peer-to-peer business lending platforms are now facilitating the equivalent of 6.56% of all new loans lent to SMEs, or 15% of all new loans lent to small businesses (i.e. micro-enterprises) by all UK banks. Similarly, in 2016, equity-based crowdfunding now accounts for 17.37% of all seed and venture stage equity investment in the UK in line with Beauhurst data.

RETAIL MARKET STABLE WHILST INSTITUTIONAL FUNDING PERSISTS

When comparing survey-based data of individual lenders and investors from 2014 and 2016, the demographics and profiles of the average retail funder remains broadly similar. The age, gender, income, education and geographical composition of retail funders in the UK have remained markedly similar over the last two years.

The institutionalisation of funding during 2016 continued to grow, with funding from an institution accounting for 34% of peer-to-peer property lending, 28% of peer-to-peer business lending, 32% of peer-to-peer consumer lending and 25% of equity-based crowdfunding being provided by institutional investors such as mutual funds, pension funds, asset managers, broker-dealers, family offices and banks.

METHODOLOGY

Since 2013, the University of Cambridge and its partners have endeavoured to document and analyse the development of the alternative finance industry in the United Kingdom. As with previous studies, this report aims to track the latest market data and emerging trends. Additionally, this report extends beyond the scope of the past studies and utilises a broader range of quantitative and qualitative data gathered by the CCAF. Selected evidence from this work has also been provided to the FCA as inputs into their ongoing review of the regulatory regime for crowdfunding.

This research was conducted over the course of six months and included three phases of research. Throughout this report, we will refer to different components of this research. Akin to our previous studies, the Centre conducted an 'Industry Tracking Survey', which was disseminated to crowdfunding, peer-to-peer lending and other online alternative finance platforms. The survey collected aggregate-level industrial data used to measure the size and growth of the industry, as well as other key metrics. Though the data collected in the Industry Tracking Survey is based upon self-reported data, the survey responses were thoroughly sanitized and verified before being aggregated for analysis. During analysis, all average data points (e.g. platform acceptance rates, funding success rates or most funded sectors) where weighted (by transaction volume) to calculate more accurate estimates based on the available data. This benchmark was conducted with the support of the Peer-to-Peer Finance Association (P2PFA) and the UK Crowdfunding Association (UKCFA) and included responses from 77 platforms, capturing an estimated 95% of the visible UK online alternative finance market. Two additional platform datasets were generated using web scraping methods and added to the total survey database, which increased the overall research sample size to 79 platforms.

In addition to the Industry Tracking Survey, this report includes results from a 'Funder Survey', modeled after research conducted in 2014 and enhanced to provide further insights into investor perceptions and motivations. The survey was designed for retail investors who actively utilised Investment-based and/or Loan-based Crowdfunding as part of their investment portfolios. The CCAF provided selected evidence from investor and fundraiser surveys to the FCA, along with aggregate reports based on transaction level data, as inputs into their ongoing review.

The models to be analysed were:
Loan-based crowdfunding:

- Peer-to-Peer Consumer (P2PC) Lending
- Peer-to-Peer Business (P2PB) Lending
- Peer-to-Peer Property (P2P Property) Lending

Investment-based crowdfunding:

- Debt-Based Securities (DBS)
- Equity-Based Crowdfunding (Equity)
- Real Estate Crowdfunding (RE CF)

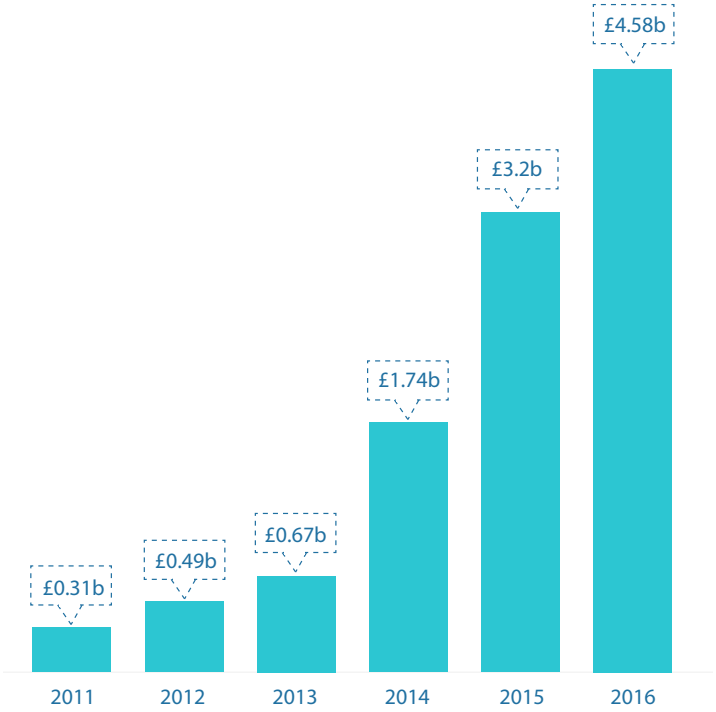
The final 2016 Funder Survey dataset comprised of 8370 responses across the six models, with peer-to-peer consumer lending having the highest number of respondents at 3837. These surveys were collected in complete anonymity and disseminated through platform-based outreach, with 22 platforms assisting in this process. A follow-up qualitative interview was conducted with 55 survey participants who explicitly gave the Centre consent to be contacted, and provided identifying information for that purpose. The survey responses were analysed in aggregate, and analysed by model type rather than specific platform.

As with the 2014 Funder survey, the 2016 activity focused on key demographic information, as well as qualitative data on funder behaviour and perspectives. The methodology and some of the data collected in the 2014 version of the survey differs from the 2016 activity. Therefore, it was not always possible to make direct comparisons between the two datasets. Only where appropriate, comparisons have been made.

The third phase of research included the collection and analysis of granular-level transaction data from 15 Investment-based and Loan-based Crowdfunding platforms. This phase of the research made it possible to review key market fundamentals and industry trends through a more sophisticated lens, for instance the average size of loan/issuance, or the number of investors per loan/issuance. To ensure the research methodology and process was consistently and independently applied, the Centre collected transaction (loan or deal level data) provided by platforms. The collected data was analysed on an aggregated basis and hosted securely on the Centre's alternative finance data depository for policy and academic use only. The data depository captured four separate but linked tables in database format. The first two data-sets include demographic information on the Funders (Investors or Lenders) and Fundraisers (Borrowers or Issuers), the third and fourth dataset included specific details on the Loan or Issuance as effected by the Funder and Fundraiser (e.g. amount sought vs amount contributed by unique funder). The data from each platform was collected securely and cleaned further to remove confidential or private information/fields before being added to the data-depository. All subsequent analysis and queries were run of off the main database, with all information fully aggregated.

TOTAL SIZE & GROWTH

Figure 1: UK Alternative Finance Market Volume, 2011-2016



The Cambridge Centre for Alternative Finance (CCAF) and its research partners have been tracking the evolution of online alternative finance market in the United Kingdom since 2011. Over the course of six years, a total of £10.6 billion market transaction volume has been intermediated from online alternative finance platforms. As the market continues to mature, the rapid growth of the earlier years has abated. Nevertheless, 2016 marks the sixth consecutive year of substantive market growth for the UK alternative finance industry.

In 2016 the online alternative finance market grew 43.13% annually to £4.58 billion. Though the overall growth rate has decelerated on a year-on-year basis for the past last two years, the overall market volume growth remains significant.

The preponderance of volume is driven by debt-based and equity-based models which can generate financial returns for lenders and investors. The underlying assumption of these models is that a funder, being an investor or lender, can reasonably expect a financial return from an equity or debt security instrument. By contrast, models which do not generate a financial return, such as donation-based or reward-based crowdfunding models (in the text, also referred to as non-investment based models) account for a small proportion of the overall volume.

Peer-to-peer lending models continued to account for the majority of market activity in the UK. Peer-to-peer business lending was the largest alternative finance model, accounting for just over £1.23 billion lent in 2016 alone, followed closely by peer-to-peer consumer lending (£1.17 billion) and peer-to-peer property lending (£1.15 billion). Peer-to-Peer Property Lending registered the fastest annual growth, at a rate of 88% from 2015 to 2016, whilst Peer-to-Peer Consumer Lending grew by 47% and Peer-to-Peer Business Lending by 36% during the same period.

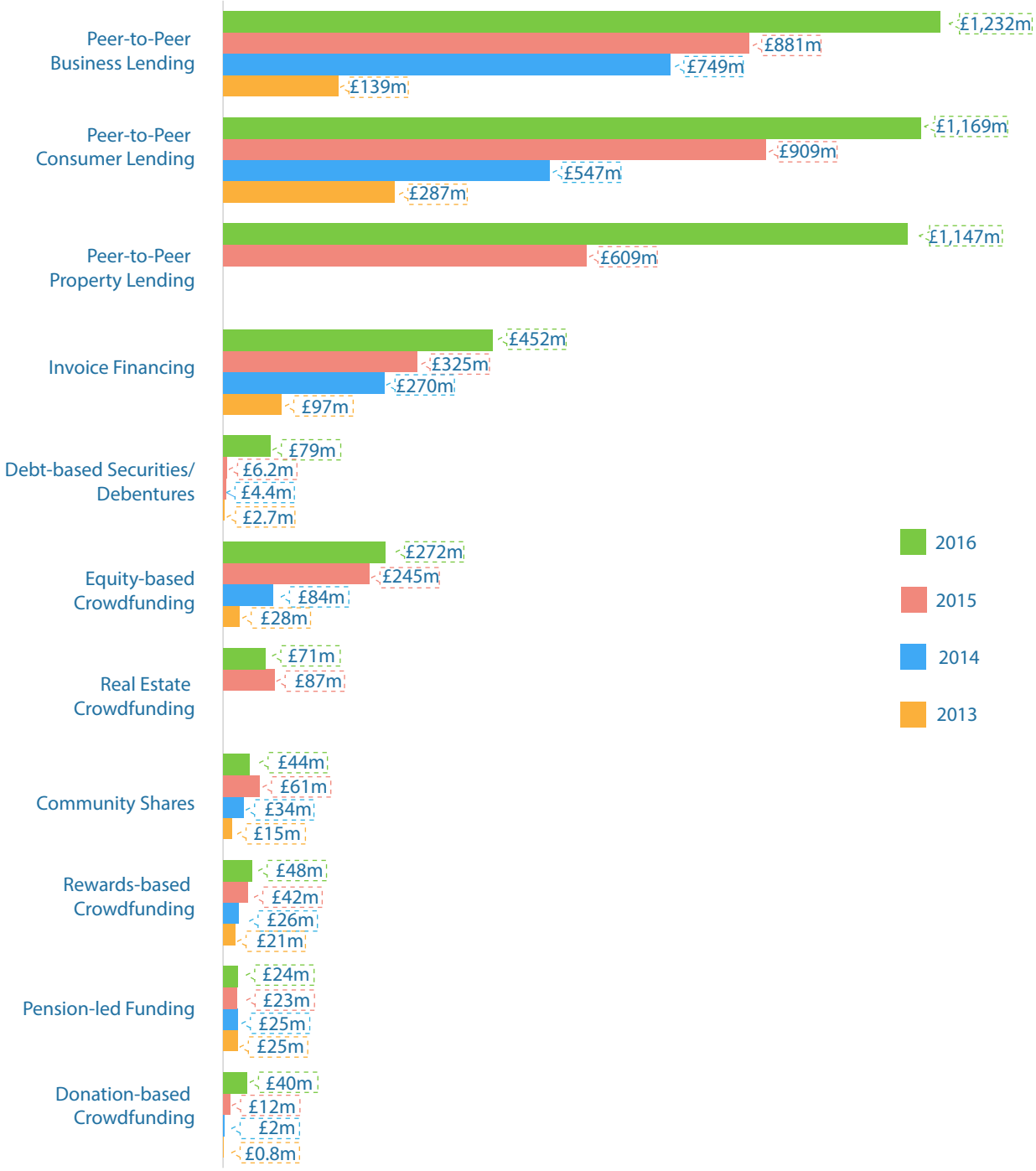
Invoice Trading – another debt-based model - accounted for £452 million in 2016, with 39% annual growth. Debt-based securities/Debentures recorded the highest year-on-year growth rate across all models tracked (1174%), driving £79 million in volume.

Equity-based crowdfunding grew by 11% from £245 million in 2015 to £272 million in 2016. The growth rate has, however, substantially slowed down when compared to previous years. Total real estate crowdfunding market activity dropped by 18% to £71 million in 2016 from £87 million in 2015. A similar trend was evident in Community Shares, where captured volumes fell from £61m in 2015 to £35m in 2016, representing a 43% decline.

Within the non-investment based space, reward-based crowdfunding drove £48m of volume in 2016, a 14% annual increase. Donation-based crowdfunding accounted for £40 million in 2016, representing a 233% annual increase. This implies that the volume of Donation-based crowdfunding could surpass that of reward-based crowdfunding should the relative growth rates continue in 2017.

SIZE & GROWTH BY MODEL

Figure 2: UK Alternative Finance Market Volume by Model, 2013-2016



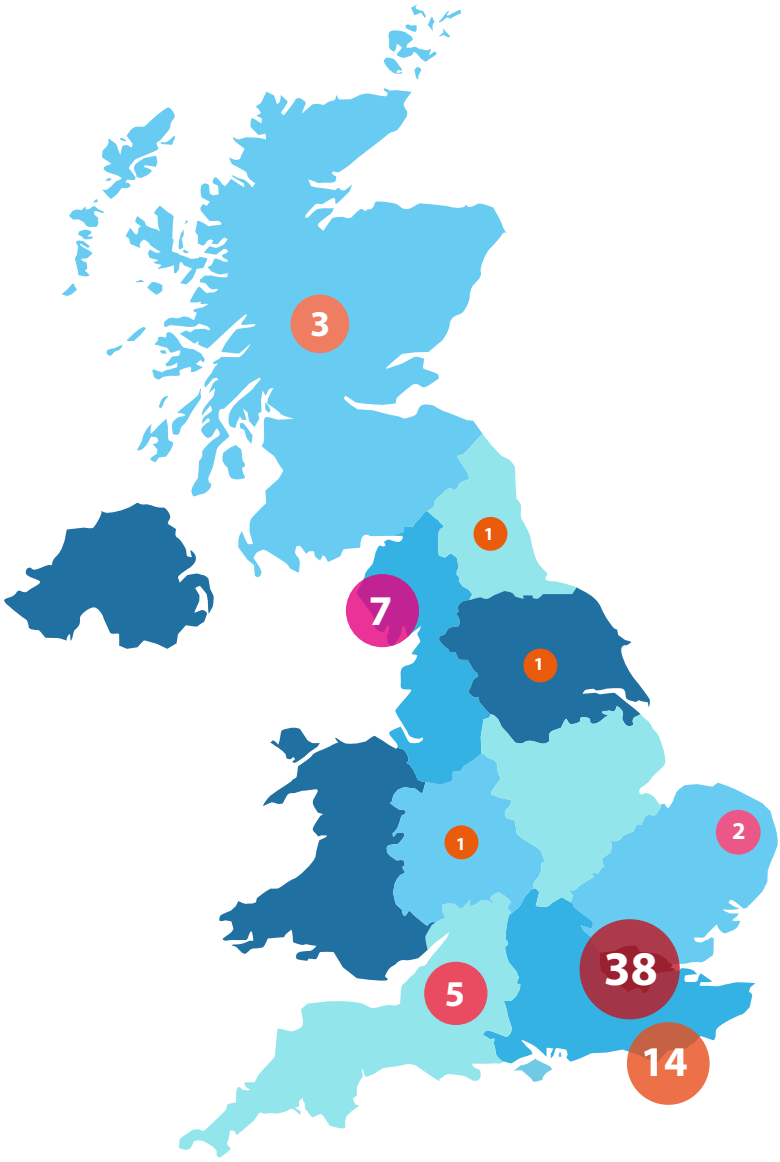
This study tracked market volumes from across eleven online alternative finance models, with comparable volume data for nine of the model types recorded since 2013.

Eight of the online alternative finance models continued to experience positive annual growth, whilst three models experienced negative growth.

THE GEOGRAPHY OF ONLINE ALTERNATIVE FINANCE IN THE UK

Figure 3: Geographical Distribution of Respondent Platforms across UK

Region	2016
London	38
South East	14
North West	7
South West	5
Other	3
Scotland	3
East of England	2
Crown Dependencies	2
North East	1
Yorkshire & the Humber	1
West Midlands	1
Total Count	77



London remains the regional leader for platform headquarters, with 44% (38) of all surveyed platforms maintaining their main office in London. 16% are based in the South East (14), 6% in the South West (5) and 2% in the East (2). Collectively the South of England accounted for over three quarters of all platforms surveyed this year. The North of England accounted for just under 12% of the total surveyed platforms, comprised of 9% from the North West (7) and one each from the North East and Yorkshire & the Humber region. 4% of platforms were headquartered in Scotland (3).

The tables below show, in descending rank, which regions received and provided the highest amount of funding by alternative finance model. London and the South East were leaders in both the provision and receipt of funding. The North West saw higher volumes than other northern regions, albeit received much more funding than it provided. The South West region also saw significant volumes.

The data also suggests that there is a possible regional redistribution of funding; the North East, for instance, features in the top 5 receivers of funding despite providing very little itself. Both real estate crowdfunding and peer-to-peer consumer lending feature prominently in this regard.

Figure 4: Level of Funding Provided by UK Region (2016)

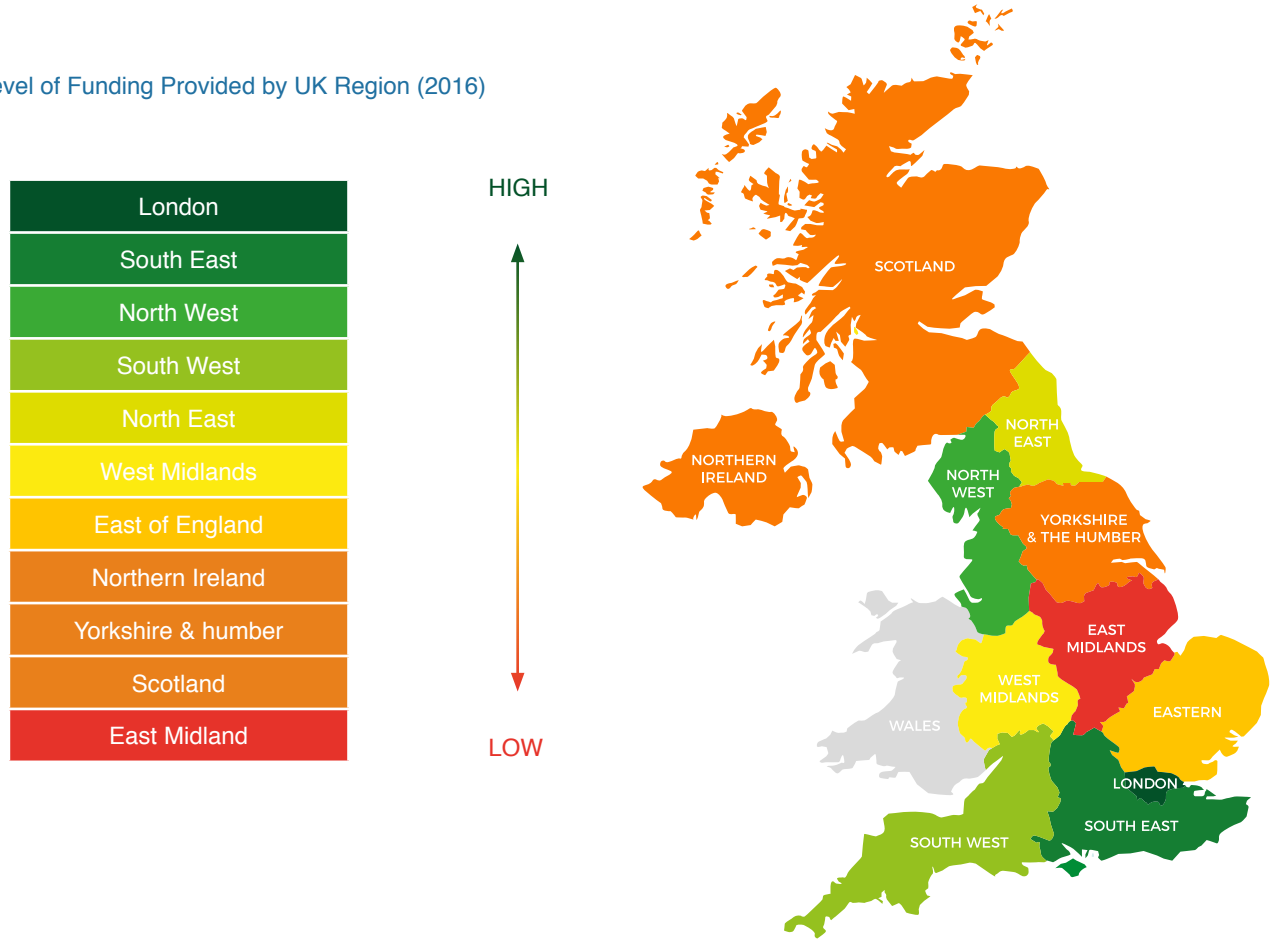
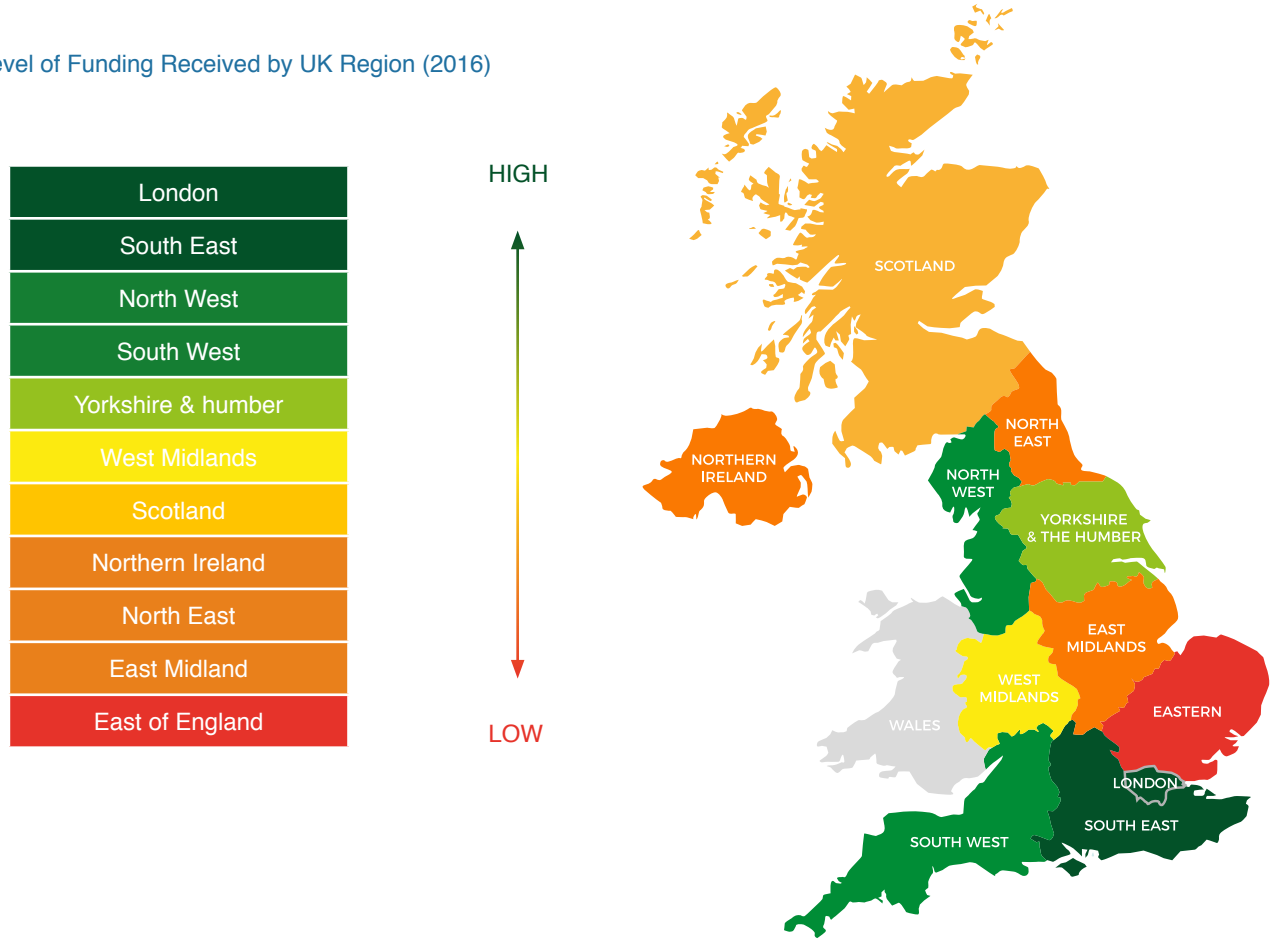


Figure 5: Level of Funding Received by UK Region (2016)



DYNAMICS AND MARKET TRENDS OF THE ONLINE ALTERNATIVE FINANCE MARKET IN THE UK

Figure 6: Alternative Finance Platform Incorporation and Start Trading Dates in 2014-2017

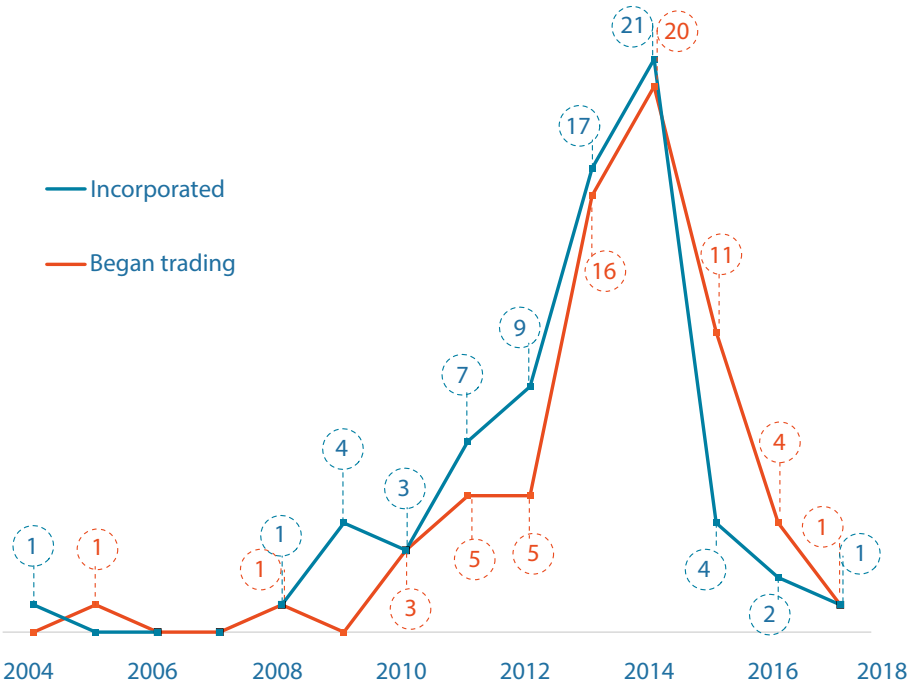


Figure 7: Suspected Inactive Platforms in 2016

ENTRY AND EXIT OF PLATFORMS

The number of platforms that have newly incorporated and/or begun trading continued to decrease in 2016 since the peak of 2014. As the market continues to consolidate, there are fewer new entrants and some previously active platforms have exited. It is notable that in the 2016 survey, the number of respondents decreased significantly against the previous year. Upon further investigation, the Centre has concluded that approximately 35 platforms are likely to have become inactive during 2016.

Some smaller platforms could not originate sufficient deal flow to maintain operations, whilst some moved away from alternative finance altogether to pursue more deregulated activities. Whilst there were several mergers in 2016, most of the suspended platform activities derive from platform closure. Of the 35 platforms observed, 29% were equity-based crowdfunding platforms, 14% were real estate crowdfunding platforms and 11% were reward-based crowdfunding platforms. These platform closures coincide with three of the key models that have experienced slow or negative growth against the previous year.

KEY SECTORS AND INDUSTRIES

The 'Industry Tracking' Survey provided platforms with the opportunity to rank the top five industries or sectors funded via their platform. Though specific volumes were not always available, the insights into which alternative finance models serve with industries remains valuable information. The below figure represents the top five most funded sectors or industries by model in 2016.

Finance and Real Estate & Housing are well represented sectors across the alternative finance ecosystem, and represent one of the top five sectors for Peer-to-Peer Business Lending, Equity-based Crowdfunding and Debt-based Securities. Construction and Manufacturing were both industries well represented by Peer-to-Peer Lending platforms, whilst the most funded sectors for Equity-based Crowdfunding were Technology and Renewable Energies, respectively. Renewable Energies was a key sector for Debt-based Securities models as well.

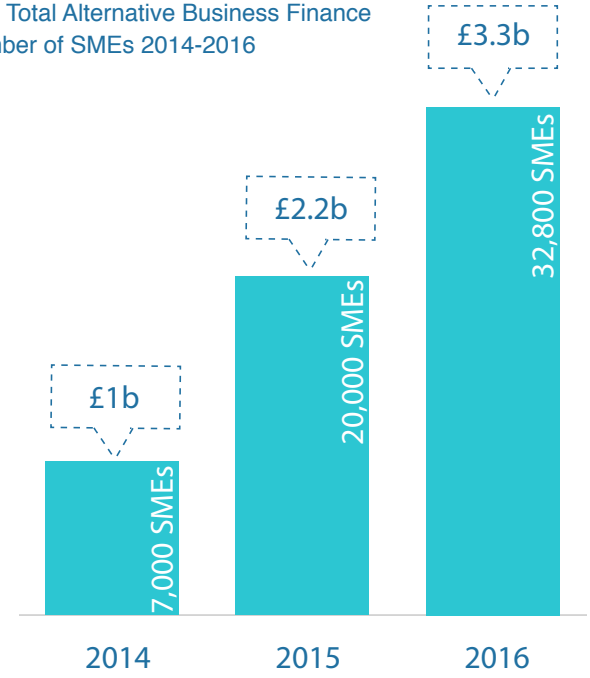
Community & Social Enterprise featured as a top five industry in Equity-based Crowdfunding and Debt-based Securities, as well as in both of the non-investment based models.

In fact, Community & Social Enterprise was the highest funded sector for both Donation-based and Reward-based Crowdfunding. This follows from the fact that fundraisers with philanthropic motives can list for funding. The second most funded sector for both reward-based and donation-based crowdfunding were Business & Professional Services, with Art, Music and Design in third place.

Top Five Represented Sectors by Model (2016)

THE USE OF ONLINE ALTERNATIVE FINANCE BY BUSINESSES IN THE UK

Figure 8: Total Alternative Business Finance and Number of SMEs 2014-2016



In 2016 approximately 72% of all alternative finance market volume, or £3.3 billion in total, was raised for UK start-ups and SMEs across a combination of the various debt, equity and non-investment funding options offered by the alternative finance industry. This was a £1.1 billion (50%) increase on the £2.2 billion of business finance raised in 2015. A total of circa 33,000 firms utilised alternative finance channels, which represents approximately 2.5% of the UK's 1.3 million employing businesses . This was an increase of 64% on the total number of SMEs utilising at least one form of alternative finance compared with 20,000 in 2015.

The survey aimed at understanding which alternative finance models, or combination of models, were utilised by UK companies. The principal source of finance for business was derived from debt-based models, which lent £2.9 billion across 30,000 businesses, whilst equity-based models provided £371 million of funding to 482 firms. Though the £14 million of funding from non-investment models is proportionally small (being less than 1% of total business volume), it is notable that this was across a significant number of firms, scilicet 1,690.

Figure 9: THE PROPORTION OF VOLUME

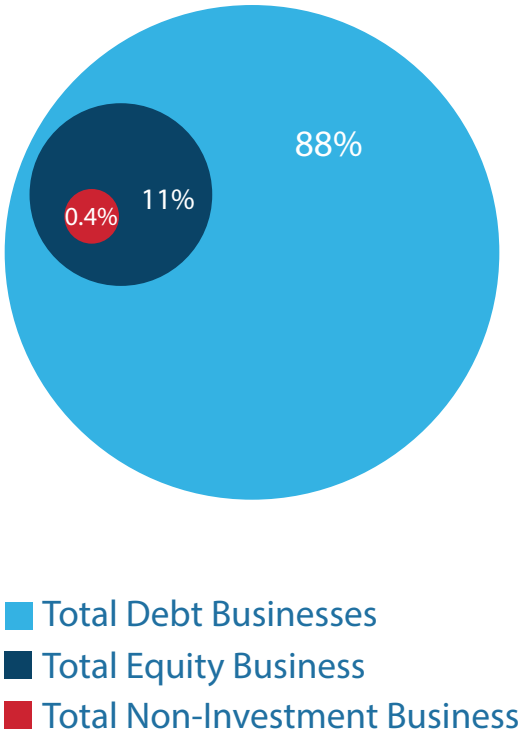
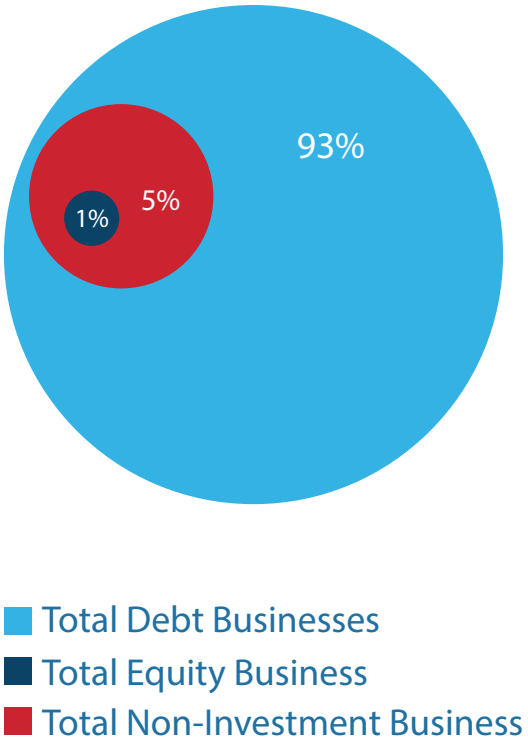


Figure 10: THE NUMBER OF SMEs BY MODEL



Over the course of six years, Equity-based Crowdfunding has become an established investment vehicle for seed, start-up, early stage and fast-growing companies seeking growth or expansion capital. When compared with the British Venture Capital Association's (BVCA) annual figures for 'total venture capital' and Beauhurst's Seed and Venture Stage figures for total equity investment funding in the UK, it is shown that equity-based crowdfunding is playing a more significant role in the provision of equity finance over time.

Figure below shows that equity-based finance in the UK plateaued in 2016 with Beauhurst's figures showing a slight drop in overall Seed and Venture stage funding (from £1,574m in 2015 to £1,566m in 2016) in the UK.

The trend in equity-based crowdfunding, by contrast, is broadly an upward trajectory, growing from just £1.7m back in 2011 to £272m in 2016, indicating that it is becoming a more important source of funding for Seed and Early Stage businesses.

To put this into context, from 2011 to 2016, the percentage of equity-based crowdfunding as a proportion of the total UK seed and venture stage equity investment has been growing rapidly from just 0.3% in 2011 to 9.6% in 2014, 15.6% in 2015 to 17.37% in 2016. Equity-based crowdfunding continues to capture a growing proportion of the UK venture capital market, suggesting that it is no longer fringe 'alternative' form of equity financing but becoming a more established and accepted channel for capital formation

Equity-based Crowdfunding as a Proportion of Announced UK Seed and Venture Stage Equity Finance 2011-2016 (£Million)

Figure 11: Equity-based Crowdfunding as a Proportion of Announced UK Seed and Venture Stage Equity Finance in 2011-2016

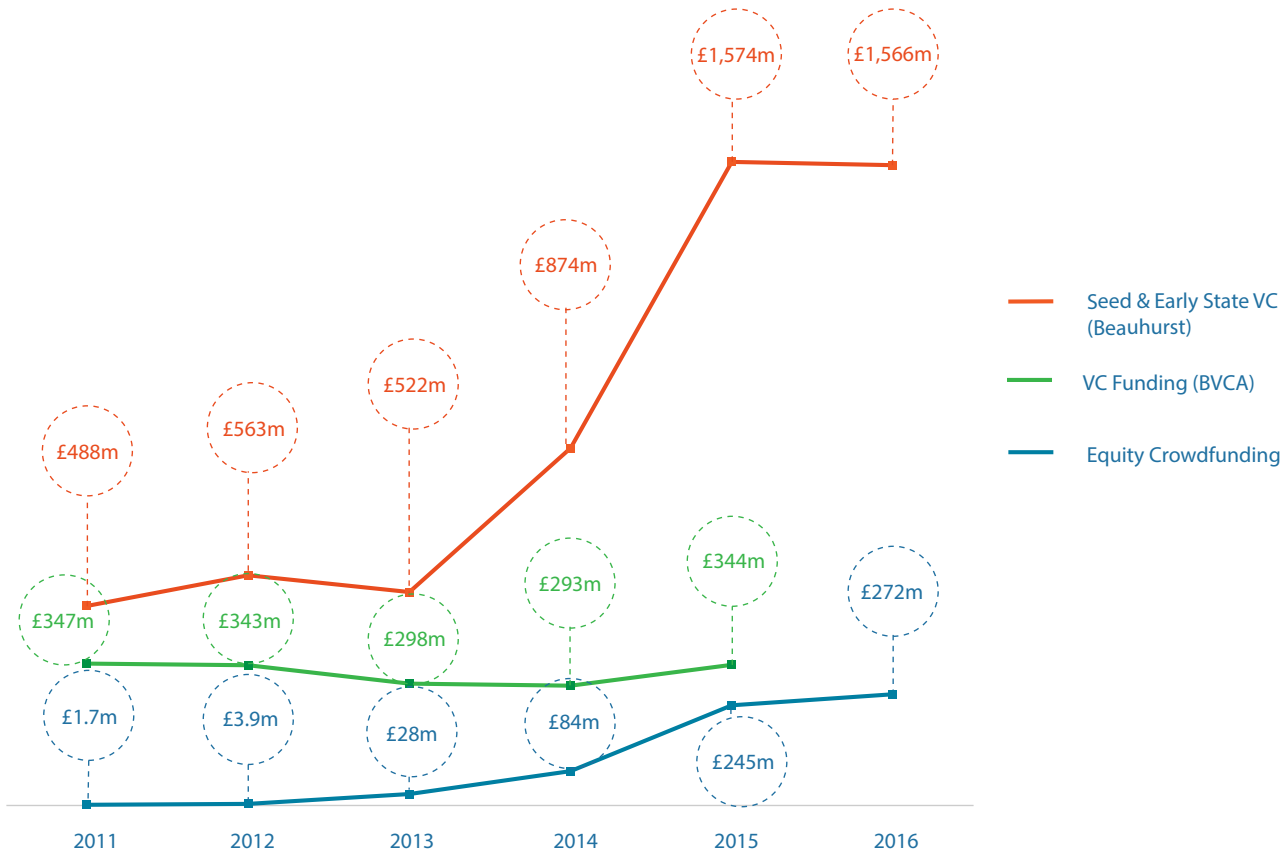
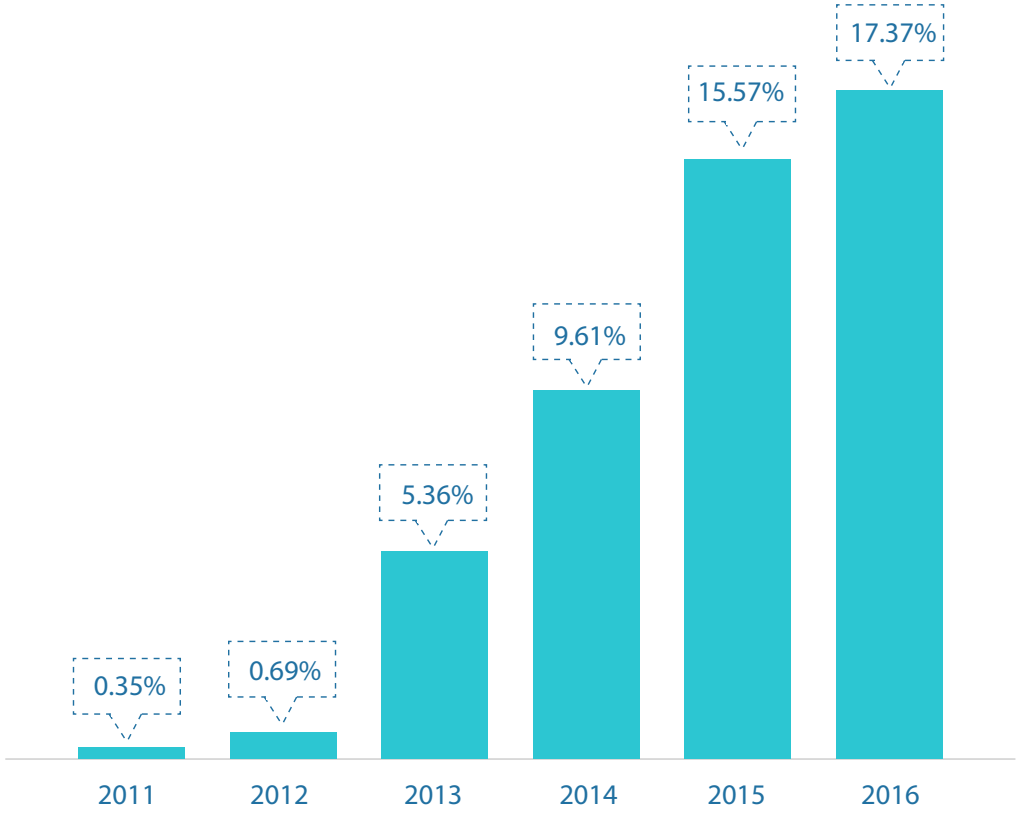


Figure 12: Equity-based Crowdfunding as a Proportion of Total Seed & Venture Stage Equity Investment in 2011-2016 (Beauhurst)



Whilst equity-based crowdfunding finance contributes an important proportion of business funding, the volumes are dwarfed by SME lending. The Bank of England estimates that £59 billion was lent to SMEs by national banks in 2016.

Comparing the UK P2P business lending volume against that of the British Bankers Association's (BBA) annual data in new loans lent to SMEs shows that the percentage of online alternative business lending has increased steadily from just 0.3% in 2012 to 6.56% in 2016. [5]

Figure 13: Peer-to-Peer Lending Compare to Bank Lending in 2012-2016

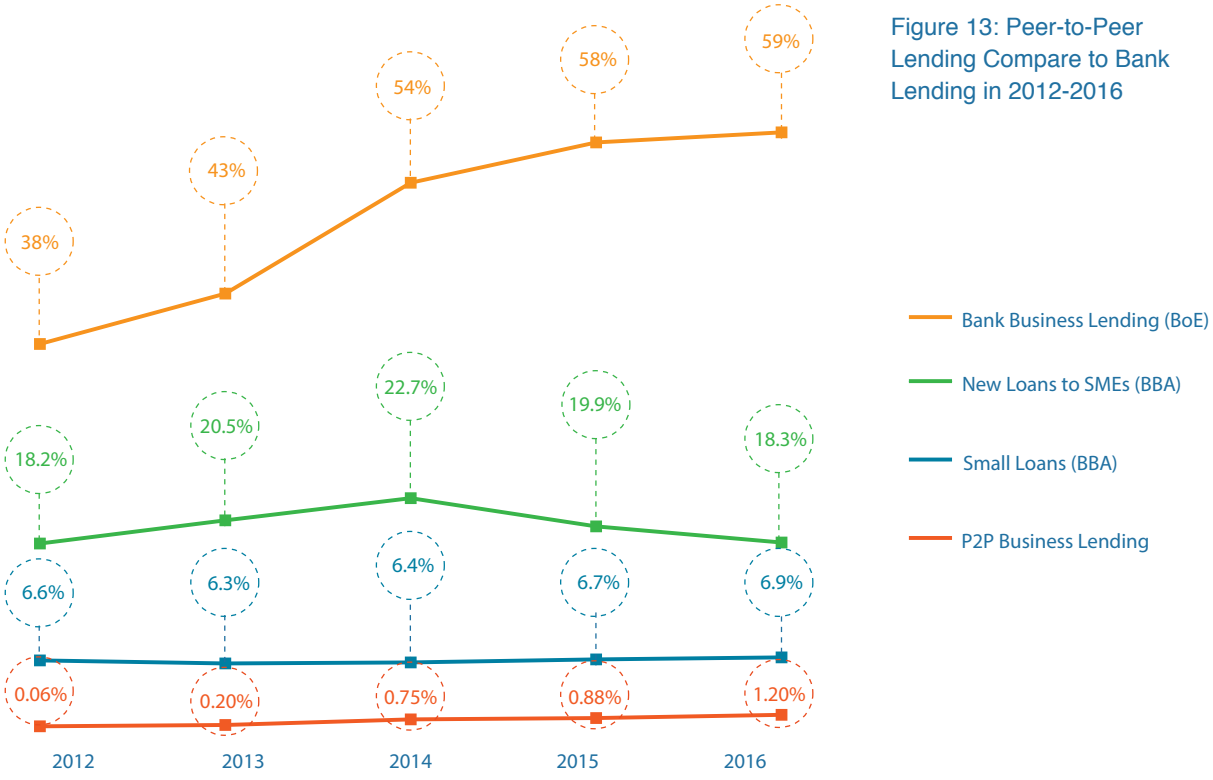
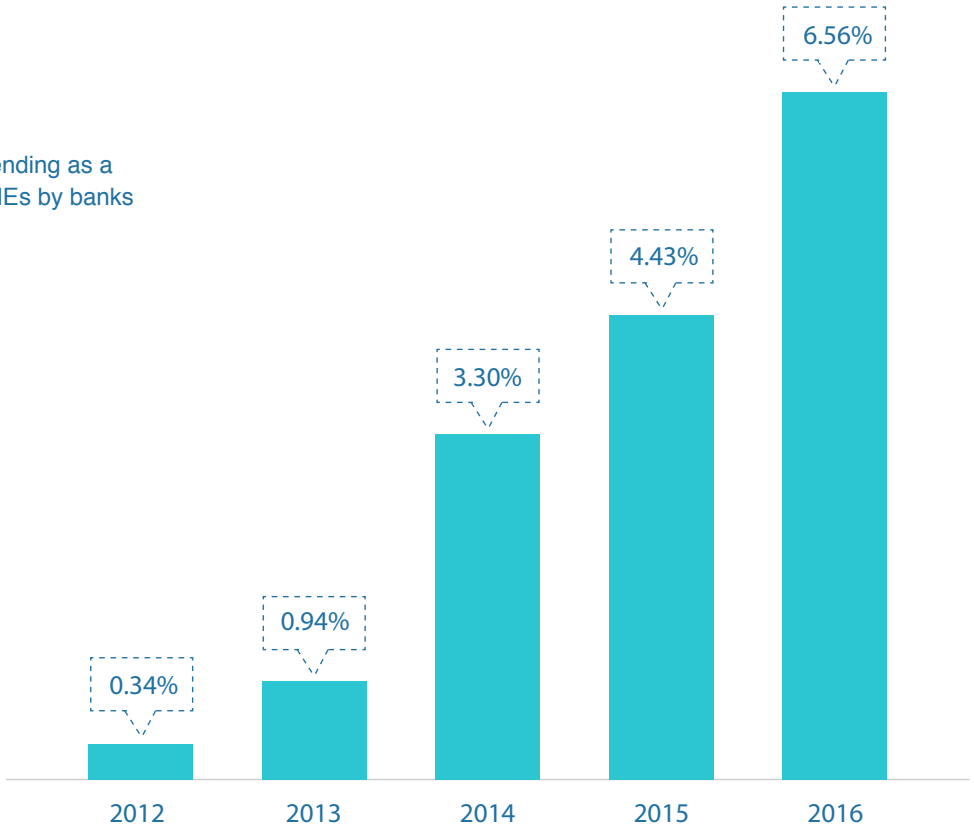


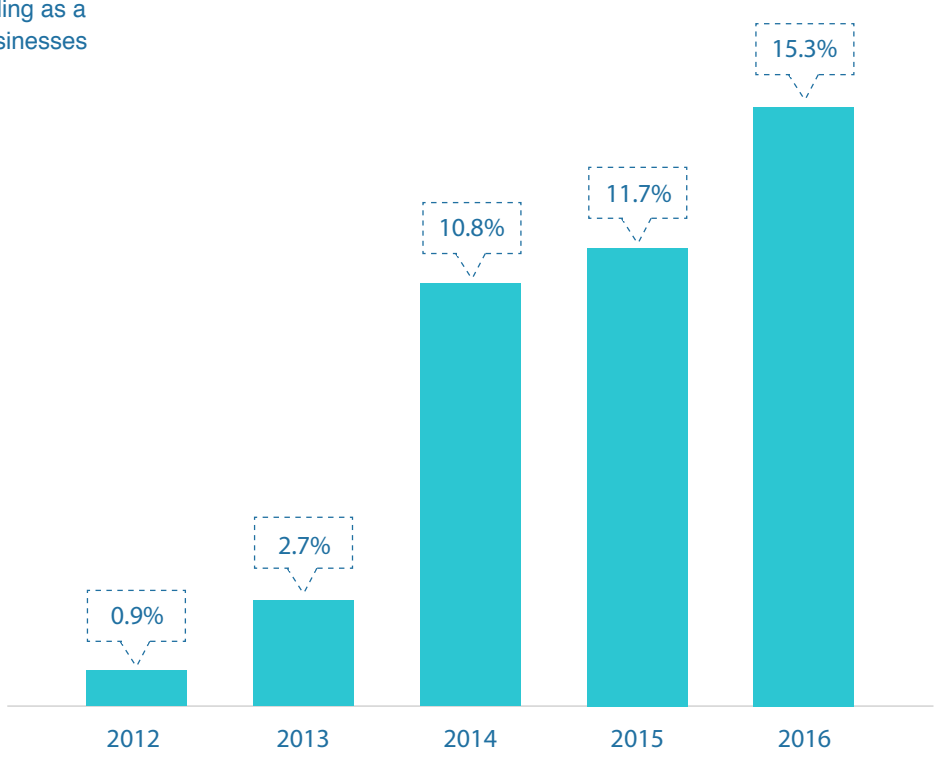
Figure 14: Peer-to-Peer Business Lending as a Proportion of Total New Loans to SMEs by banks in 2012-2016 (BBA Data).



The data also shows that peer-to-peer business lending is most utilized by small business borrowers, with the average business loan being circa £95,000 in 2016. The chart below shows that peer-to-peer business lending volume in the UK is now equivalent to just over 15% of all bank lending to small businesses in 2016 .

Therefore, peer-to-peer business lending is becoming an increasingly material contributor to SME financing in the UK in comparison to bank lending channels.

Figure 15: Peer-to-peer Business Lending as a Percentage of New Loans to Small Businesses in the UK (BBA Data 2012-2016)



INNOVATION ACROSS ALTERNATIVE FINANCE PLATFORMS

Figure 16: Alternative Finance Platform Changes to Business Model

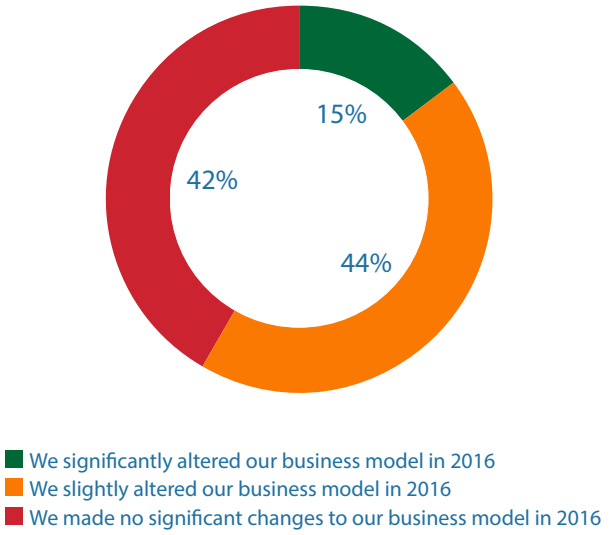
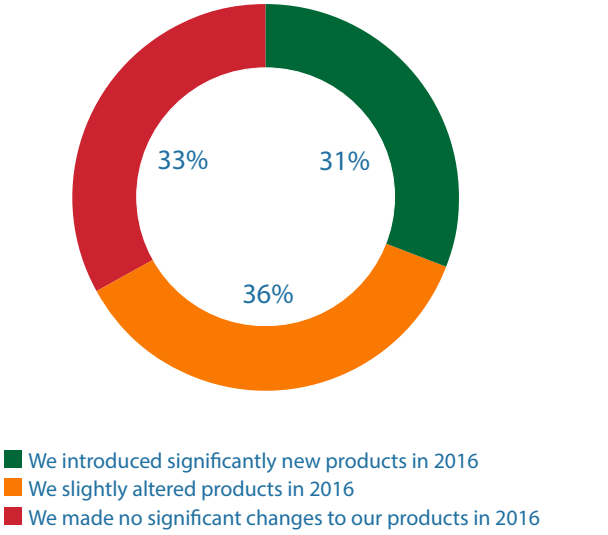


Figure 17: Alternative Finance Platform Changes to Products

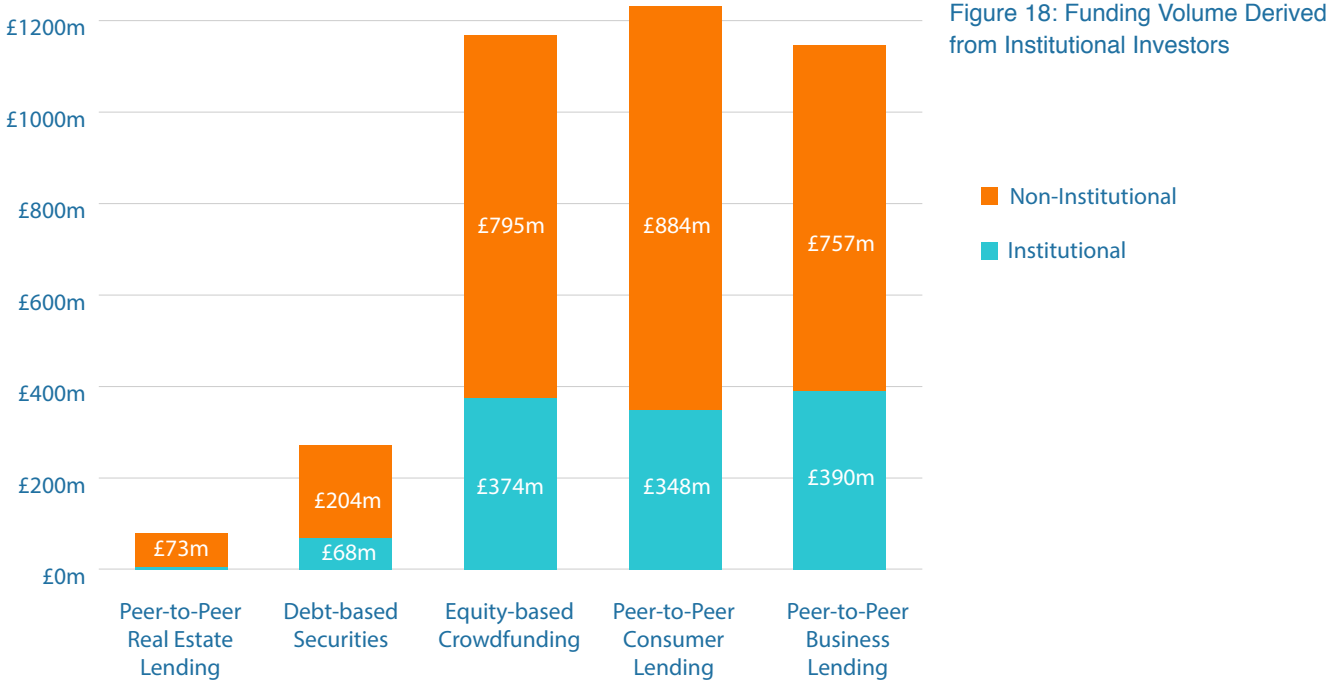


In this year's UK Industry Tracking Survey[8], platforms were asked indicate of the level of innovation within both their business models and the products they offered in 2016. 15% of the surveyed platforms indicated that they significantly changed their business model in the past year, whilst 44% slighted altered their business model. With 59% surveyed platforms either signfiicantly or slighted altered their business model, 2016 was seemingly a year of change and innovation for the UK alternative finance industry.

Survey responses show that product innovation was more prevalent, with more than 31% of surveyed platforms introducing new products in 2016 and a further 36% slightly altering their products in 2016. Only a third of the surveyed platforms stated that they made no significant changes to their products in the last year.

INSTITUTIONALISATION

Figure 18: Funding Volume Derived from Institutional Investors



One of the key findings in the previous UK report, Pushing Boundaries, was increased institutionalisation within the market, where institutionalisation was defined as institutions investing directly through platforms to SMEs and individual fundraisers.

Subsequently, in the 2016 survey, platforms were asked to indicate the proportion of volume funded by institutional investors.

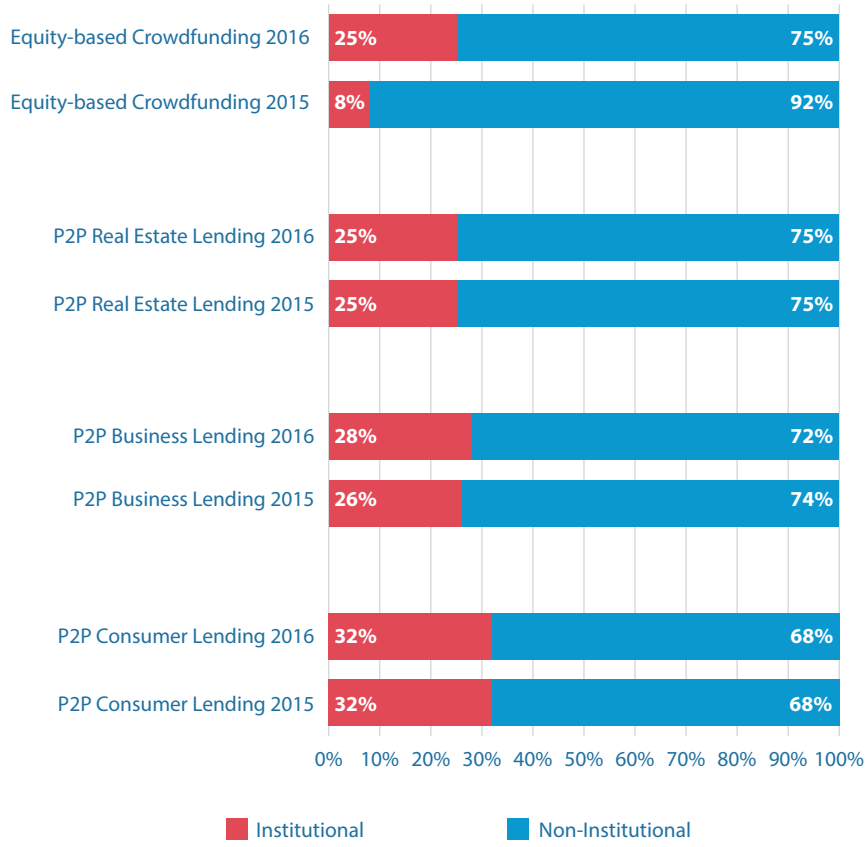


Figure 19: Proportion of Funding from Institutional Investors, 2015 vs 2016

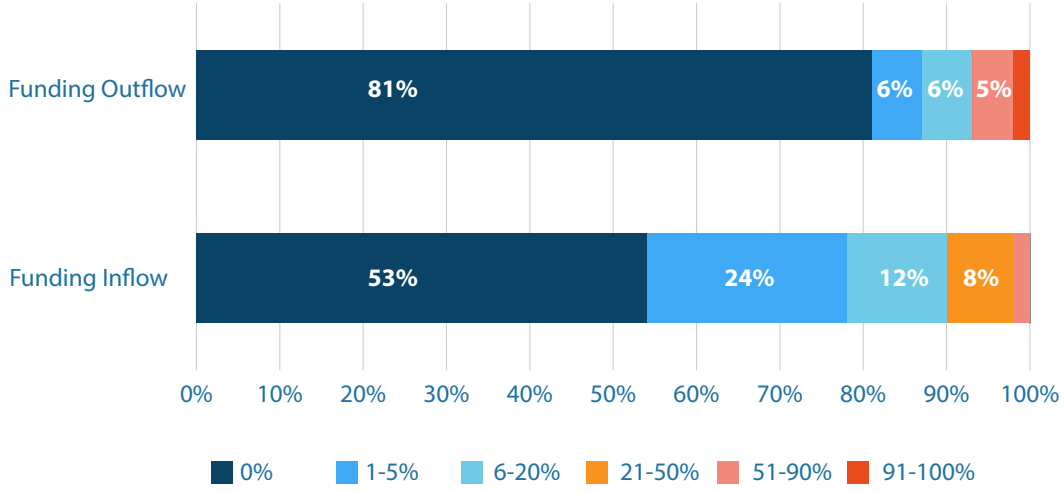
Though retail investment remains the main driving force of alternative finance volumes, in key models' institutional investors contributed significant sums. The sources of institutional funding vary significantly from model to model, but, by and large, peer-to-peer lending models tend to attract investment from traditional banks, mutual funds, pension funds, hedge funds and asset management firms. Public and governmental funders, such as local authorities and the British Business Bank, also actively lend through such channels. 34% (£390 million) of the peer-to-peer Property Lending volume came from institutional investors, a sharp increase from 25% in 2015. The corresponding figure for peer-to-peer Consumer Lending was 32% (£374m). This proportional split is identical to the 2015 split, signalling that the funding mix between retail and institutional has grown at equal levels irrespective of volume growth. Similarly, peer-to-peer Business Lending also remained proportionally similar, from 26% in 2015 to 28% in 2016, deriving £348 million from institutional investors. In the case of peer-to-peer Business Lending, the largest model in the UK market, retail investment continues to drive volume.

Equity-based and Real Estate Crowdfunding both reported that 25% of their volume originated from institutional investors, representing £68m and £18m respectively. For equity-based crowdfunding, this represents a significant increase in institutional investment, up from 8% in 2015. This suggests that there are an increasing number of co-investment deal whereby traditional VCs or Angels are investing alongside retail investors through a crowdfunding platform. Regrettably, we are unable to provide comparative figures for Real Estate Crowdfunding, as the 2015 survey did not track institutionalization for this model.

Likewise, the Debt-based Securities/Debentures model also did not capture comparable 2015 data. As such, this report can only present the proportion of institution-led volume for the 2016 year, which accounted for 8% of the volume through this model, being £6m.

CROSS BORDER ACTIVITY

Figure 20: Proportion of Funding as Related to Cross Border Flows



The proportion of cross-border transactions within alternative finance continues to be a topic of interest within the UK and globally. Data showing actual funding inflows and outflows demonstrate that the financing of online alternative finance deals remains a predominantly national activity, with limited inward or outward Foreign Direct Investment ("FDI"). Platforms were asked to provide an estimate of overseas funding inflow (the proportion of funding raised through the platform for UK-based fundraisers from foreign investors) and funding outflow (the proportion of funding raised for fundraisers based outside of the UK from non-foreign investors).

As per the chart below, 81% of platforms indicated that none of their funding goes to fundraisers located outside the UK, which is up from 66% of platforms which had no outward foreign direct investment in 2015. Nevertheless, whilst most of financing remains within the UK, there are some instances of outward FDI; 6% of platforms indicating that between 1-5% of the funding went to foreign campaign owners, another 6% stated between 6-20% of funding left UK shores. 5% of surveyed platforms stated between 51-90% of funds left the UK and only 2% of surveyed platforms stated that between 91-100% of funds left the UK.

As with outward FDI, inward FDI too has declined year-on-year. In 2015 approximately 32% of platforms indicated no inward FDI secured for UK businesses, suggesting that over half of all platforms were experiencing some levels of inward investment, albeit at varying degrees. In 2016 53% of platforms indicated no inward FDI, while 24% stated between 1-5% came from outside the UK. 12% of survey platforms stated between 6-20% of funds came from non-UK funders and 8% came stated 21-50% of funds came from outside foreign funders. 2% of firms stated that the majority of between 51-90% of funds came from non-UK funders and no platforms stated between 91-100% of funding came from externally based funders.

Diminishing cross-border investment in 2016 reverses a trend seen over previous years, in which it was steadily increasing. In other geographies, however, cross-border investment continues to grow, albeit slowly, especially within regions. This finding necessitates further investigation, especially against the context of a future Brexit and increasing harmonization across continental Europe.

INDUSTRY PERCEPTIONS OF REGULATION

Figure 21: Platform Perception towards FCA Ongoing Crowdfunding Review

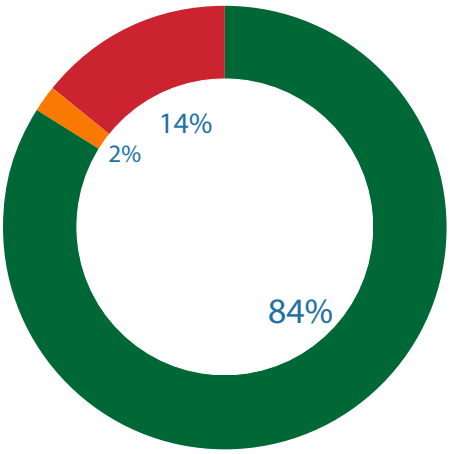


Figure 22: Perception of Existing Loan-based Crowdfunding Rules from Applicable Platforms

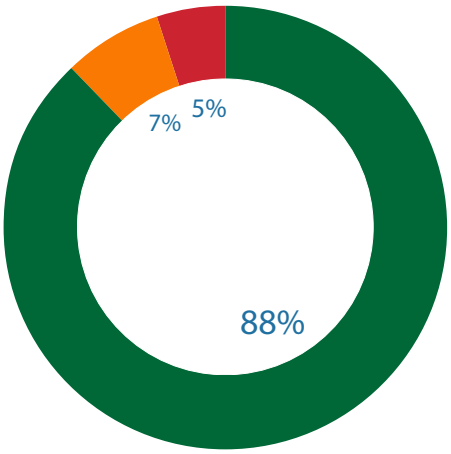
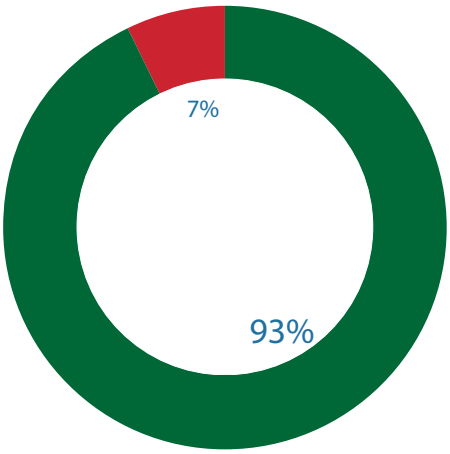


Figure 23: Perception of Existing Investment-based Crowdfunding Rules from Applicable Platforms.



Adequate and appropriate for my platform activities
Inadequate and too relaxed for my platform activities
Excessive and too strict for my platform activities

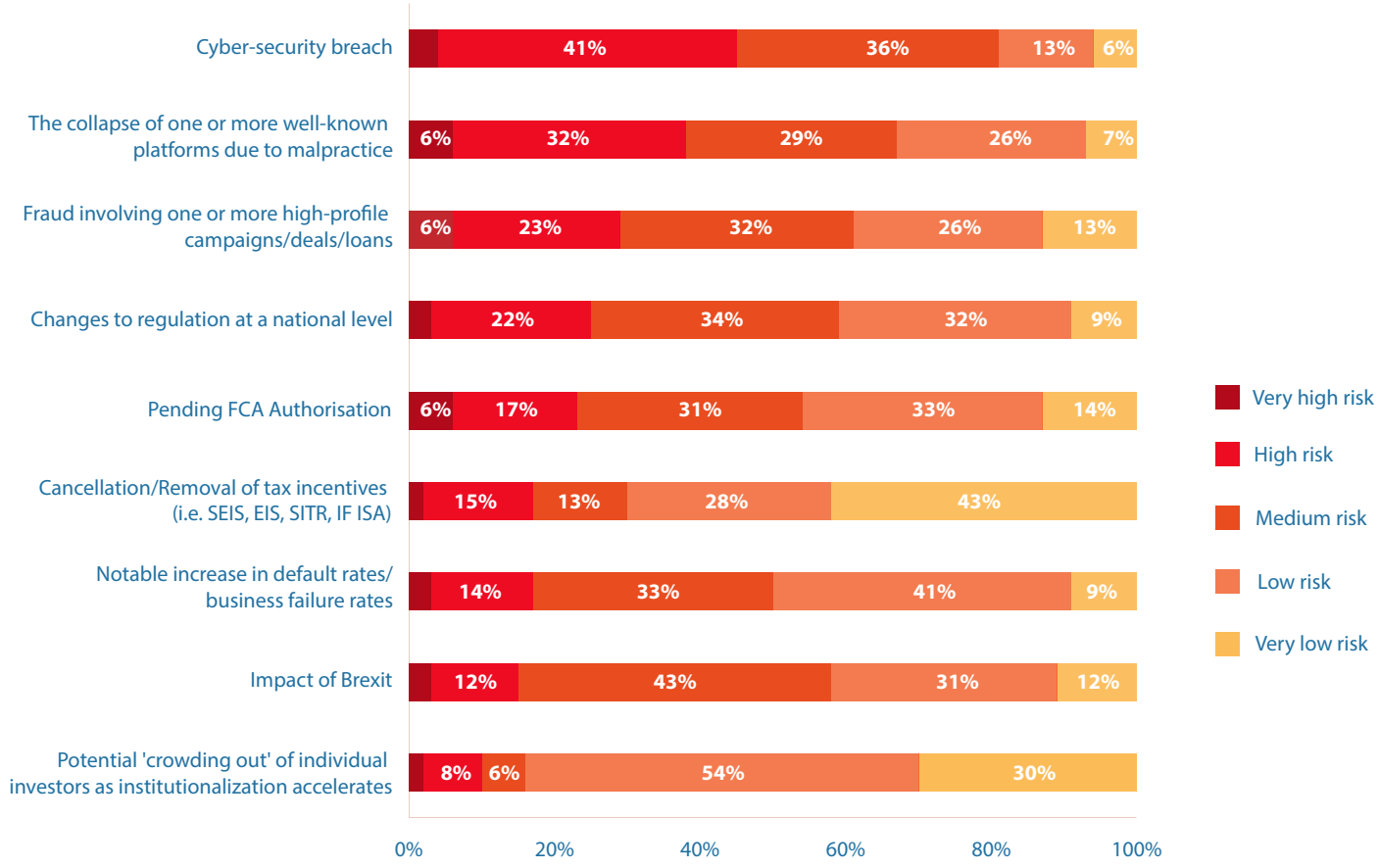
2016 was an important year for the UK alternative finance industry – particularly for loan-based and investment-based crowdfunding as defined by the UK Financial Conduct Authority ("FCA"), who launched the second part of their post-implementation review of the regulatory regime for these sectors last year. Some of that evidence is presented in this report. In light of the ongoing review of the regulatory regime for this sector, the study also asked UK platforms for their perspectives on the FCA approach to regulating the sector.

The majority of loan-based crowdfunding platforms surveyed deemed existing FCA loan-based crowdfunding regulations to be adequate and appropriate with 88% of surveyed platforms stating so. Only 7% of surveyed loan-based platforms thought that existing regulations were too relaxed for their platform activities, while an even smaller percentage of platforms (5%) stated existing loan-based crowdfunding regulations are too stringent.

With respect to investment-based crowdfunding which encompasses equity-based crowdfunding but also debt-based securities, 93% of surveyed investment-based crowdfunding platforms saw existing FCA regulation to be adequate and appropriate compared to 7% who deemed existing regulations to be too relaxed and inadequate. No platforms stated that UK investment-based crowdfunding regulation was too excessive or strict.

The collective perceptions of loan-based and investment-based platforms regarding the FCA crowdfunding regulatory review show that the majority of the industry are satisfied with the process with 84% of surveyed platforms consider the review as appropriate and adequate. However, 14% surveyed platforms stated that the FCA's ongoing crowdfunding review may lead to regulations that are too excessive and strict.

Figure 24: Industry Perceptions of Risk in the UK in 2016



Platforms were asked to rate nine different factors based upon perceived level of risk to their platform operations. These risk factors included fraud, increase in default rates, collapse of well-known platforms due to malpractice, cyber-security breach, crowding-out of individual investors, changes in national regulation, pending FCA authorisation, cancellation of tax incentives and the impact of Brexit.

Perceived risk across these factors remains relatively high, with most alternative finance platforms indicating Medium-to-Very High Risk for at least six of the nine factors. The factor viewed as the most significant risk to an individual company is that of Cyber-Security; 81% of platforms view a breach in cyber-security as a Medium-to-Very High-risk factor and 45% deeming this factor with High- to-Very High risk. The next most critical factor perceived as Medium – to- Very High risk is that of 'the Collapse of one or more well-known platforms due to malpractice', with 67% of platforms falling within this spectrum. 'Fraud involving one or more high-profile campaigns/deals' followed closely with a 61% response rate.

Two-thirds of factors were considered to be above average risk. Yet, if we just observe High-to-Very High Risk, it is interesting to note that two factors 'Cancellation/Removal of tax incentives' and 'Notable increase in default rate/business failure' actually recorded a 17% for High-to-Very High Risk, despite being viewed overall as part of the three factors below the 50%. Conversely, the 'Impact of Brexit' although ranking fifth in terms of risk, registers only 15% of platforms viewing this factor as 'Very High to High' risk (whilst overall 57% of platforms perceived this as above average risk).

The 'potential of crowding out' is viewed as the least risky towards a platform's operations, with only 16% of platforms ranking this factor as a 'Medium to Very High risk'. This is not altogether surprising given the increase in institutional funding available to platforms discussed earlier. As noted previously, retail investors continue to make up the largest proportion of funders both in terms of users and in terms of contributed funds.

KEY FINDINGS RELATED TO ACTIVE FUNDERS

In the UK Industry Tracking Surveyed, plaforms were asked to indicate the number of active individual and institutional funders who provided funding via their platform in 2016, thus providing us an indication of the active funder population. In 2016, the number of funders utilising a platform increased by 131%, jumping from 1.09m funders in 2015 to over 2.5 million funders in 2016.[9] Whilst this figure definitely will include high level of double counting (for instance, repeat donors for donation-based crowdfunding), it nevertheless provides a snapshot of the rapidly growing number of individuals providing finance through online alternative finance platforms.

Whilst this benchmark survey did not capture the categorisation of these individuals in terms of their retail investor category (High-net-worth, Sophisticated, Ordinary Retail), it is nonetheless noteworthy that over 2.5 million individuals are utilising an online alternative finance model in the UK. This survey also captured the number of institutional investors participating in online alternative finance, indicating an estimate participation from 2,500 institutions (e.g. banks, broker-dealers, family offices, asset managers, mutual funds, pension funds, venture capital funds etc.), a 139% increase against the 2015 number (1031).

Figure 25: Total Number of Active Individual Funders in the UK (2015-2016)

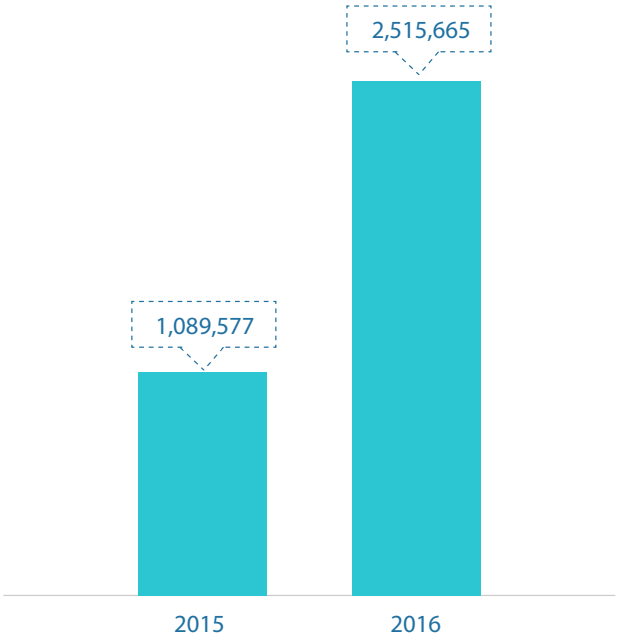
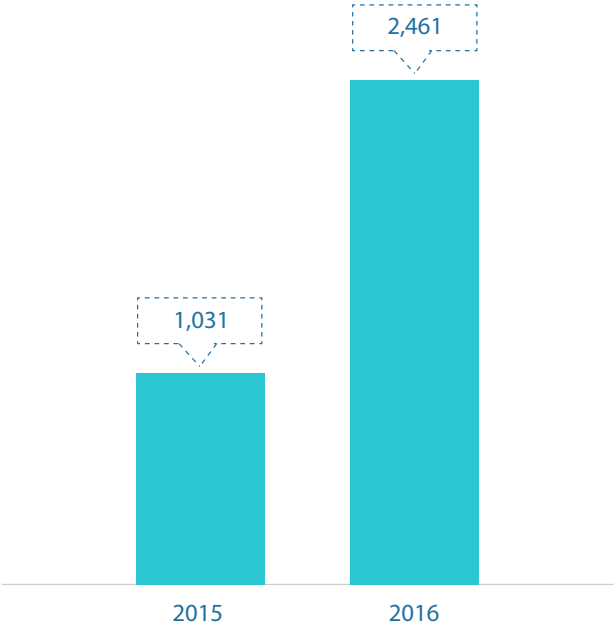


Figure 26: Total Number of Active UK Institutional Funders (2015-2016)



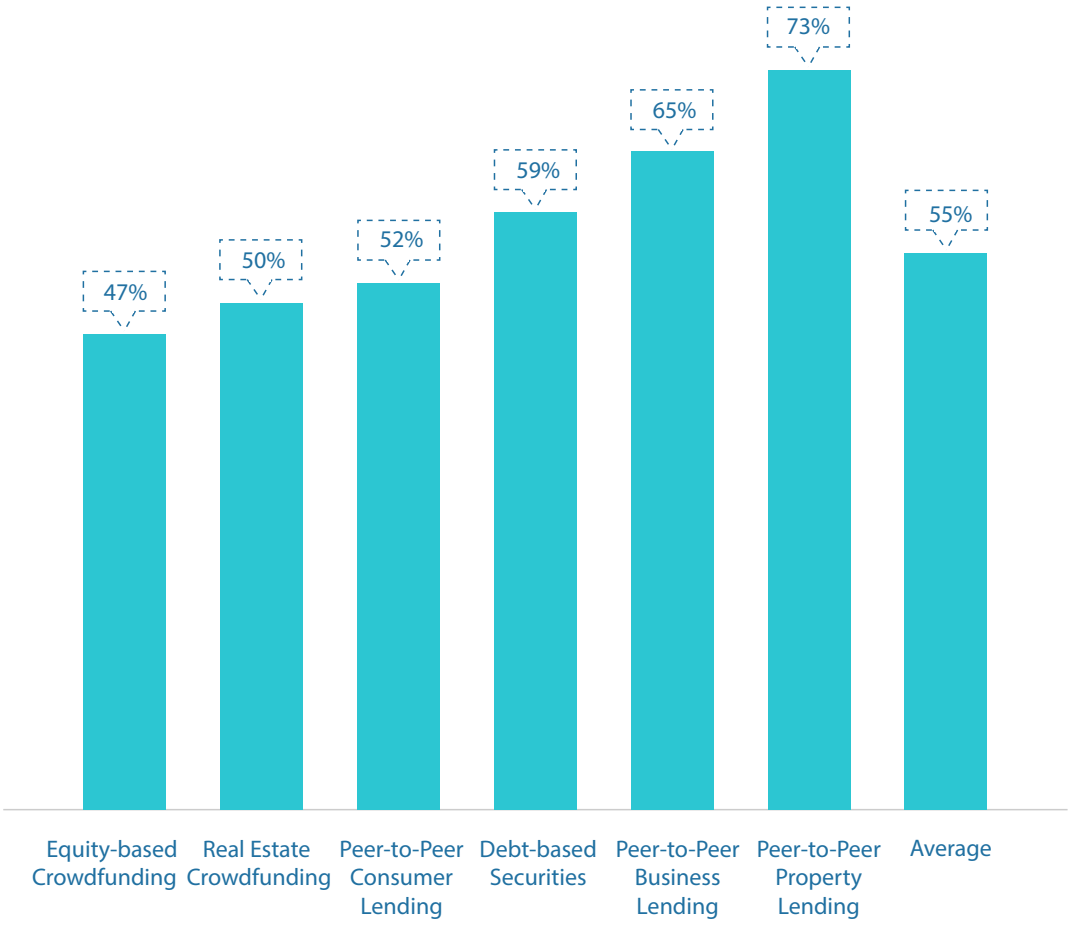
FUNDERS WHO UTILISE TWO OR MORE PLATFORMS

In addition to the platform-focused benchmarking survey, this report also presents data collected from from the 2016 Funder Survey distributed through December 2016 to January 2017. This survey was based upon the 2014 Funder survey distributed by Cambridge University and its research partners. This updated iteration of the survey captured responses from 8,370 funders, over 6 alternative finance models and aimed to track and analyse investor demographics and behaviour.

The survey and benchmark data cannot precisely show the number of different platforms used by an individual funder, but can imply the proportion of multi-platform users.

Based upon the responses collected from the Funder Survey, the chart below displays the percentage of individuals who are using at least two or more alternative finance platforms. The aggregated data shows that just over half of all funders (regardless of model) are using two or more platforms to pursue their online alternative finance investing or lending. P2P Property Lenders exhibited the highest levels of multi-use, with 73% of lending across two or more platforms, whilst Equity-based Crowdfunding investors fell just below average, with 47% of users utilising two or more platforms.

Figure 27: Percentage of Investors that Use at Least Two Alternative Platforms in 2016

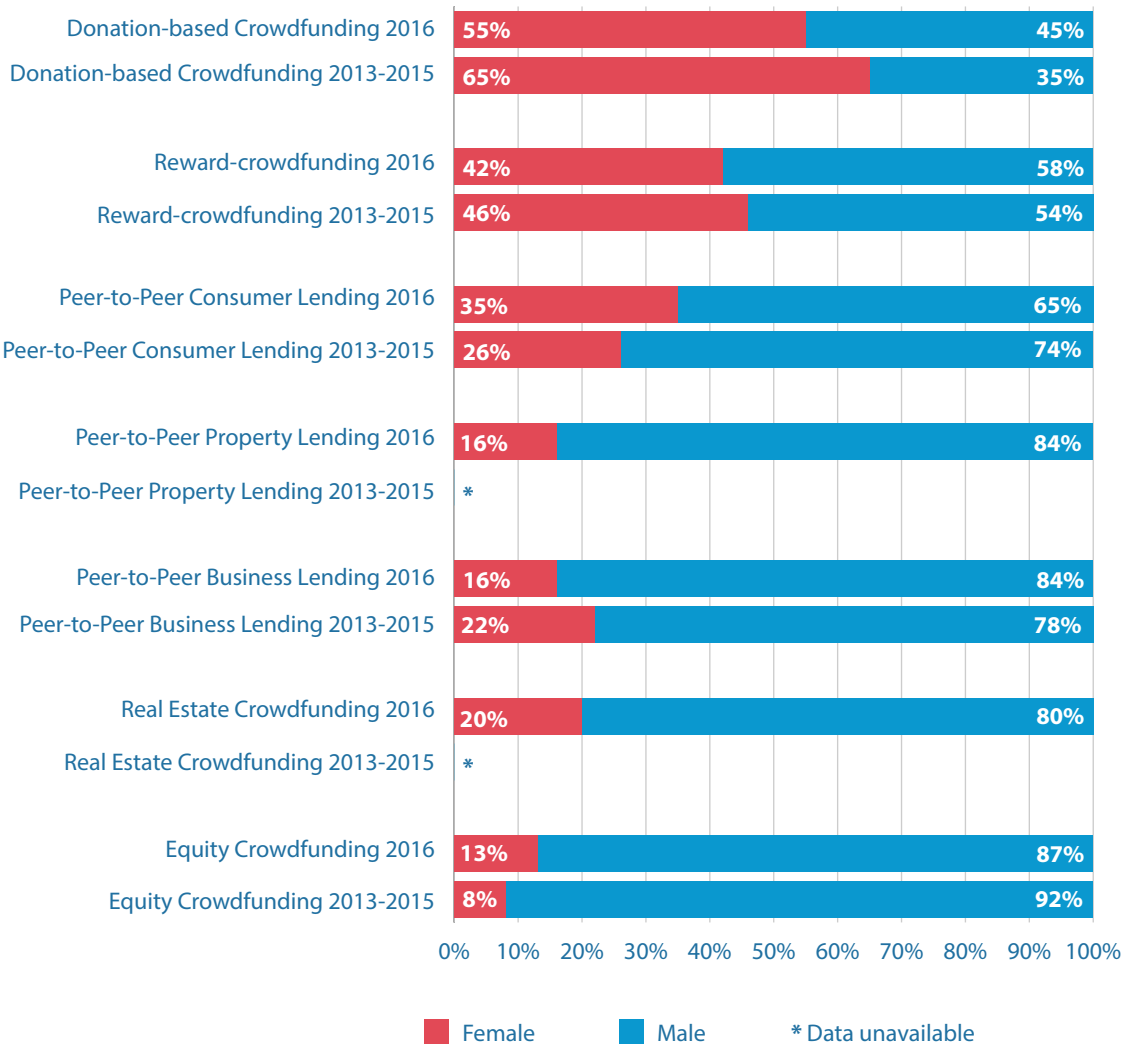


GENDER

The role which alternative finance can play in increasing financial inclusion and in bridging systemic gender gaps in both the provision and receipt of funding deserves greater attention, though limited evidence-based research currently exists. For the past two years, CCAF has begun tracking female participation in order to better understand the demographics and user case-study of female funders and fundraisers. Both the benchmarking and funder surveys enquire as to female participation to allow for ongoing and future analysis of this topic.

In 2016 donation-based and reward-based crowdfunding registered the highest levels of female participation both in terms of funders and fundraisers. Around a quarter of lenders were female across Peer-to-Peer Lending models, although the proportions of female borrowers differed between them; 35% of borrowers in P2P Consumer Lending were female, compared to 16% in P2P Property and Business Lending. Finally, relative to the other models, equity-based crowdfunding registered the lowest proportion of female participation in terms of both investors (19%) and issuers (13%).

Figure 28: Percentage of Female Fundraisers (2013-2015 vs 2016)



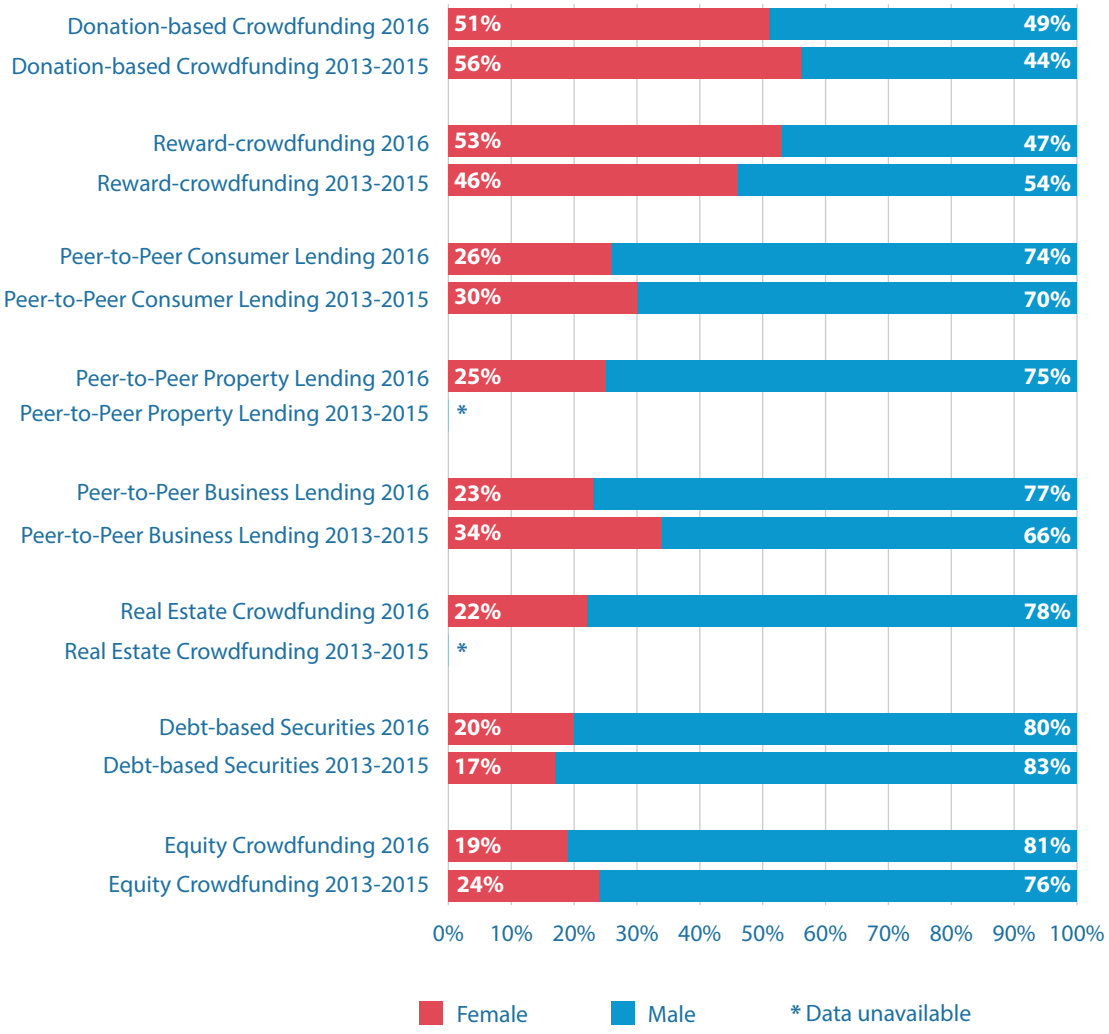
GENDER IN TERMS OF INVESTED FUNDS

In addition to observing the gender split in terms of funder population, granular level data collected during this study revealed that when gender is viewed in terms of proportion of invested funds, female investor and lender activity may indicate a more significant impact in terms of the amounts provided through a given model. For instance, female lenders to the P2P Business Lending model contributed 29% of investment, while female lenders to the P2P Consumer Lending model contributed 36%.

When taken in conjunction with the participation statistics, female lenders are shown to contribute more finance on a given deal than their male counterparts.

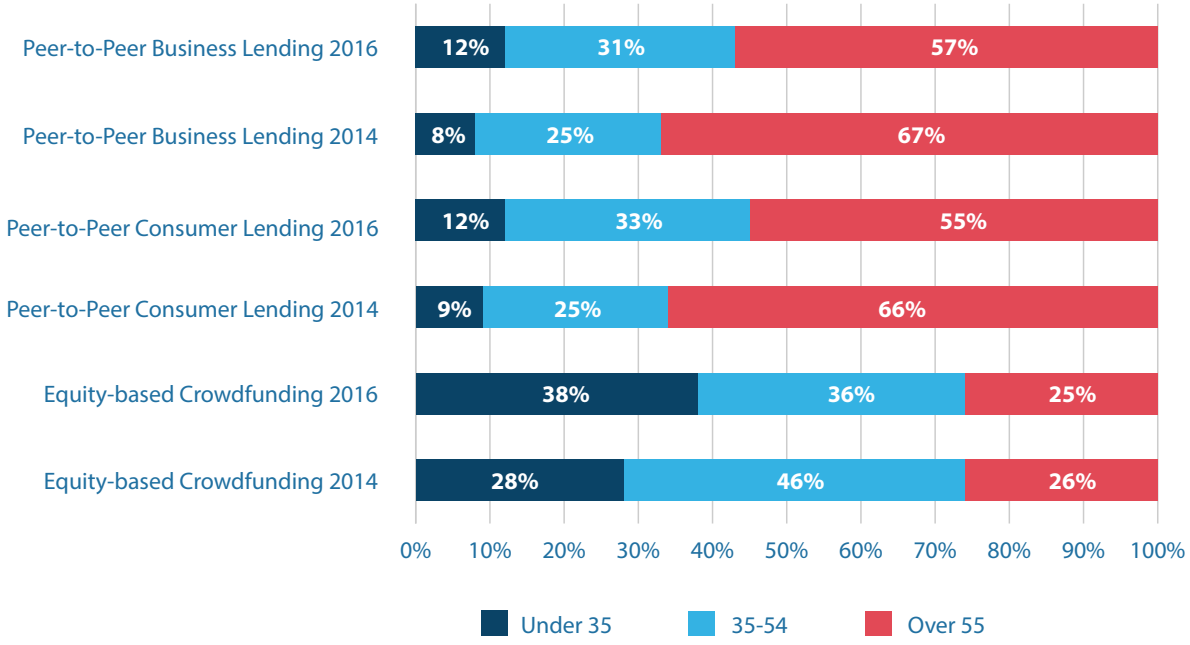
Conversely, female lenders in P2P Property lending contributed 17% of investment, suggesting that the female lender is contributing less finance on a given deal. With respect to equity-based crowdfunding, the population and proportion of finance from female investors is quite similar, with 12%.

Figure 29: Percentage of Female Funders (2013-2015 vs 2016)



AGE OF FUNDERS

Figure 30: Funder Age by Model, 2014 vs 2016



When compared to the 2014 study it is notable that the average investor age has increased across all models. This is evident from the following chart, which focuses on the proportion of 'older' investors, being those above 55 years.

By comparing the demographic data from the 2014 and 2016 funder surveys, the age of the investor population has notably shifted towards an older investor, especially with respect to the lending models.

In the case of equity-based crowdfunding, 28% of the 2016 investors are under 35, down from 38% in the 2014 survey data. Investors between 35 and 54 make up 46% of the investor cohort, growing considerably from 36% in 2014.

Focusing on the investment amount for older investors in the 2016 survey data, 32% of investment by equity investors (excluding real estate crowdfunding investment) came from investors aged 55+ (10% of which is from 65+ age range), whereas 49% of real estate crowdfunding investment came from investors over 55 (16% of which was from over 65).

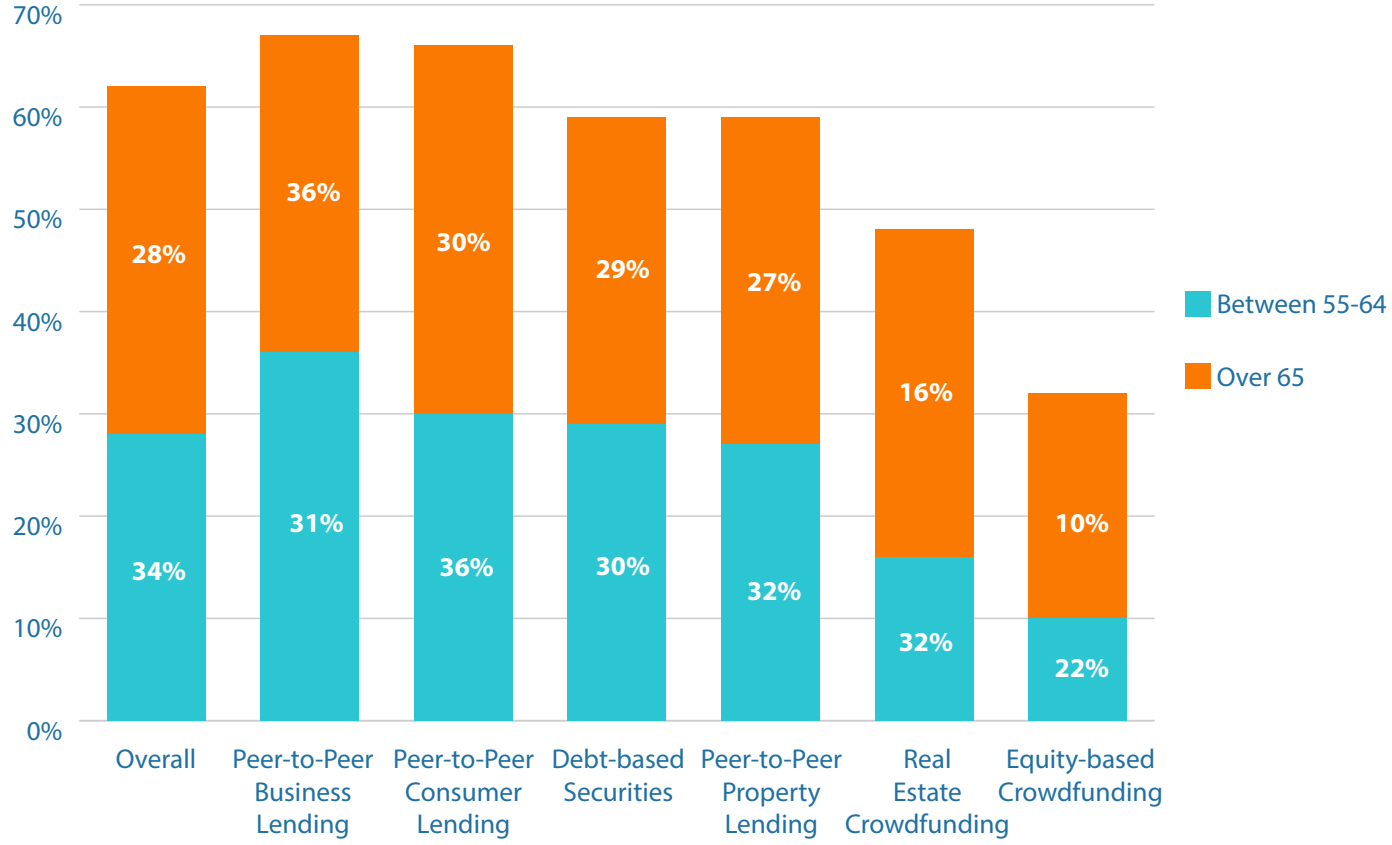
It should be noted that in the data from the 2014 survey the Peer-to-Peer Property lending model was not treated separately to Peer-to-Peer business lending and is therefore included in the Peer-to-Peer business lending model findings. Therefore, to compare the 2014 survey data with the 2016 data the 2016 Peer-to-Peer business figure in the graph also includes respondents identified from the Peer-to-Peer property lending model. Over the three-year period, the proportion of investors aged 55+ has increased 10%, from 57% of lenders in 2014 to 67% in 2016. The 2016 survey data showed the total amount invested is predominantly sourced from older investors, with 68% of investment in Peer-to-Peer business (excluding Peer-to-Peer property) coming from those aged 55+ (31% of this is from those over 65) and 59% of investment in Peer-to-Peer property investment from investors over 55 (of which 27% is from those over 65).

Similarly, the proportion of lenders from the Peer-to-Peer consumer-lending model over 55 has increased by 11%, from 55% to 66%. In the 2014 survey, those under 35 made up 12% as opposed to 9% in 2016. As with Peer-to-Peer business lending, the amount of money invested comes from a majority of investors aged 55 or over, with 67% of the investment coming from this age group (31% of which were 65+).

INVESTING IN MIDDLE AGE AND RETIREMENT

The emerging demographic trend is therefore an increasing proportion of older participants in alternative finance platforms. The Peer-to-Peer lending models had the highest levels of participation by people aged over 55 of any investment-based model. In every Peer-to-Peer Lending model reviewed, over half of the funders were 55+; 59% of Peer-to-Peer property lenders and debt-based securities were 55+, with 66% of Peer-to-Peer consumer lenders and 67% of peer-to-peer business lenders over 55. For the equity-based models, the majority of funders were below 55; 48% of funders on real estate crowdfunding were over 55 and only 32% of funders via equity-based crowdfunding.

Figure 31: Proportion of Funders by Model Aged over 55 and 65 in the UK in 2016



FUNDS DERIVING FROM RETIRED INVESTORS

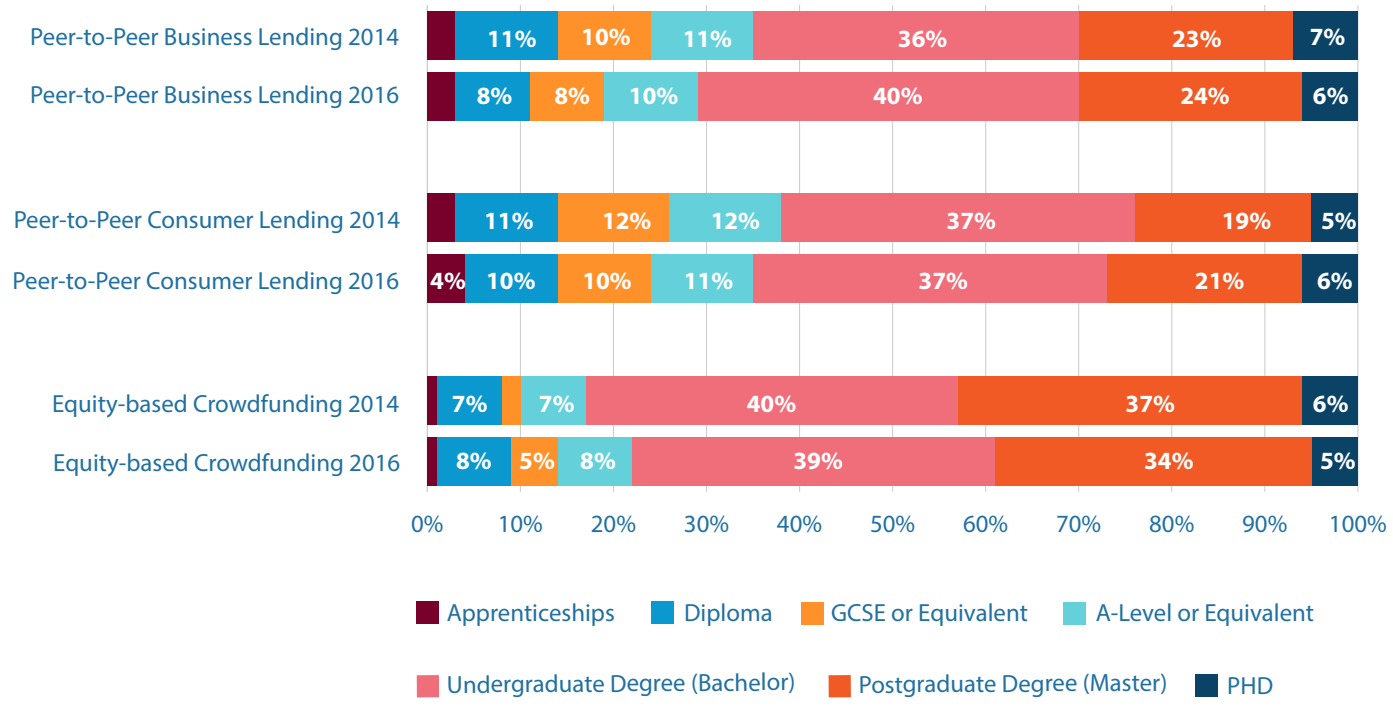
Analysing the proportion of total investment by age band and 'retired' status demonstrates that a significant proportion of platform funding comes from this group; more than half of retiree funding comes from this age bracket in the case of P2P Property lenders (61%) and P2P Business lenders (56%), while 43% come from this cohort in terms of P2P Consumer Lending. It is only Equity-based Crowdfunding that derives a smaller proportion of finance from this cohort (18%). Ultimately, not only is the proportion on retiree aged 55+ participating in alternative finance increasing, they too are contributing significant overall investment towards platform volumes.

EDUCATION

The level of education attained by investors in 2016 closely mirrors the 2014 data. The majority of investors in both investment-based and loan-based crowdfunding have an undergraduate degree or higher and the distribution of education level has remained largely unchanged - as is shown in the table below. The number of P2P business lenders obtaining an undergraduate degree or above has increased 5%, whereas there has been a 5% decrease for equity crowdfunding.

For equity-based crowdfunding the picture skews somewhat towards funders with high levels of education; participants in Equity-based crowdfunding generally show the highest level of educational attainment, with 40% having postgraduate degrees and a further 40% having at least an undergraduate degree'. Around a fifth had no university education.

Figure 32:



INCOME

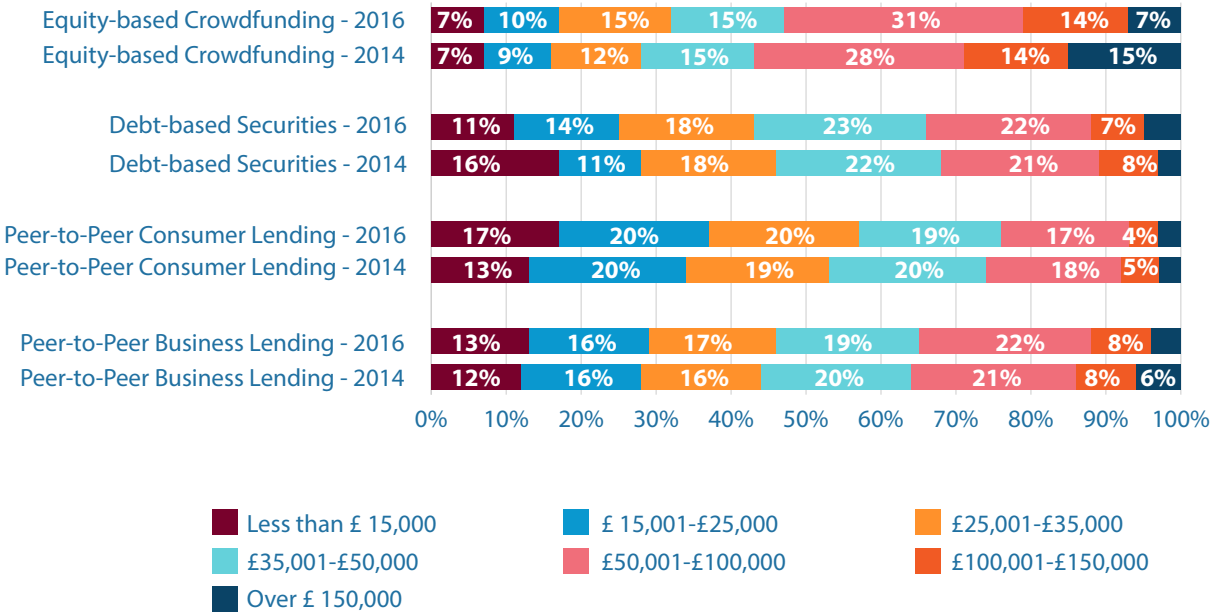
Income is another metric which provides insight into the types of individuals participating in different alternative finance models. For Peer-to-Peer Business Lending, around 30% of surveyed funders had below the average UK salary with less than £25,000 per year and this was at similar levels in both 2014 and 2016. For Peer-to-Peer Consumer Lending, 37% of funders had less than £25,000 per year in 2014 and this proportion fell to 33% in 2016. Equity-based crowdfunding had the lowest proportion of funders with an annual income of less than £25,000 with 17% in 2014 and 16% in 2016.

Around one-fifth of Peer-to-Peer consumer lenders earn between £25,001 and £35,000, which is below the higher income bracket. For P2P business lending, circa 17% of funders were in this income bracket and for equity-based crowdfunding a slightly small number with 15% in 2014 which fell to 12% in 2016.

Between 15% and 20% of funders were in the higher income tax bracket across equity-based crowdfunding and Peer-to-Peer business and consumer lending models. For those earning £50,001 to £100,000 around a fifth of funders in both Peer-to-Peer consumer and business lenders were in this income bracket, compared to around 30% were in this bracket for equity-based crowdfunding.

The number of funders in the highest income bracket – being above £100,000 – increased from 19% to 21% of funders in equity-based crowdfunding from 2014 to 2016. For Peer-to-Peer consumer lending, 7 to 8% of funders earned above £100,000, while 12 to 14% of funders earned this level of income for Peer-to-Peer business lending. Overall this suggests that funders within equity-based crowdfunding typically have higher incomes on average.

Figure 33: Funder Income by Model (2014 vs 2016)



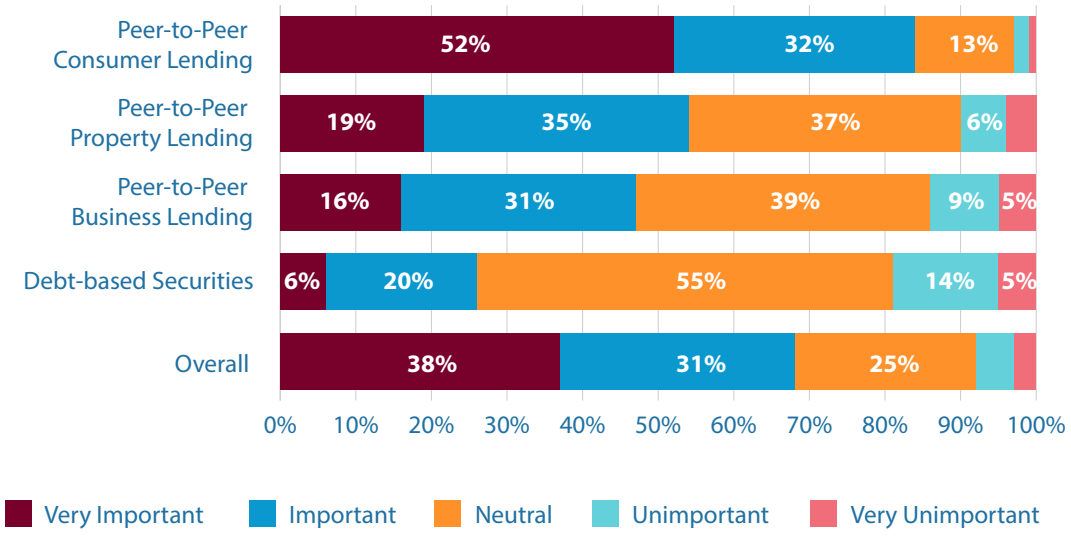
FUNDER DYNAMICS – THE IMPACT OF CONTINGENCY FUNDS RELATIVE TO LENDING OPPORTUNITY

Lenders were asked to assess the availability of a provision fund relating to their lending activity. Contingency funds (e.g. provision funds) are commonly defined as collectively pooled funds (i.e. crowdsourced from investors themselves) and are designed to cover investor portfolio losses. These are a common feature of Peer-to-Peer consumer lending platforms.

They are typically viewed positively by investors when selecting a platform, with 84% of Peer-to-Peer consumer investors ranking provision funds as important or very important.

Contributions for the fund are deducted as a margin from the investor returns. Some Peer-to-Peer Consumer lending platforms require all investors to participate in a provision fund, whilst others allow lenders to opt out.

Figure 34: Availability of a Contingency Fund as a Motivational Factor in Selecting a Lending Opportunity



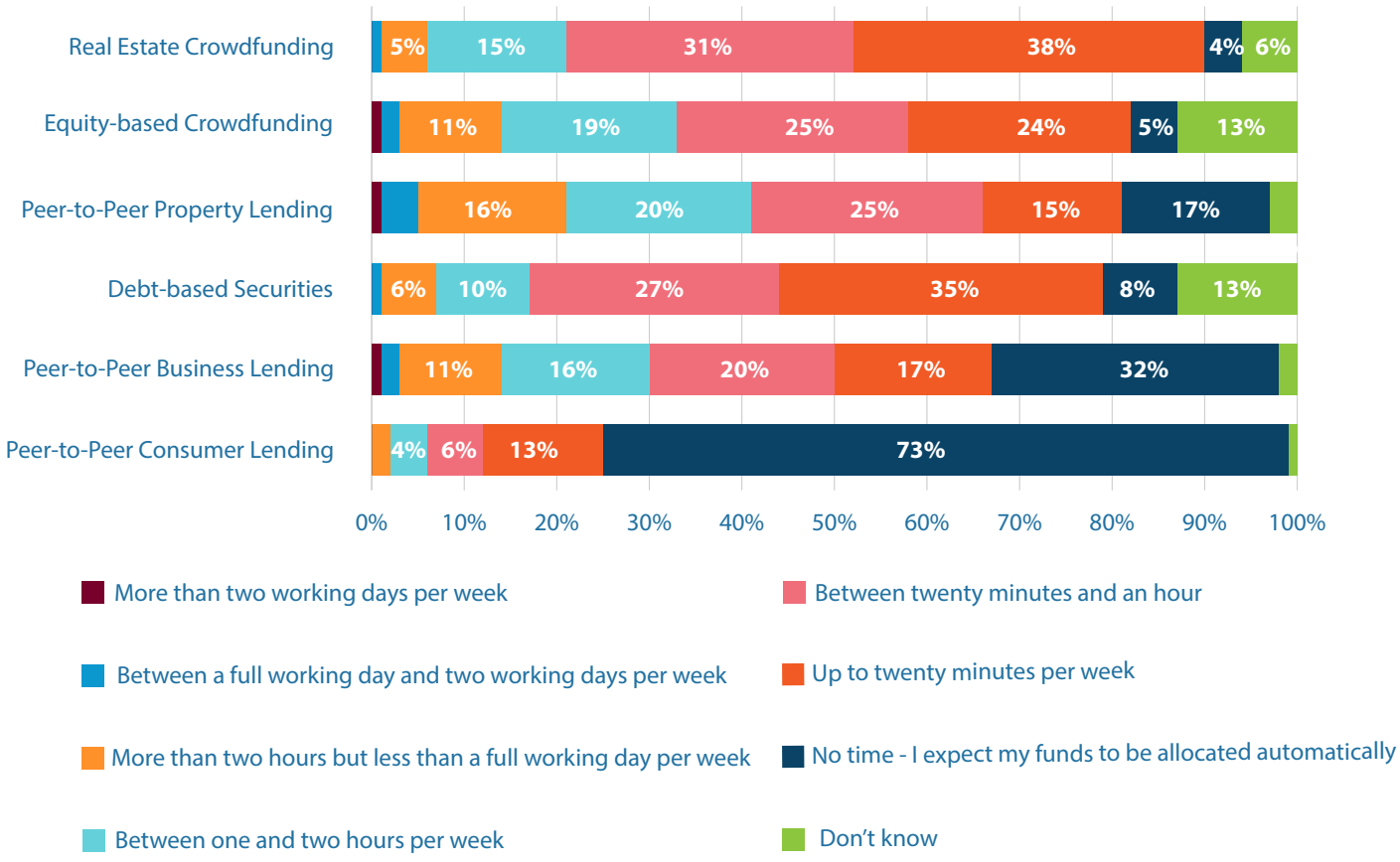
FUNDER DYNAMICS – DUE DILIGENCE TIME SPENT SELECTING A DEAL

The time spent selecting a potential investment opportunity is indicative of the time spent performing due-diligence on an investment. Funders were asked the average amount of time they spent selecting a unique loan or investment opportunity.

Most investors utilising investment-based crowdfunding (Real Estate Crowdfunding, Equity-based Crowdfunding and Debentures) spend between 20 minutes to an hour a week selecting investments. Only a small proportion of investors spent less than 20 minutes.

However, investors in loan-based crowdfunding (P2P Lending Models) tend to spend less time analysing prospective investment opportunities. This is especially true of P2P consumer lenders, whereby capital tends to be deployed passively via structured products. Auto-bid features have become more prevalent in P2P business lending and lenders are placing more reliance on the platform's software to allocate their funds to investments based on an investor's criteria; a lender usually specifies investment parameters and the platform matches these against available investments. Within P2P Consumer Lending 73% of lenders spent no time selecting investments. For models where automation is utilized less or unavailable, investors spend varying lengths of time selecting investments; 32% of P2P Business Lenders relied wholly on auto-selection, 17% spend up to 20 minutes per week, 20% between 20 minutes to 1 hour and 16% between 1 and 2 hours.

Figure 35: Time Per Week Spent Picking Potential Investments (2016)

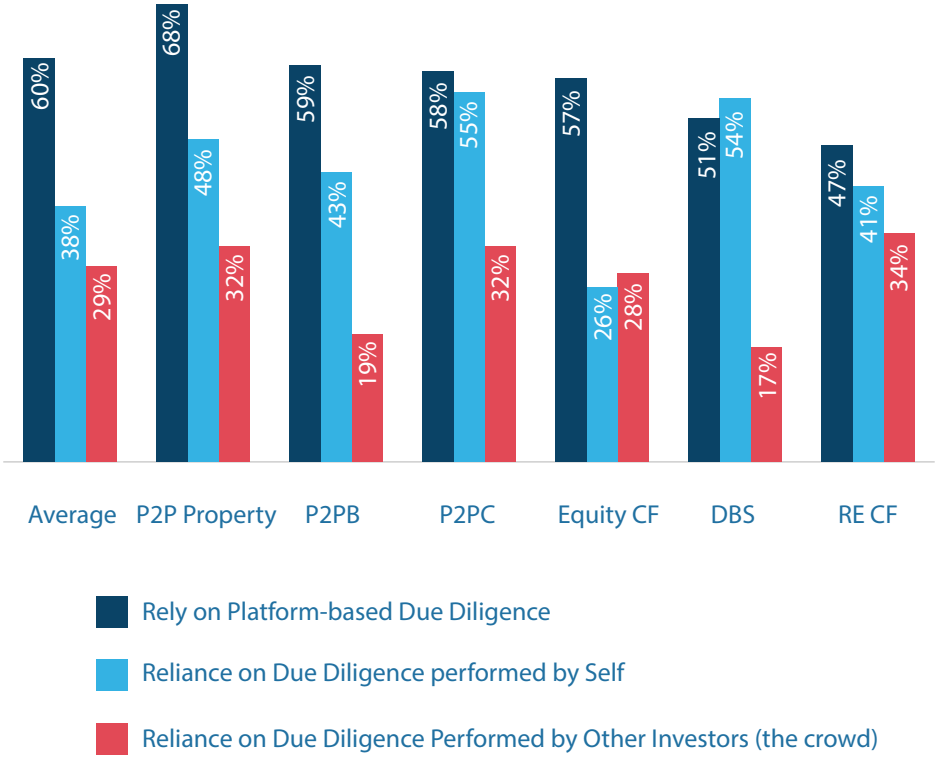


WHO SHOULD CONDUCT DUE DILIGENCE

The primary purpose of Crowdfunding and P2P platforms is as matching vehicles between funders and investees or borrowers. When assessing an investment opportunity, a funder can either rely upon third-party or individual due-diligence. To ascertain details on how due-diligence was typically performed, funders were asked to identify which parties they relied upon to determine the viability of an investment or loan opportunity.

Across all models an average of 60% of funders relied upon platform-led due diligence, with 38% relying upon their own due-diligence and 29% on the due diligence performed by 'other investors' utilising the platform. Although there is some cross-over, whereby reliance was placed upon multiple sources of due-diligence, it is evident that platform-led due-diligence is critical to investors. This was especially true for the P2P Lending models, where auto-bid tools are more readily utilised by investors.

Figure 36: Funder Reliance on Due Diligence When Selecting Investment Opportunity



Reliance on platform-led due diligence was highest for P2P Property lenders (68%). Where funders were asked questions regarding the form of due diligence they expected from the platform, 97% of investors expected the platform to obtain and verify details on the property and 82% expected the platform to perform stress tests against the value of the real estate or property asset. The implication is that the critical information that an investor bases their investment decision on is should be reliable.

Funders utilising P2P Business Lending and P2P Consumer Lending had a similar reliance on platform-led due diligence (59% and 58% respectively), although in the latter a higher level of self-reliance (55% compared to 43%) and reliance on the 'crowd' (32% compared to 19%) was reported. This is consistent with the fact that 79% of P2P Consumer lenders felt that the due diligence performed by the platform exceeded expectations.

Observing lender responses against portfolio exposure shows that those with larger portfolios were more likely to rely upon platform due diligence than their own or that of their peers.

In the case of Equity-based Crowdfunding, 57% of investors rely upon platform led due diligence, followed by 'crowd' led due diligence (28%) and finally self-performed due diligence (26%). It is notable that this is the only model in which self-reliance is the lowest ranking type of due diligence. In addition to confirming the accuracy of basic information about the company, business principals and financial information, most investors (83%) expected platforms to verify how issuers intended to use funds. Overall 59% of investors agree that their expectations are being met.

Debt-based Securities/Debentures was the only model in which investors tended to rely more upon their own due-diligence, albeit only marginally (54%). 79% of these investors viewed platform due diligence as sufficient to their expectations.

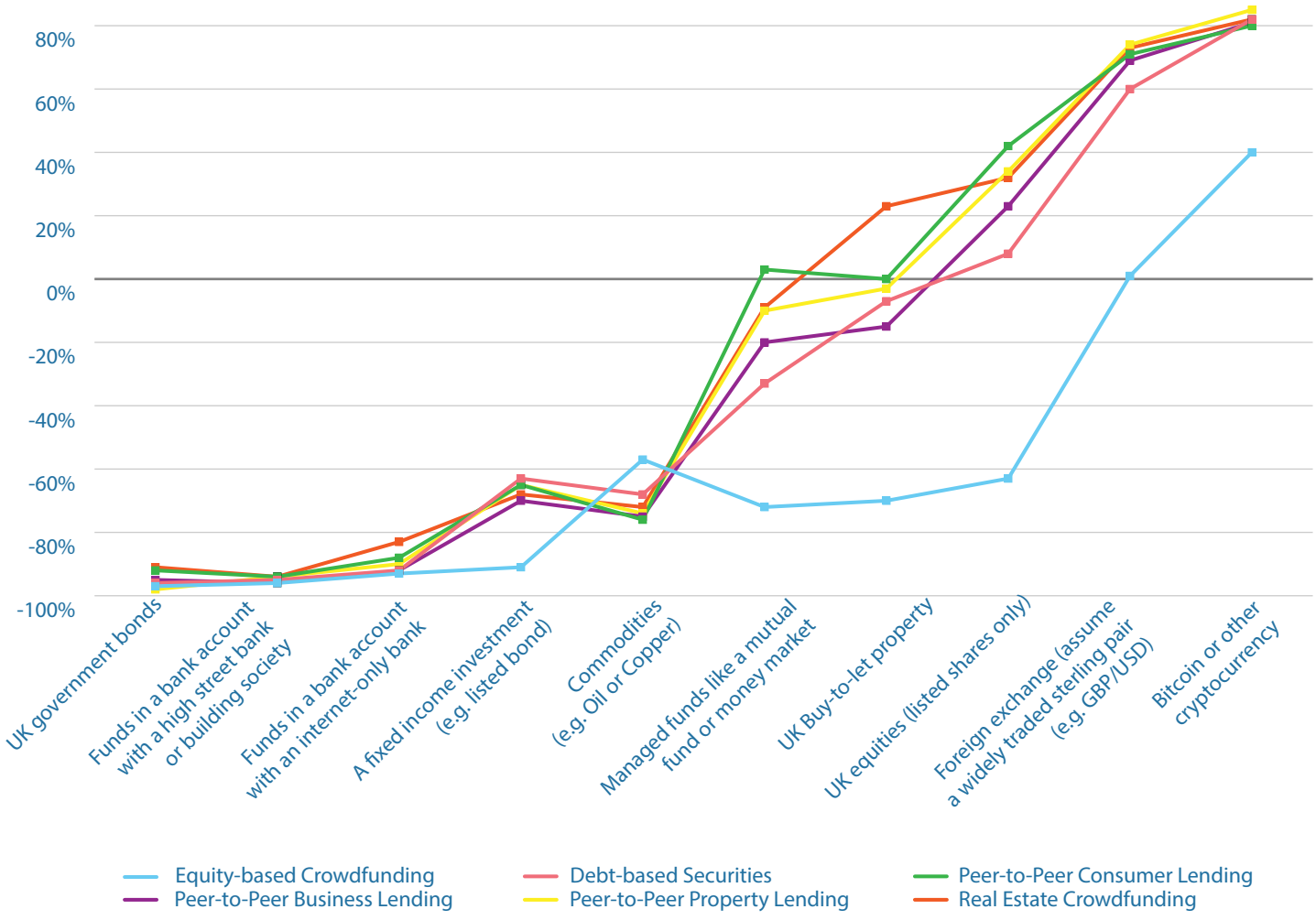
PERCEIVED RISK IN COMPARISON TO OTHER INVESTMENT PRODUCTS

Funders were asked to consider the 'riskiness' of their online alternative finance activity compared to other forms of investment activities. To compare perceptions of risk against other asset classes, responses were measured relative to one other, assigning the most risk as -100% (i.e. all the respondents considered crowdfunding riskier than the individual asset class) and the least risk as 100% (i.e. all the respondents considered crowdfunding less risky than the individual asset class). On this scale, 0% would represent the same amount of risk when comparing crowdfunding with the asset class.

The results of the survey show that investors tend to view crowdfunding activities as riskier to more traditional investment activities, with equity-based crowdfunding considered the riskiest investment channel. All investment models are, however, broadly regarded as having similar levels of risk, with the exception of real estate crowdfunding; UK Buy-to-Let is seen as less risky than real estate crowdfunding compared to other crowdfunding models.

Unsurprisingly, UK Government Bonds and funds held in a bank account are viewed as significantly less risky compared to Crowdfunding models, in contrast to FX Trading and Bitcoin which are considered much riskier investments.

Figure 37: Percieved Risk of Alternative Finance Compared to Other Forms of Investment by Model

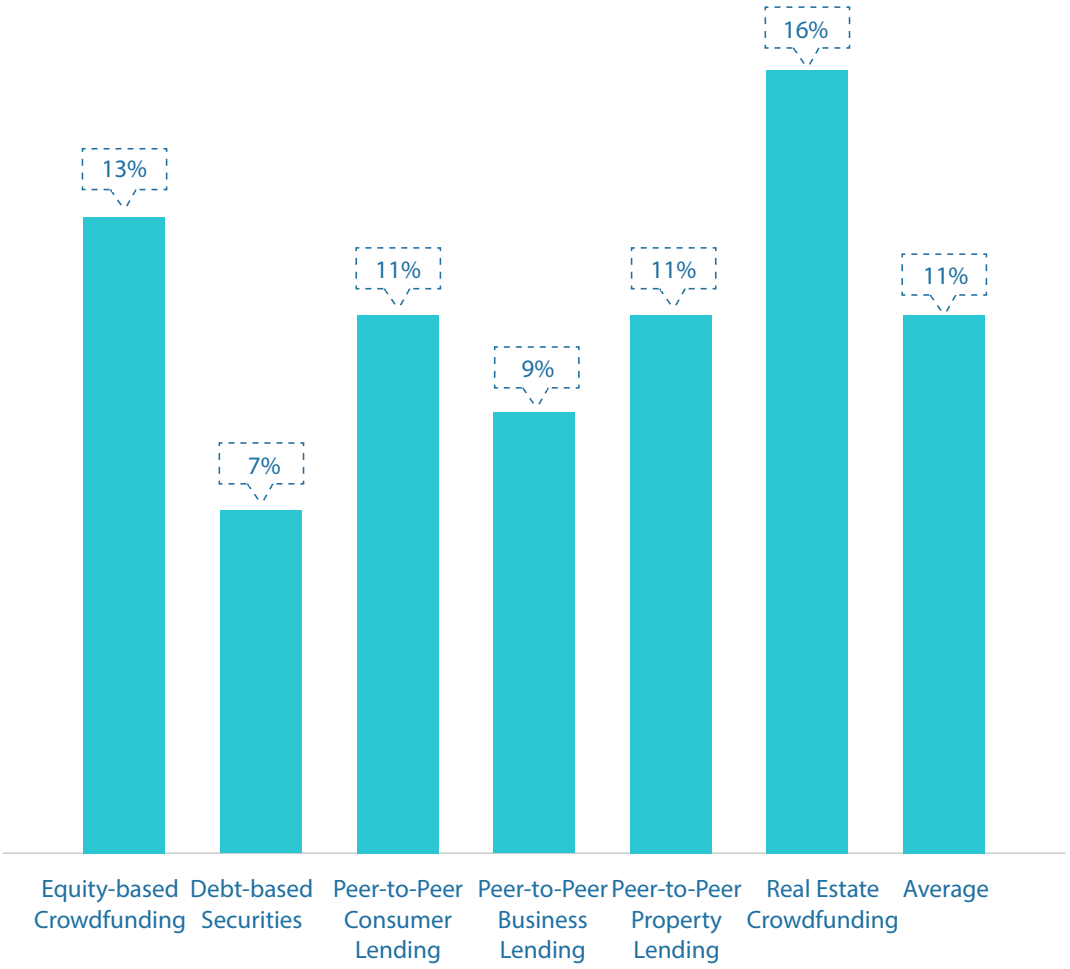


CONFIDENCE IN FUND RECOVERY IN THE EVENT OF PLATFORM FAILURE

In the event of platform failure, funders were asked how confident they would be in recovering funds. Alternative finance models which funders had the highest level of confidence was real estate crowdfunding at 16%, followed by equity-based crowdfunding at 13% of survey respondents. For both peer-to-peer consumer and property lending, 11% of funders were confident they would recover their investment which is slightly above the 9% of funders for peer-to-peer business lending. Debt-based securities had the lowest level of confidence, with only 7% of survey respondents confident they could recover their investment if the platform failed. Therefore, this suggests minimal confidence that an investment could be recovered in the event of platform failure irrespective of the alternative finance model.

The low percentage is, to some extent, incongruous with the fact that one of the most important factors indicated by investors when selecting a platform was the 'wind down' plan in the event of platform failure; across all crowdfunding or P2P platforms, 52% of investors stated they placed heavy emphasis on the platform's wind-down policy. The importance assigned to the wind-down policy does not therefore correlate to the level of confidence in investment recovery in the event of platform failure. Emphasis was also placed on a review of platform contracts especially as applied to investors (38%) and FAQs (32%).

Figure 38: Investor Confidence of Investment Recovery in the Event of Platform Failure

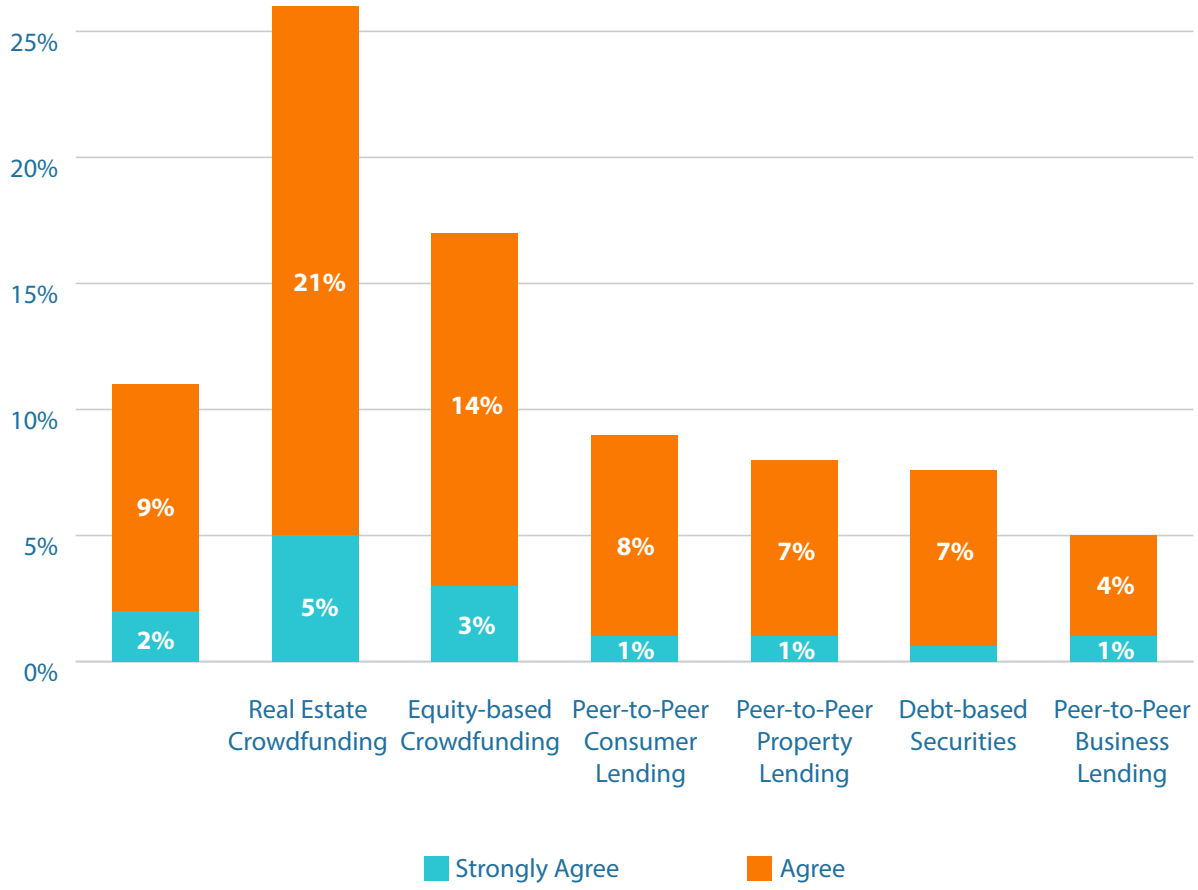


MITIGATING RISK – SEEKING INDEPENDENT FINANCIAL ADVICE

Funders were also asked the extent to which they agreed with the notion that seeking independent financial advice reduces or mitigates the risk associated with their online alternative finance activity. Across all models, only 2% of funders strongly agreed with this statement, while a further 9% agreed with it. Therefore, this suggests that the use of external financial advice is minimally utilised by funders, and that the utility of such advice is minimal in mitigating risk.

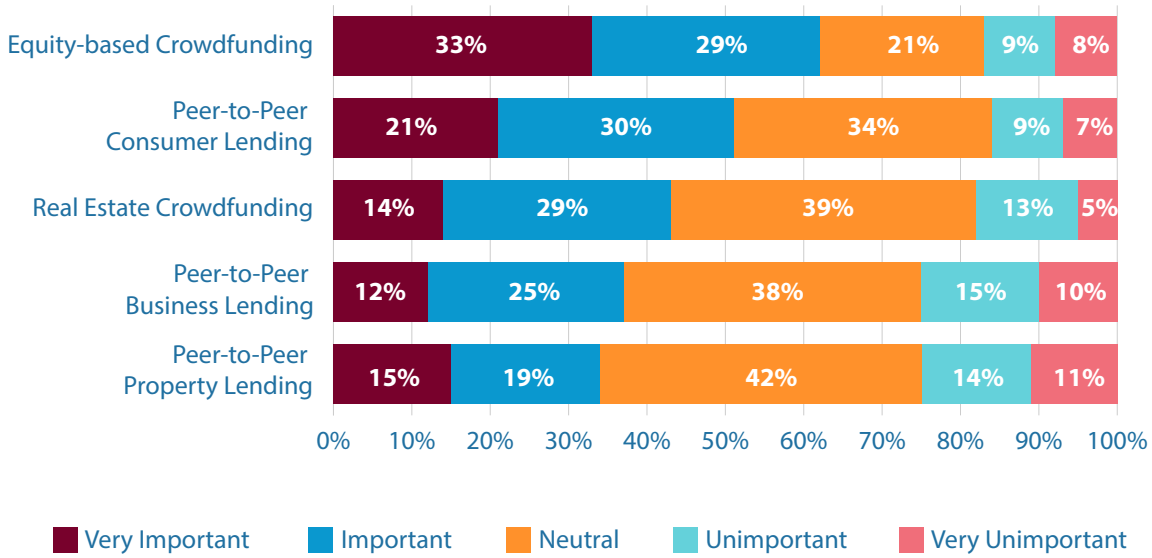
When reviewing responses from each constituent model, just over a quarter of investors from the Real Estate Crowdfunding model agree or strongly agree in seeking external advice, while 17% of investors utilising Equity-based crowdfunding agree or strongly agree with this statement. By contrast, less than 10% of investors in P2P lending and Debt-based Securities deemed external advice as advantageous to risk mitigation.

Figure 39: Mitigating Risk - Seeking Independent Financial Advice



ELIGIBILITY OF TAX INCENTIVES OR SCHEMES AS A FUNCTION OF INVESTMENT SELECTION

Figure 40: The Importance of Tax Incentives (IFISA, SEIS, EIS) to Funders by Model



There are several tax incentives available to investors towards their online alternative finance activity. Tax relief schemes such as the Enterprise Investment Scheme ("EIS") , Seed Enterprise Investment Scheme ("SEIS") , and Social Investment Tax Investment Relief ("SITR") aim to encourage equity investment in early-stage businesses and can be exploited via investment based crowdfunding platforms. There are various tax-free wrappers for loan-based crowdfunding that can be applied to returns, including Innovative Finance ISA , Personal Saving Allowance ("PSA") , Self-investment Personal Pension Scheme ("SIPPS") and SITR.

Funders were asked whether using a tax wrapper or scheme with reference to investment selection on an online alternative finance platform was considered 'Important'. 62% of Equity-based Crowdfunding investors felt that tax reliefs were 'Important' to 'Very important' to their investment decision, compared with only 43% of Real Estate Crowdfunding investors. Despite this, the survey data revealed that investors have a relatively limited awareness of the available tax wrappers; 62% of investors were unaware of SITR and only 1% of investors participate in the scheme.

The level of awareness partly reflects the newness of the scheme, whilst participation in it is limited by the number of investments offered by platforms that fit the criteria. Both EIS and SEIS had higher investor participation, at 52% and 39% respectively. However, 24% of equity-based crowdfunding investors were unaware of EIS, whilst 24% were unaware of SEIS.

Half of P2P Consumer lenders felt that tax wrappers were important to very important, which falls to 37% for P2P Business lenders and 34% for P2P Property lenders. Of the different incentive schemes applicable to P2P lending platforms, understanding was lowest for the IF-ISA (23%) and SIPPS (21%). Almost a third of respondents stated they were not using and were unlikely to be using their PSA on their loan-based crowdfunding investments. 44% of loan based crowdfunding investors were not using but expected to use the IF-ISA.

The data suggests there is an appetite for greater investment through tax wrappers; over 40% of loan-based crowdfunding investors anticipate that they will utilise an IF-ISA once it becomes available, and 40% indicated that they would increase their investment portfolio once they can utilise this tax wrapper.

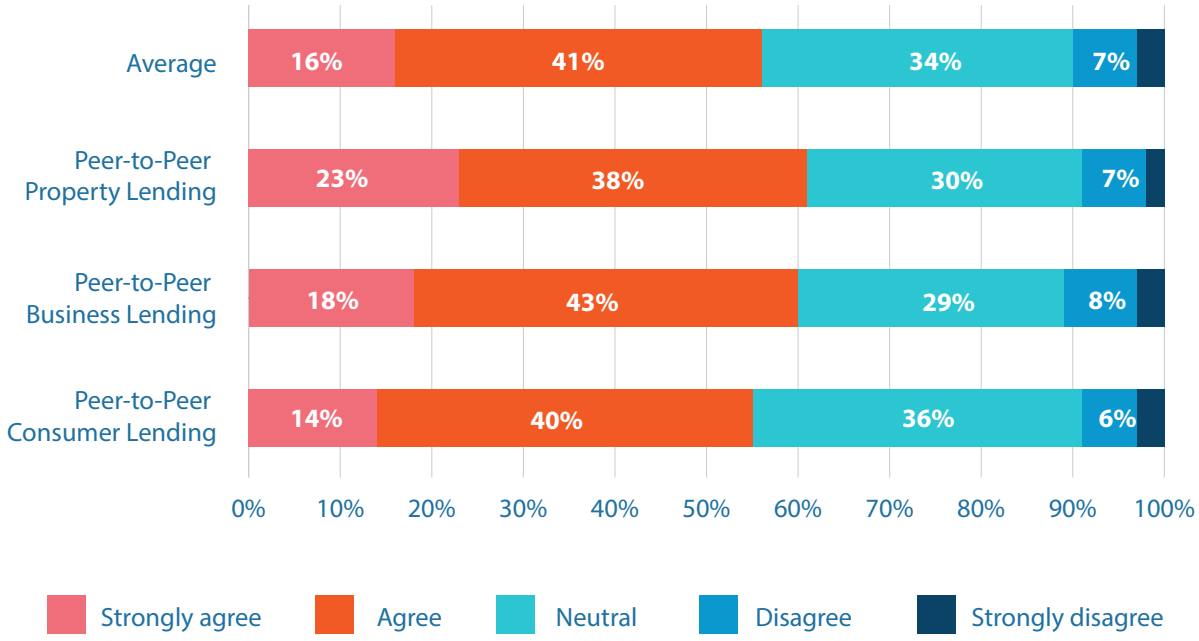
LIQUIDITY

The Lender-focused surveys looked at a lender's perception of liquidity for P2P Lending models. More than half of respondents felt it important to be able to withdraw their funds out of loans before they came to term. To facilitate this some platforms offer secondary markets enabling investors to divest their portfolios, although less than half of the investor felt that secondary markets were important. Lenders had a higher expectation of the time platforms would take to deploy their funds than to retrieve them. The option of utilising an auto bid tool, which serves both to diversify investors portfolio against specified criteria and assist in keeping a secondary market liquid, are exclusively used by 25% of P2P Business Lenders and often used to deploy large portfolios.

ABILITY TO LIQUIDATE POSITION

Only 10% of surveyed lenders utilising P2P Lending models disagreed that the ability to liquidate their positions was important, whereas 57% of lenders felt it was important to very important.

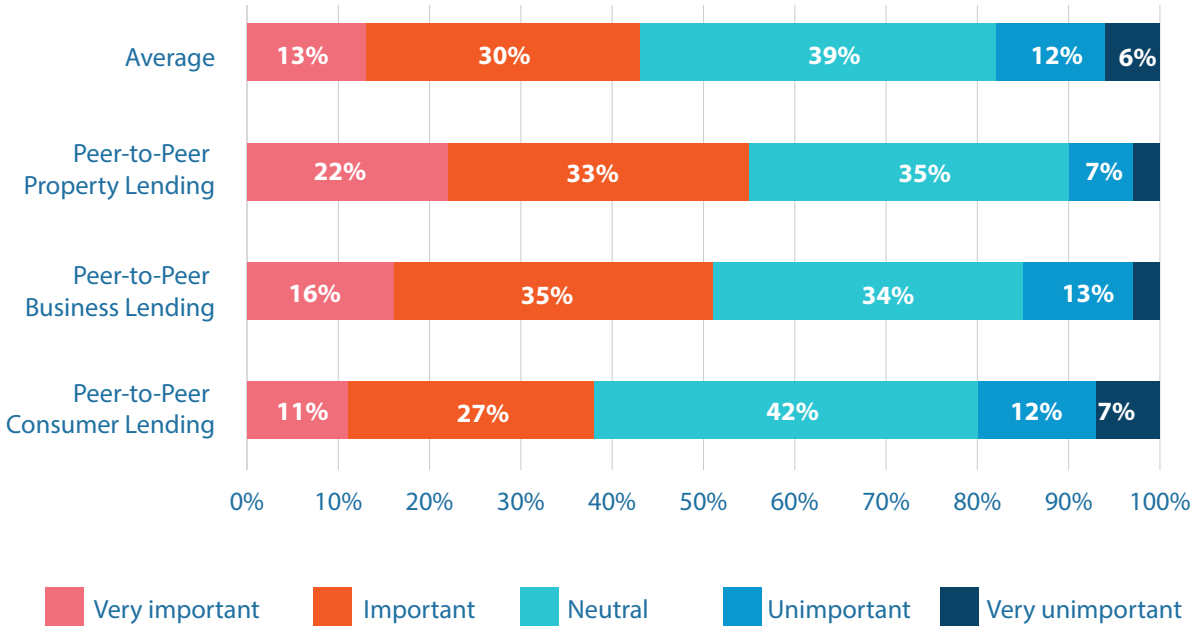
Figure 41: The Importance of Lenders' Ability to Liquidate their Investment Position



ACCESS TO A SECONDARY MARKET

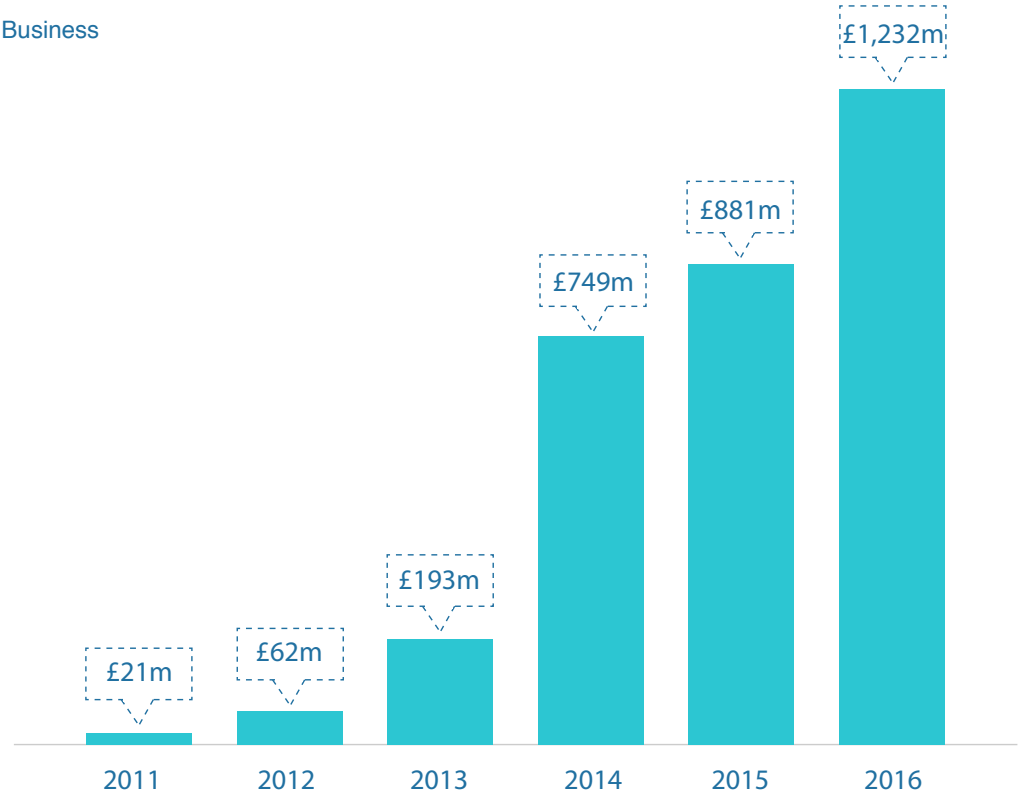
While over half of investors in Loan-based Crowdfunding felt it was important to have the ability to liquidate their position, only 43% saw the importance of a secondary market with a large proportion (39%) of respondents giving a neutral response.

Figure 42: The Importance of Ledners' Ability to Access a Secondary Market



PEER-TO-PEER BUSINESS LENDING

Figure 43: Total UK Peer-to-Peer Business Lending 2011-2016 (£ million)



In 2016 P2P business lending was the largest contributor to the UK's total online alternative finance volume, generating £1.23 billion. Over the course of 6 years this model has generated over £3.14 billion of lending, of which 40% generated in 2016 alone. The annual growth rate in volume was 40% between 2015 and 2016, which represents a substantial increase on the 18% in the preceding year.

The qualification/onboarding rate, which represents the proportion of borrowers considered sufficiently qualified to raise finance via a platform and create a campaign, increased from 23% in 2015 to 38% in 2016. Of those borrowers deemed appropriate for the platform, 31% went on to successfully raise finance. 39% of all successful borrowers were repeat platform users, an increase from 19.5% in 2015. This implies that there is an increasing reliance on alternative finance channels relative to traditional finance providers to raise capital. Across the models the default rate remained relatively low, at 2.07%, though marginally higher than the previous year's 1.63%.

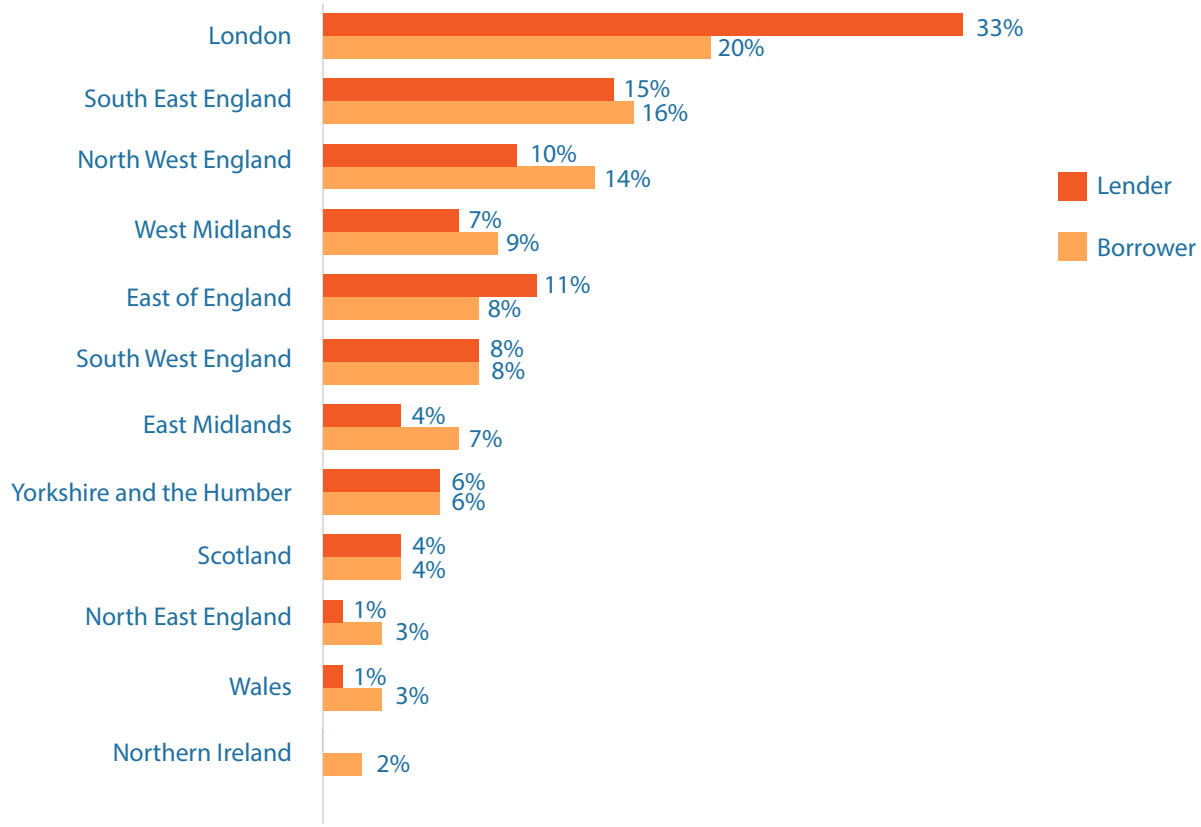
The highest proportion of borrowers came from either Construction, which accounted for 33% of all funds raised, and engineering (22%). The Real Estate & Housing sector accounted for the third highest volume, though this was only 2% of the total.

The average P2P Business loan increased, from £76,280 in 2015 to £95,000 in 2016, with the average number of investors participating per loan increasing from 347 in 2015 to 640 in 2016. This increase in numbers of investors per deal may be influenced in part by the rising proportion of lenders utilising an auto-selection/auto-bid function to automatically allocate funds across applicable and available loan offerings on a given platform. In 2016, the number of lenders who relied upon auto-selection/auto-bid rose from 42% to 61%.

The data also shows an increasing reliance on platform-run balance sheet funding. Circa 39% of P2P Business funding was derived from the use of a platform-run balance sheet, totalling £480.5m. Very few platforms ran an exclusively balance sheet led model , 27% of platforms indicated they maintained and used their own balance sheet to run alongside retail and/or institutional investors.

BORROWER AND LENDER DYNAMICS

Figure 44: Lender and Borrower Location by Region



The proportions of finance provided and received by location can be identified by aggregating transaction data. The preponderance of lenders can be found in the South of England, with a small majority of lenders located in London. Most borrowers are similarly located in London, though there is a more diverse geographic spread among borrowers than lenders.

The transaction data shows that lenders are biased towards localised funding. The diversity of lending across the UK indicates that P2P Business Lending might be a suitable solution to systemic geographic biases that exist in traditional and bank SME lending.

BORROWER DEMOGRAPHICS – BORROWER TURNOVER

As stated previously, P2P Business lending equates to approximately 15% of new small business loans according to BBA data. When reviewing borrower turnover, 72% of successful business borrowers had an annual turnover up to £2 million, with 45% of borrowers having an annual turnover up to £1 million. This finding is important as it suggests that the model is increasingly recognized by businesses as a viable financing tool, potentially as a 'port of first call', to businesses that have been typically underserved by traditional finance channels.

Over time, it is also worth noting that the turnover of business borrowers has increased. In 2016, a greater number of businesses had turnovers above £2 million, representing 38% of borrowers compared to the 25% of borrowers in 2015.

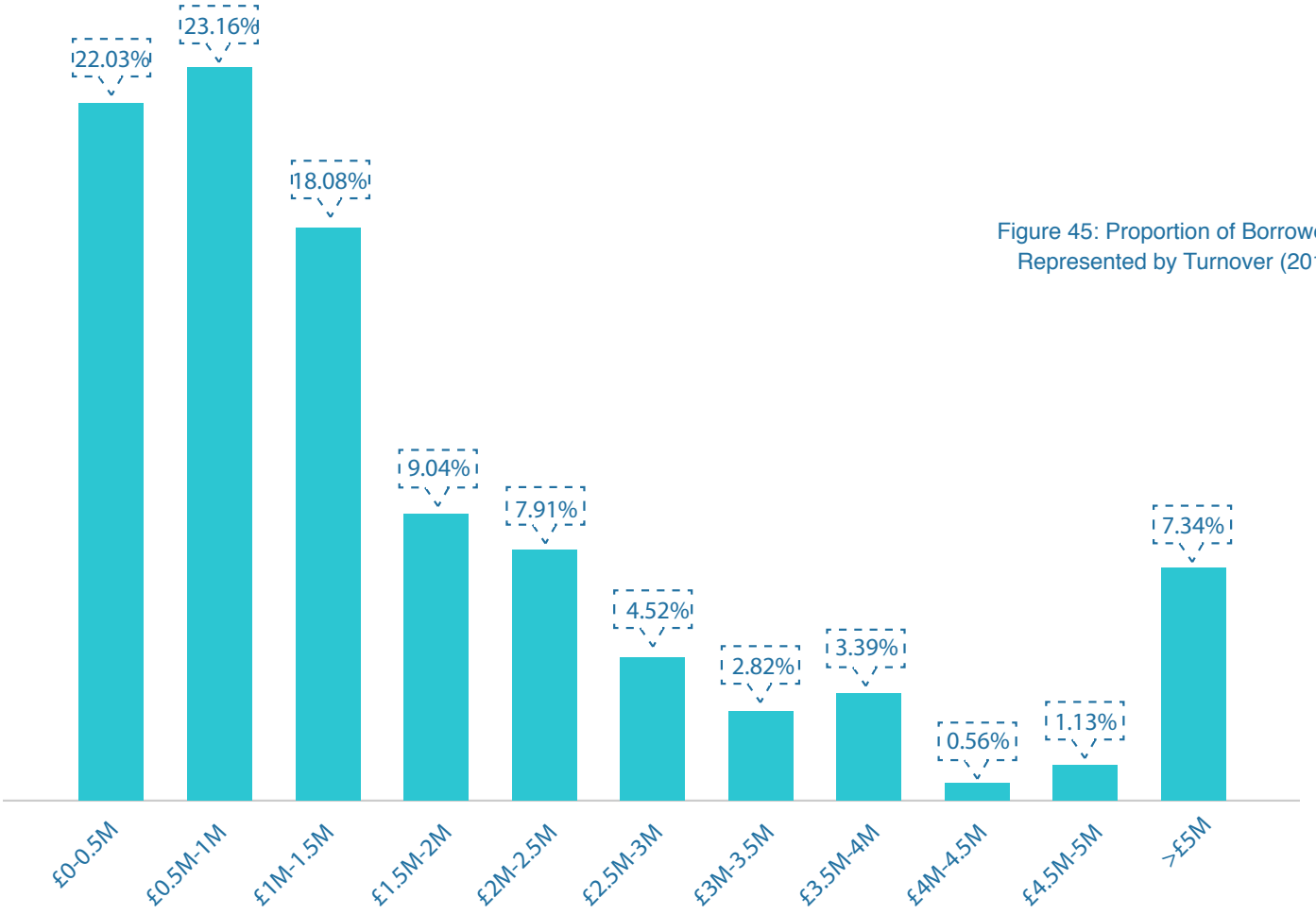
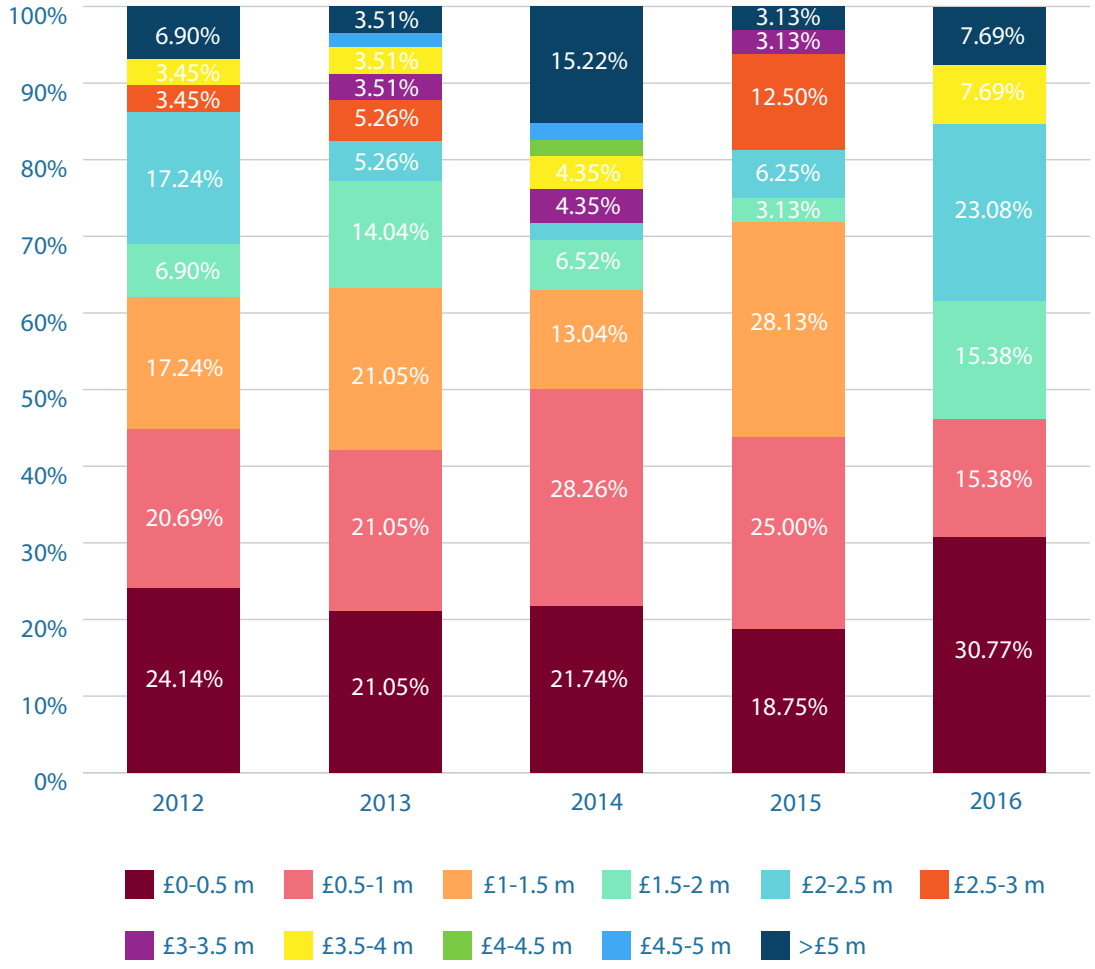


Figure 45: Proportion of Borrowers Represented by Turnover (2016)

Figure 46: Borrower Profile by Turnover (2012-2016)



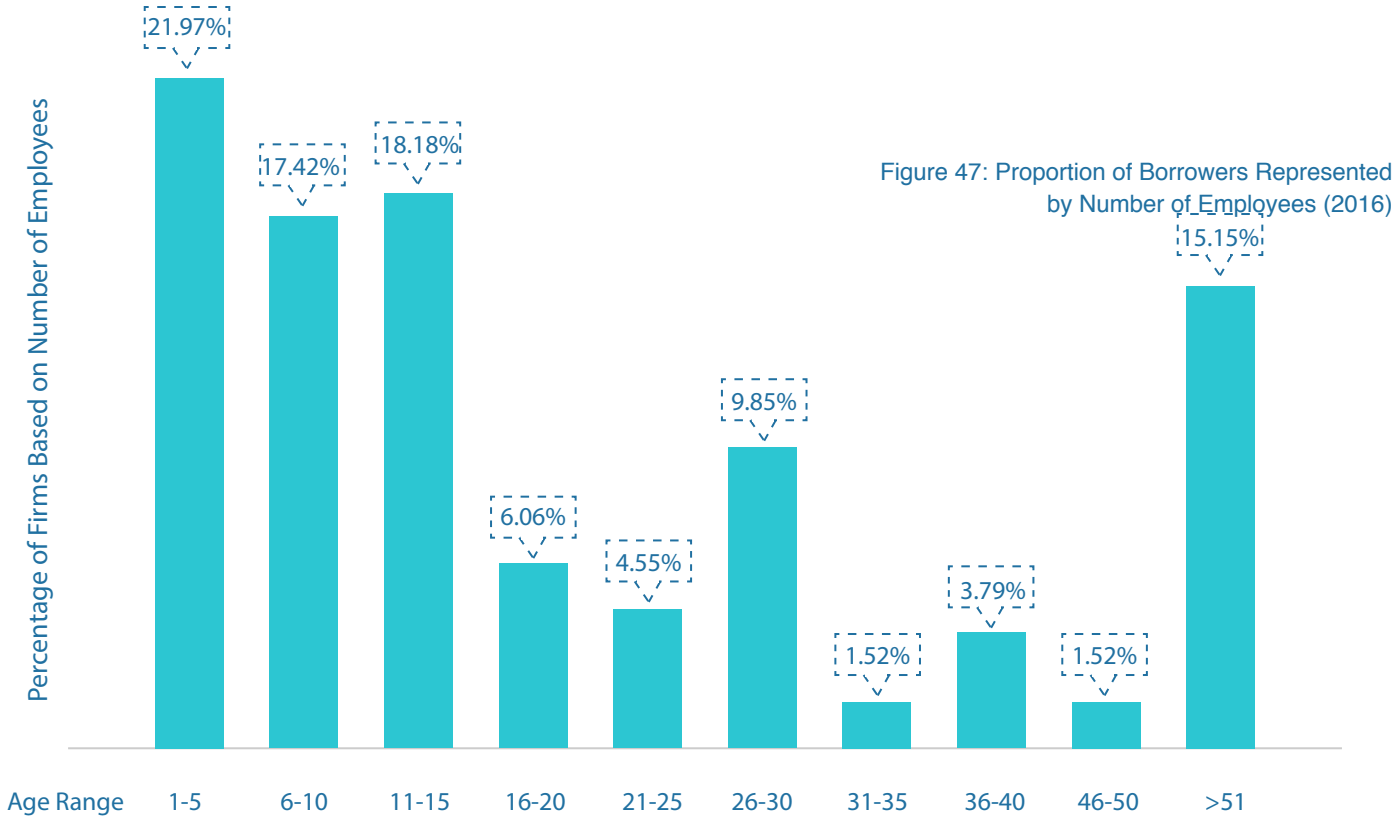
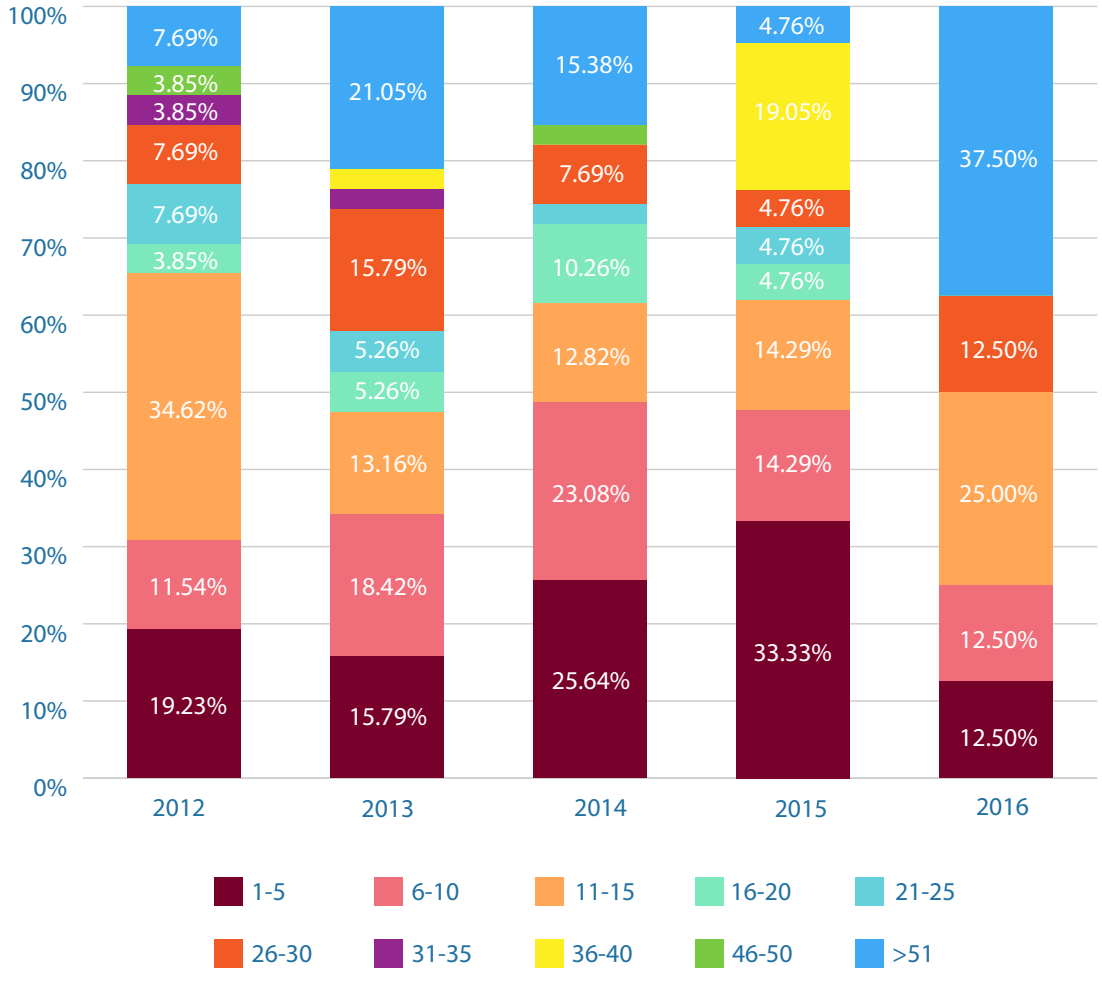


Figure 47: Proportion of Borrowers Represented by Number of Employees (2016)

Figure 48: Borrower Profile by Number of Employees (2012-2016)

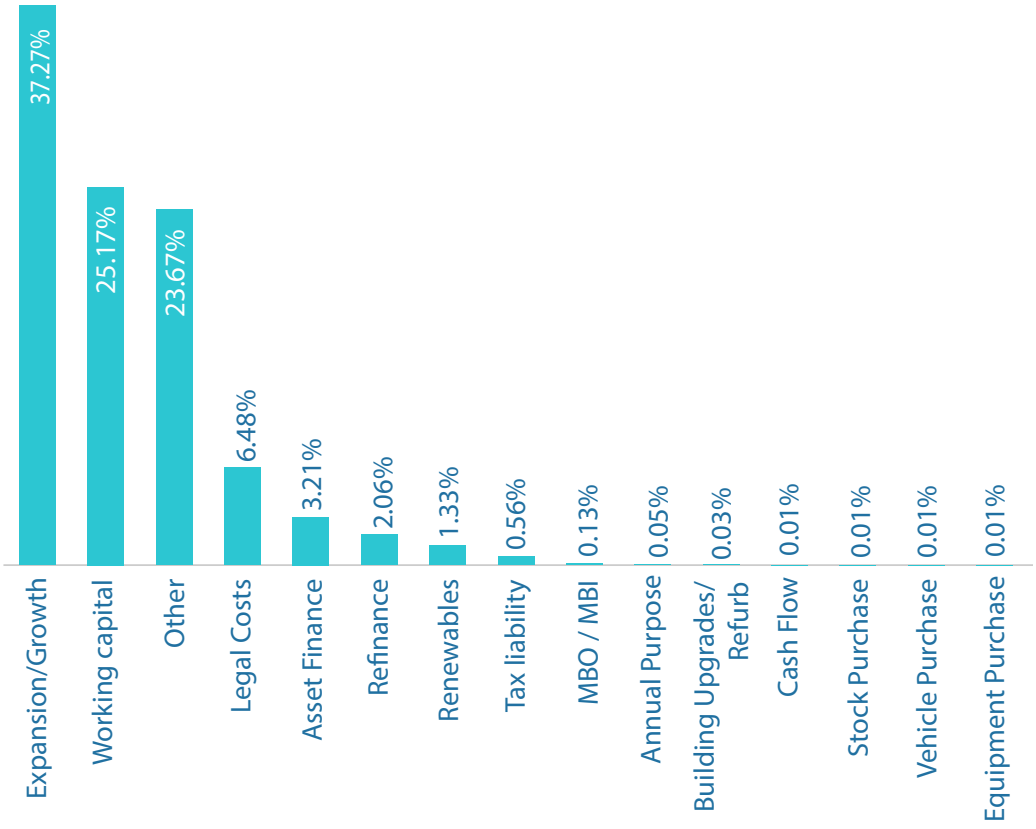


FUNDING PURPOSE AS A PROPORTION OF TOTAL BUSINESS LOANS

Borrowers usually have to specify the purpose of the loan when making a platform application. The transaction data collected included information on loan purposes and showed that 37% of business loans were for business expansion or growth and 25% for working capital.[19]

P2P business lending is growing year-on-year as a proportion of total SME lending relative to bank lending. In 2016 peer-to-peer business lending equated to 2% of total SME lending by banks. This proportion increases for small SMEs, whereby the volume of peer-to-peer business lending is 5.5% of bank lending, which is up from 4% in 2015. Peer-to-peer business lending is becoming an increasingly material contributor to SME lending in the UK compared to bank lending.

Figure 49: Purpose of Business Loans Relative to Model Volume

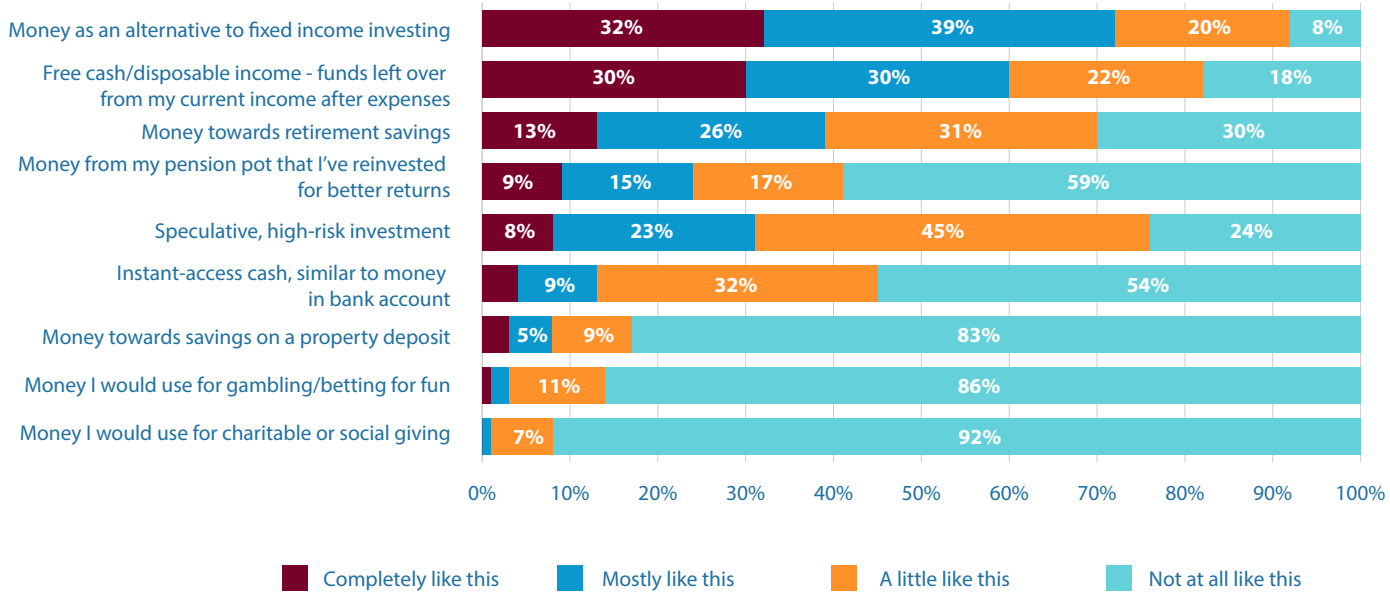


LENDER MOTIVATIONS AND BEHAVIOUR

Lenders who participated in the Investor Surveys were asked about their motivations and behaviours when investing in a P2P Business lending platform, thereafter eliciting conclusions about investment preferences and selection process.

In the first instance, lenders were asked how they perceive the funds that they deploy on a platform as compared to more mainstream uses of their money. Generally, lenders view the funds that they deploy via an alternative finance platform as a viable alternative to fixed income investing (32% viewing it as 'completely like this' and 39% as mostly like this), followed by a significant proportion who view these funds as free cash, or disposable income, relating to funds left over after expenses (with 60% viewing it as 'completely to mostly like this'). 39% of lenders perceive these funds as money towards retirement saving, however, 59% of lenders disagree that the funds they are using would be comparable to money they would siphon from their pension pot. [20]

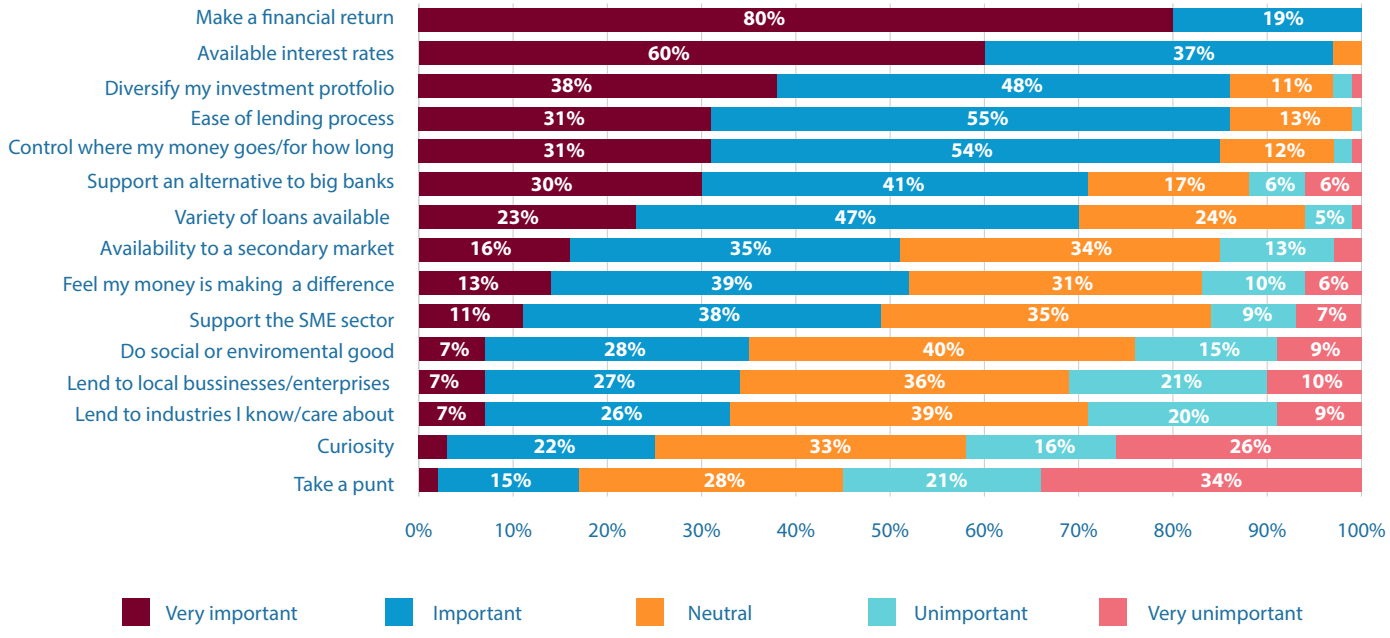
Figure 50: Lenders' Perceptions of Their Funds Relative to their Peer-to-Peer Business Lending Activity



The survey shows that 100% of P2P business lenders consider 'make a financial return' as the most 'important to very important' factor for funding. It follows that available interest rate (96%) was also viewed as a key motivator. Other key motivators were diversification (86%), ease of process (86%) and monetary control (85%).

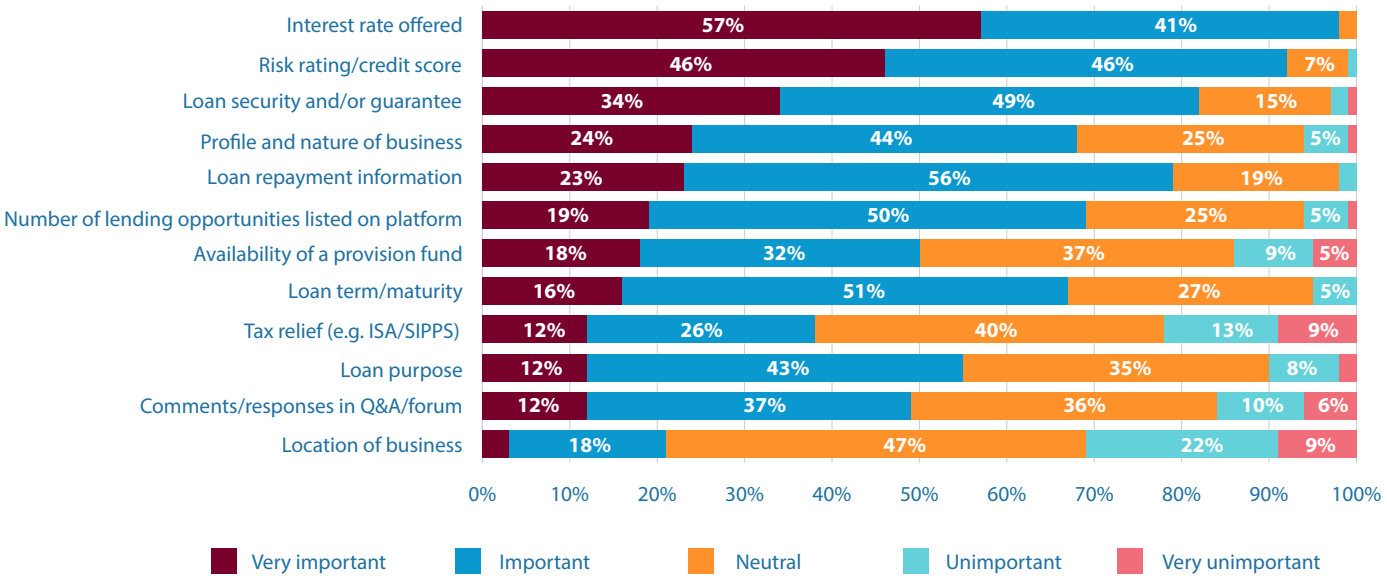
Although the key motivators related to making financial return, several non-financial motivators feature prominently; 71% of respondents were motivated in 'supporting an alternate to big banks', 53% by the prospect that their funds were 'making a difference' and 49% by supporting the SME sector.

Figure 51: Factors that Influence Lender Behaviour in Peer-to-Peer Business Lending



Lenders also rated the influencing factors when specific lending opportunities are considered. 98% viewed the interest rate offered as the most influencing factor, which ties in with the emphasis on return. Further to this, 92% viewed the loan's risk rating as 'very important to important', followed by loan security (83%) and loan repayment history (79%).

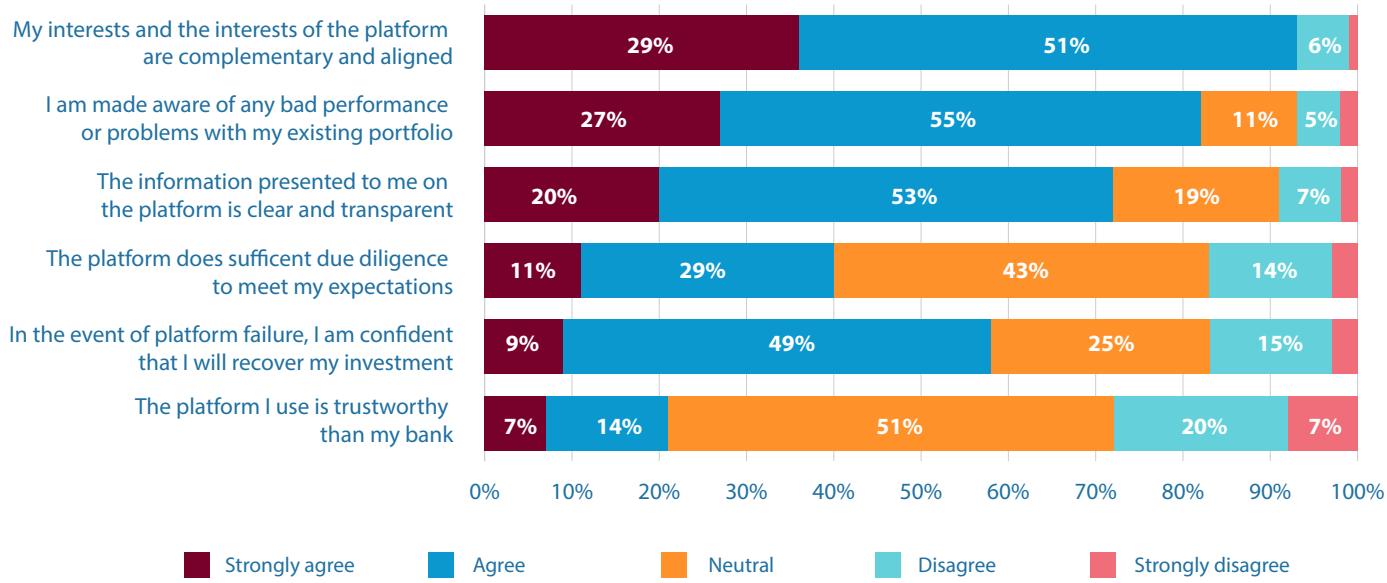
Figure 52: Key Factors Influencing Lenders' Investment Decisions



Lenders were also asked to consider the extent to which they agreed with a variety of statements regarding the levels of trust a lender has towards the platforms they use.80% of lenders 'agreed to strongly agreed' that their interests and those of the platforms were aligned and complementary.

Lenders also tended to agree that platforms ensured that lenders were aware of any poor performance or portfolio issues (82%) and that information was clear and transparent (73%). However, only 40% of respondents reported lender satisfaction to platform led due-diligence.

Figure 53: The Trust Dynamics Between Lenders and Their Primary Platforms



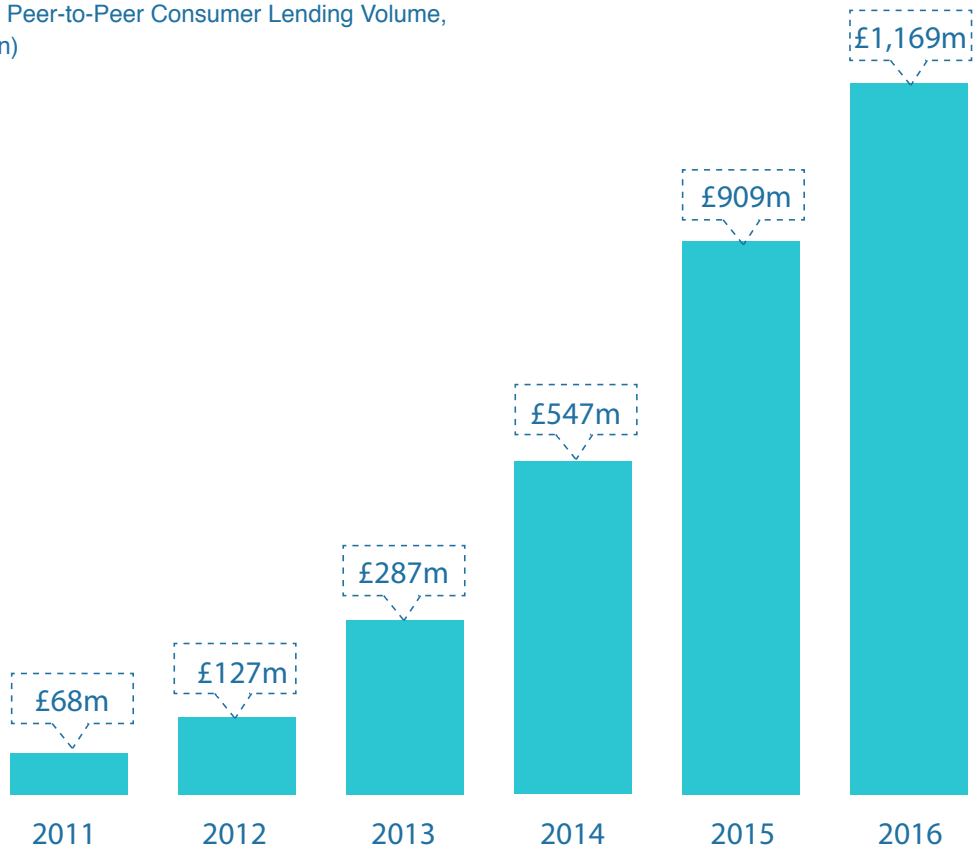
PEER-TO-PEER CONSUMER LENDING

BORROWER AND LENDER DYNAMICS: DYNAMICS

The second largest model in the UK is that of P2P Consumer Lending, with a total volume of £1.169b in 2016, which is a 29% annual increase. Volume data has been recorded for P2P consumer lending since 2011 and since then a total of £3.1b has been generated.

Though the annual growth rate of the model has decelerated annually since 2013, it remains a fundamental channel for finance for individuals and micro businesses in the UK.

Figure 54: Total UK Peer-to-Peer Consumer Lending Volume, 2011-2016 (£ million)



25% of all borrowers were repeat borrowers in 2016, which is an increase of 9% year-on-year. The qualification/onboarding statistics show that 44% of prospective borrowers were allowed to proceed with a funding campaign, 34% of which successfully raised finance. Across the model the default rate was 2.48%.
The average P2P Consumer loan remained a similar size, decreasing slightly from £6,583 in 2015 to £6,289 In 2016, with an estimated average of 217 investors per loan. In 2016 circa 95% of lenders relied upon auto-selection/auto-bid to allocate funds into investments.

Analysing P2P Consumer Lending by geographical location shows that lenders are concentrated in the South of England, with 27% of lenders based in London followed by 20% in the South East and 9% in the South West. 12% of lenders came from East of England. Similarly, to the P2P Business model, borrowers are more geographically diverse, with a much smaller concentration of borrowers in London (15%) and South East (14%) relative to lenders. The North accounts for 15% of total borrowing, with the North West and North East accounting for 11% and 4% respectively. The spread indicates that while significant proportions of funding come from a few distinct regions, the provision of the finance is far more geographically diverse.

Figure 55: Lender and Borrower Location by Region

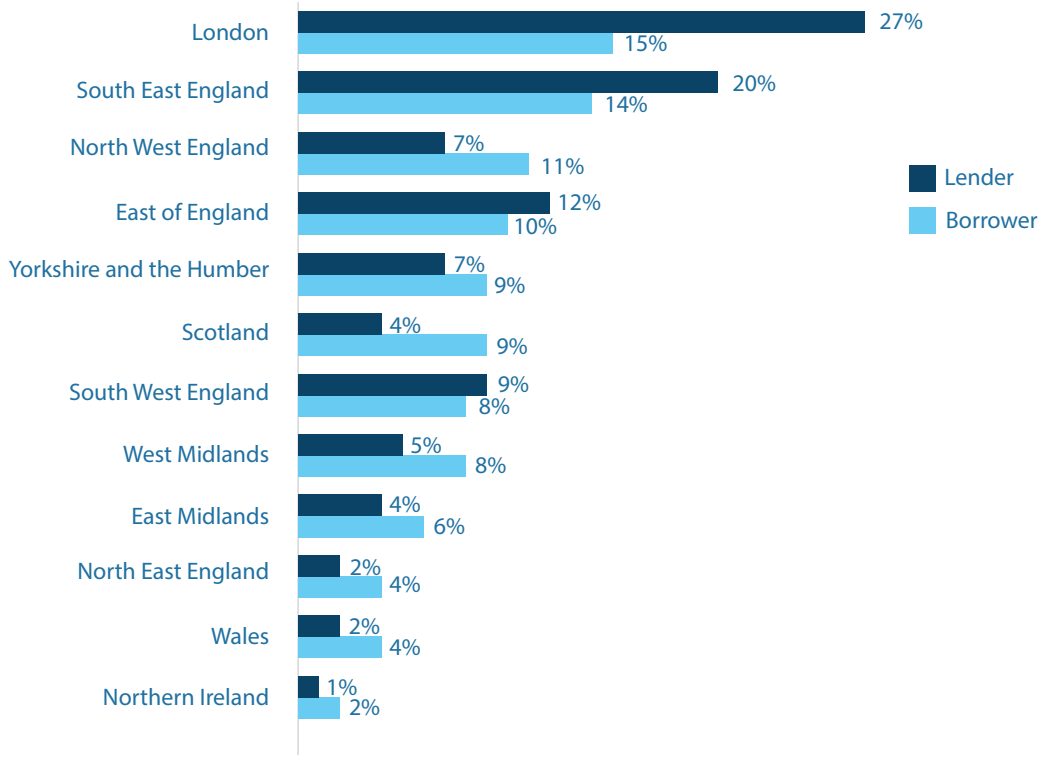
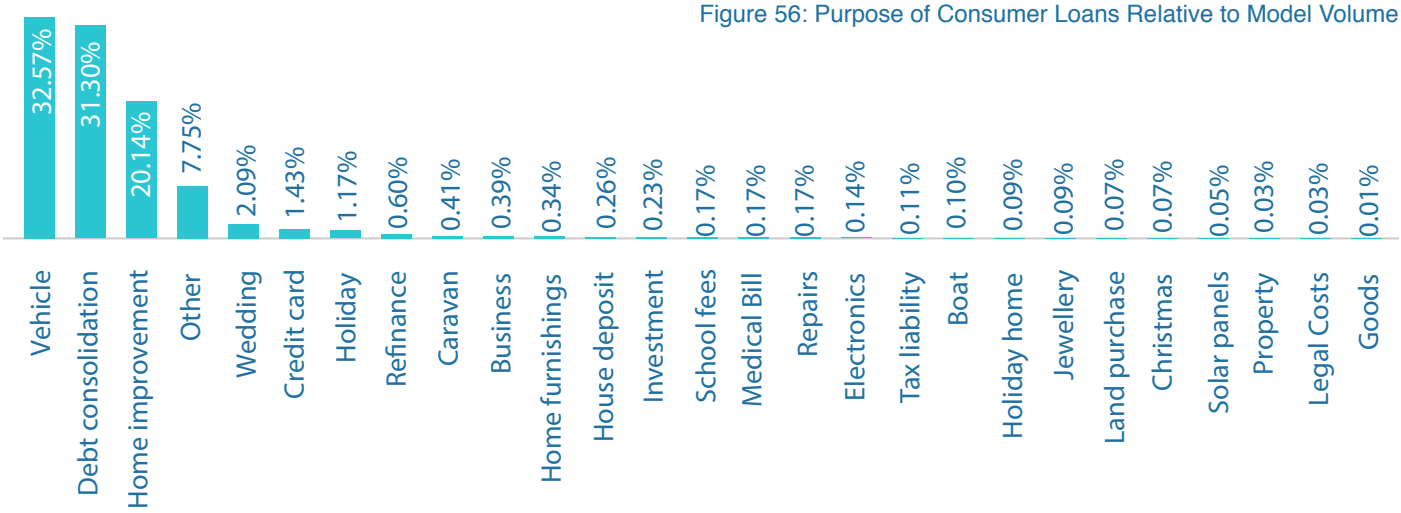


Figure 56: Purpose of Consumer Loans Relative to Model Volume



The transaction level data collected also identified the primary loan purpose as stated by successful borrowers. The most common purpose was for the purchase or financing of a vehicle, representing 32.57% of the total.

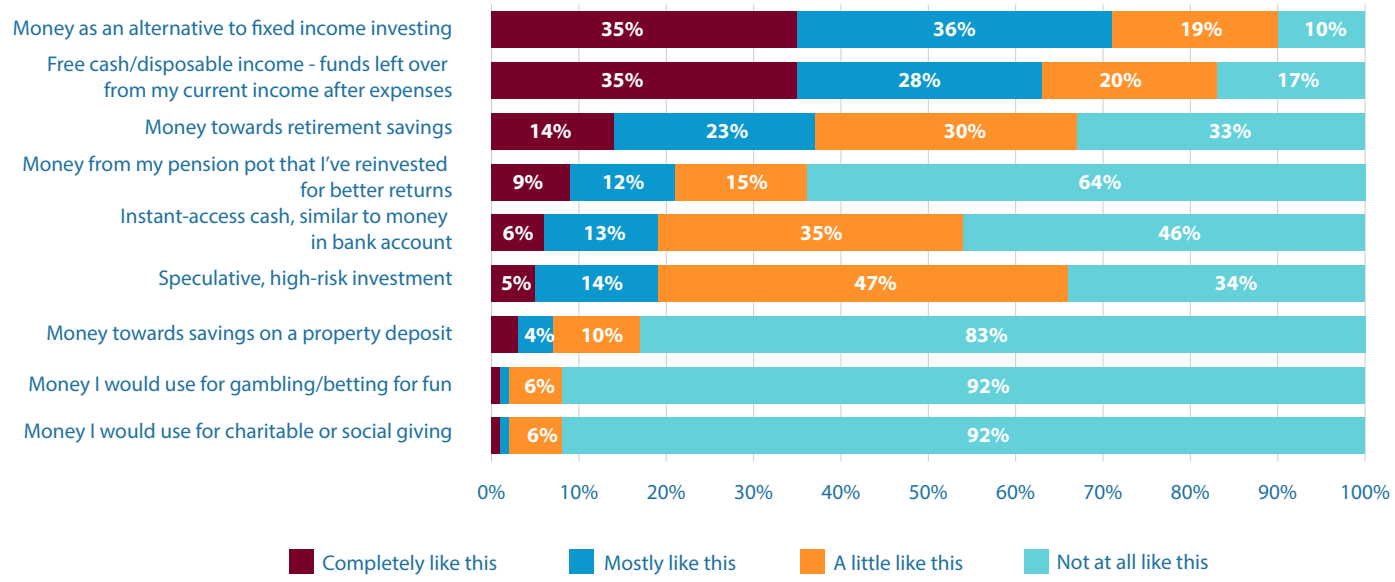
In the platform-based survey, participants were asked to indicate the types of partnerships with external businesses or organizations in relation to referrals, origination and deal flow.

Near to 40% of P2P Consumer lending platforms have an external referral partnership with organizations directly or indirectly associated with the automotive industry, which accords with the data on loan purpose. Debt-consolidation (31%) and home improvement (20%) ranked second and third respectively.

LENDER MOTIVATIONS AND BEHAVIOUR

Lenders who participated in the Investor Surveys were asked a series of motivation and behaviour questions regarding their lending activities on P2P Consumer lending platforms

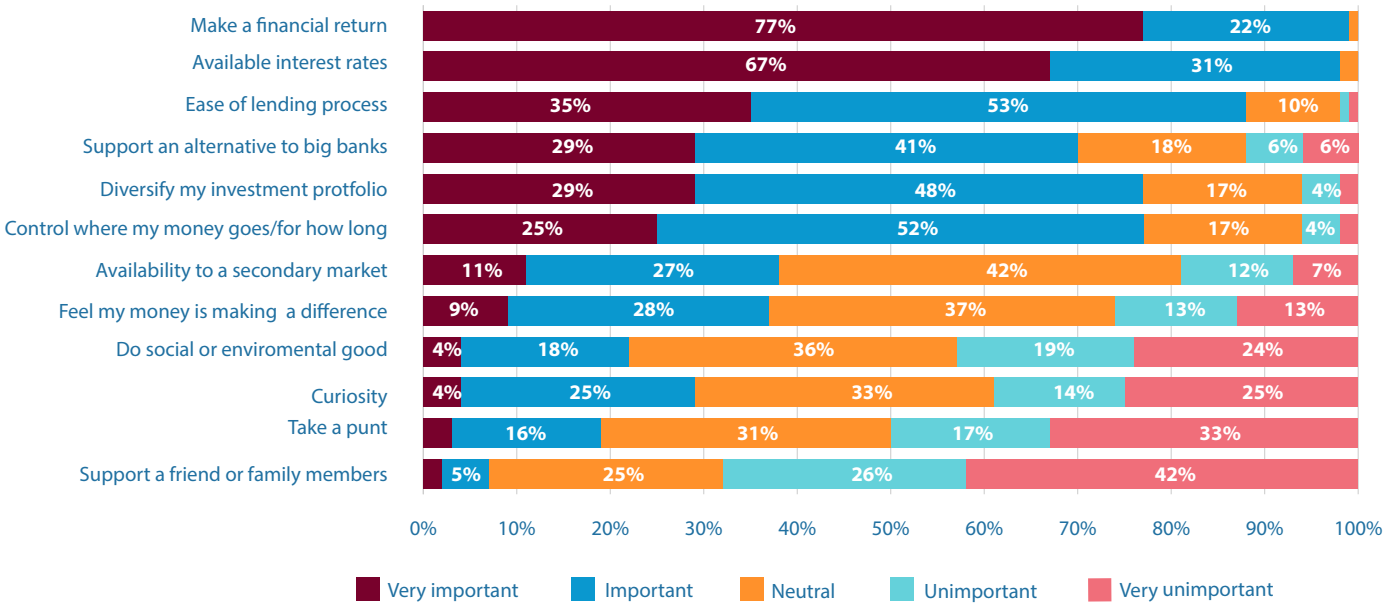
Figure 57: Lenders' Perceptions of Their Funds Relative to their Peer-to-Peer Consumer Lending Activity



Most lenders view the funds that they deploy via an alternative finance platform as a viable alternative to fixed income investing (35% viewing it as completely like this and 36% as mostly like this), followed by a significant proportion who view these funds as 'free cash', or disposable income, relating to funds left over after expenses (with 63% viewing it as 'completely to mostly like this'). 19% of lenders viewed their P2P Consumer lending funds as comparable to 'speculative, high-risk investment, whilst another 19% viewed it as most like instant-access cash, akin to monies in a bank account. 79% of lenders disagree that funds used towards P2P consumer lending are comparable to money from their pension pot.

When considering influencing factors, the survey found that 99% of lenders viewed 'make a financial return' as the most 'important to very important' factor for investing through P2P Consumer Lending, followed closely (98%) by the 'available interest rate'. 'Ease of lending process' also ranked as an important to very important factor (88%) for lenders when investing in P2P Consumer Lending.
More altruistic factors, such as 'doing social good' or 'Supporting a friend or family member' were not key considerations.

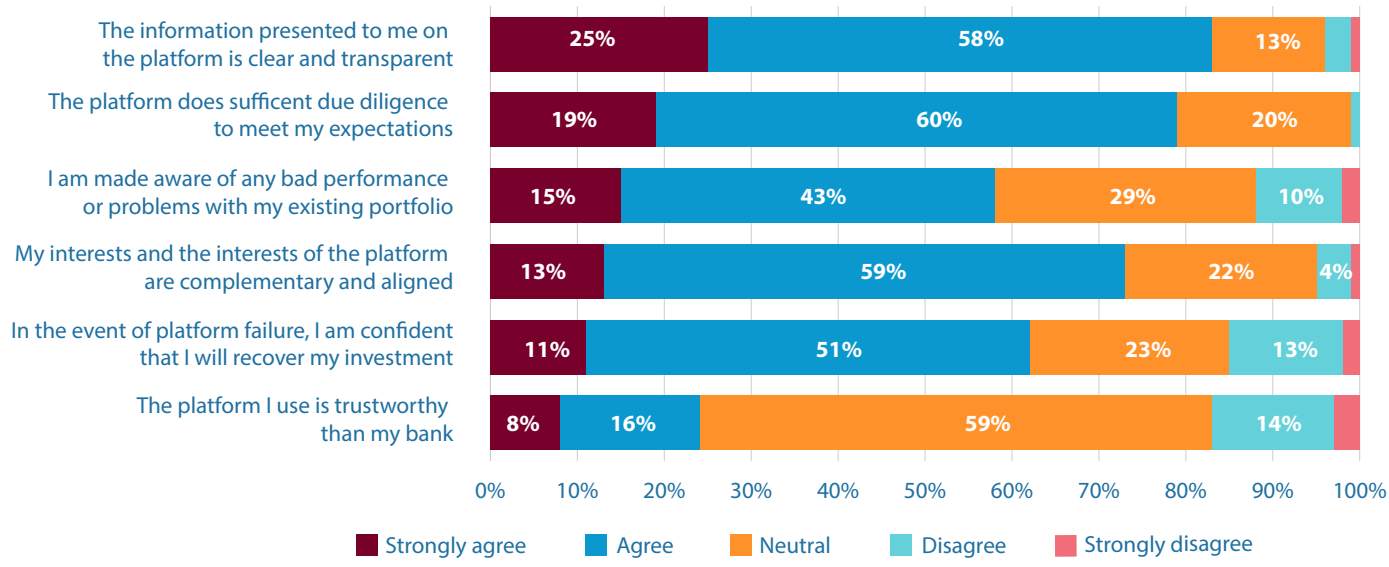
Figure 58: Factors that Influence Lender Behaviour for Peer-to-Peer Consumer Lending



Given the highly automated nature of lending via this model, funders were asked to consider several statements relating to their 'trust' levels and expectations placed upon the platforms they used.

84% of lenders agreed or strongly agreed that the platform they were lending through presented information clearly and transparently; 79% of these lenders thought that their due diligence expectations have been met by their platform and 73% view their interests aligned and complimentary to those of the platforms. Nevertheless, only 24% of lenders strongly agree to agree that their platform is more trustworthy than their bank, with 59% indicating a neutral view.

Figure 59: Trust Dynamics Between Lenders and Their Primary Platforms

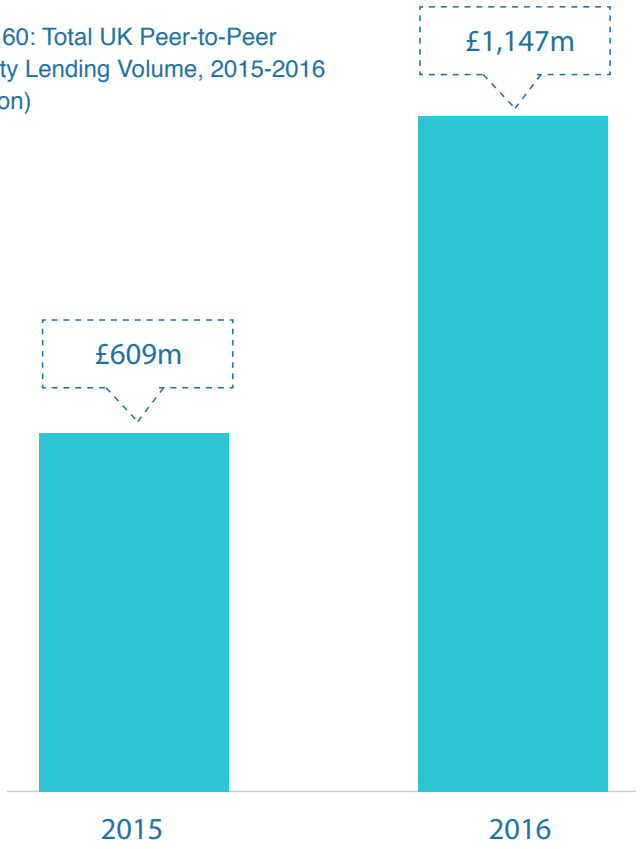


PEER-TO-PEER PROPERTY LENDING

The Peer-to-Peer Property Lending model was only categorised as an independent model from 2015 onward (previously captured within Business Lending) and has proven to be one of the largest drivers of the UK's alternative finance industry.
It is the third largest model by volume, generating £1.147b in 2016, which represents an 88% annual increase. In 2016 over 1,000 commercial and residential developments were financed by this model comprised of a variety of financing products, ranging from short-term bridging finance (with typical terms of 6 to 18 months), to longer-term commercial & residential mortgages (usually 3 to 5 years in duration) and traditional construction & development debt finance. The average loan size in 2016 was £772,434.
The qualification/onboarding rate for P2P Property lending was just under 17%. Of those borrowers deemed appropriate for the platform 84% went on to successfully raise finance. Over the course of the year, the level of institutional funding has also increased from 25% to 34% of the total generated model volume.

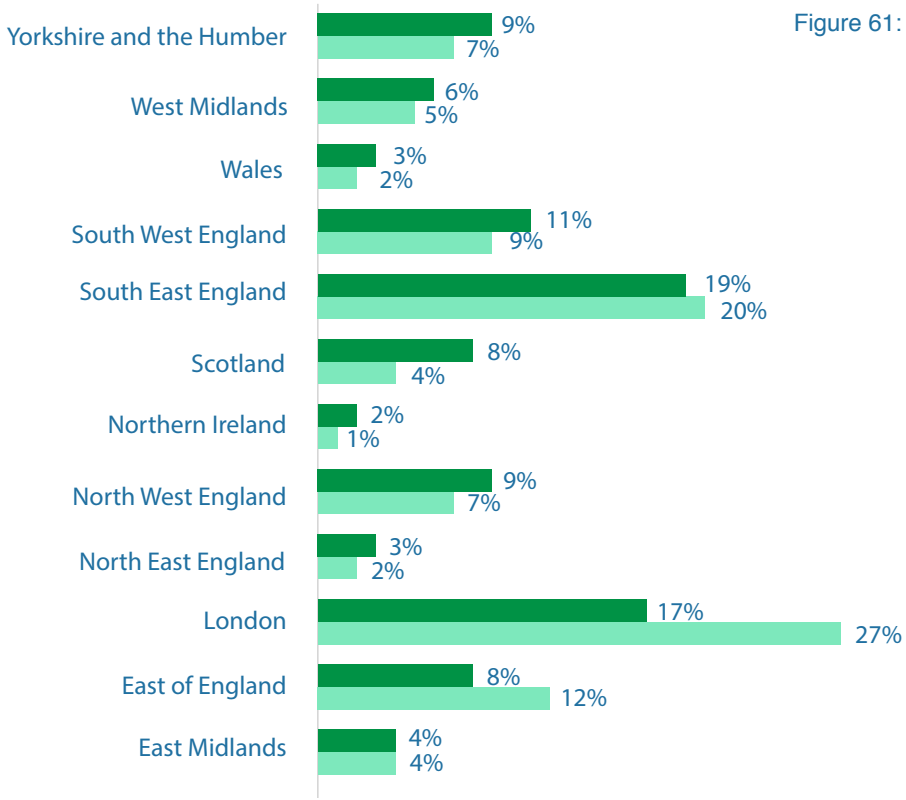
One noticeable trend in 2016 was the use of auto-selection, which has increased from 18% in 2015 to 60% in 2016. The rate of repeat borrowing has also increased, from 17% in 2015 to 28% in 2016.

Figure 60: Total UK Peer-to-Peer Property Lending Volume, 2015-2016 (£ million)



LENDER AND BORROWER DYNAMICS

Figure 61: Lender and Borrower Location by Region

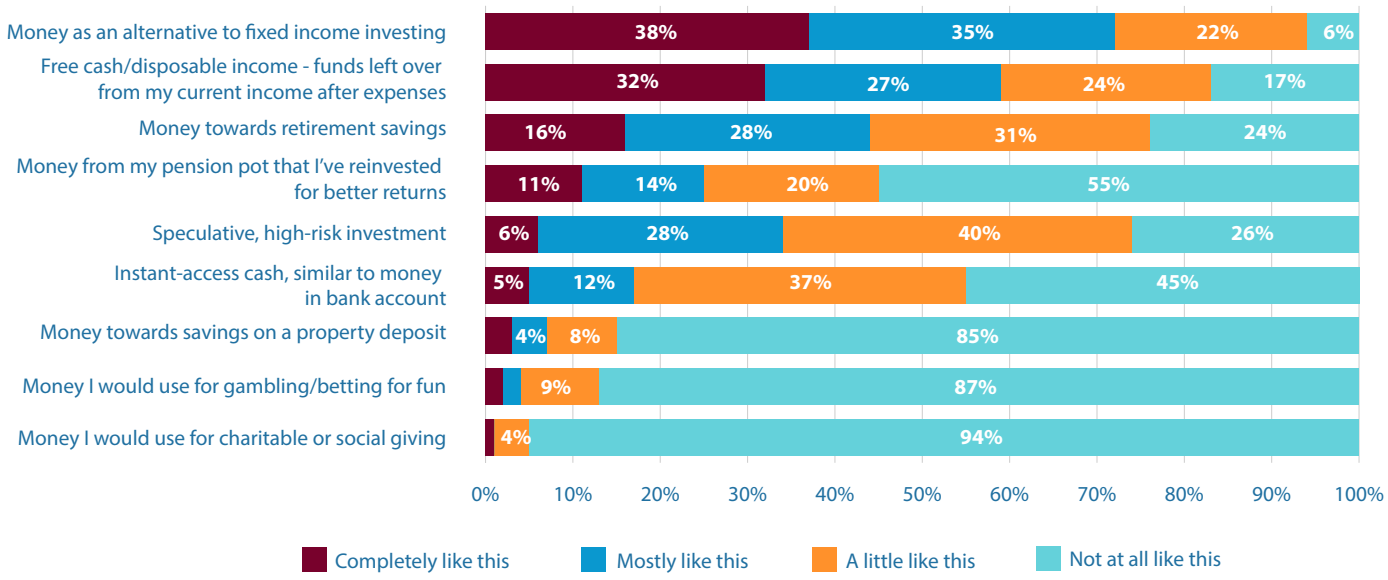


With respect to lending, London (27%), the South East (20%) and East of England (12%) provide the most funds via this model. Despite the South England emphasis, there is a wide spread of lending activities across the country.
Equally, while there are greater instances of borrowers in the South, funds derived from this model are reaching properties throughout the country.

LENDER MOTIVATIONS

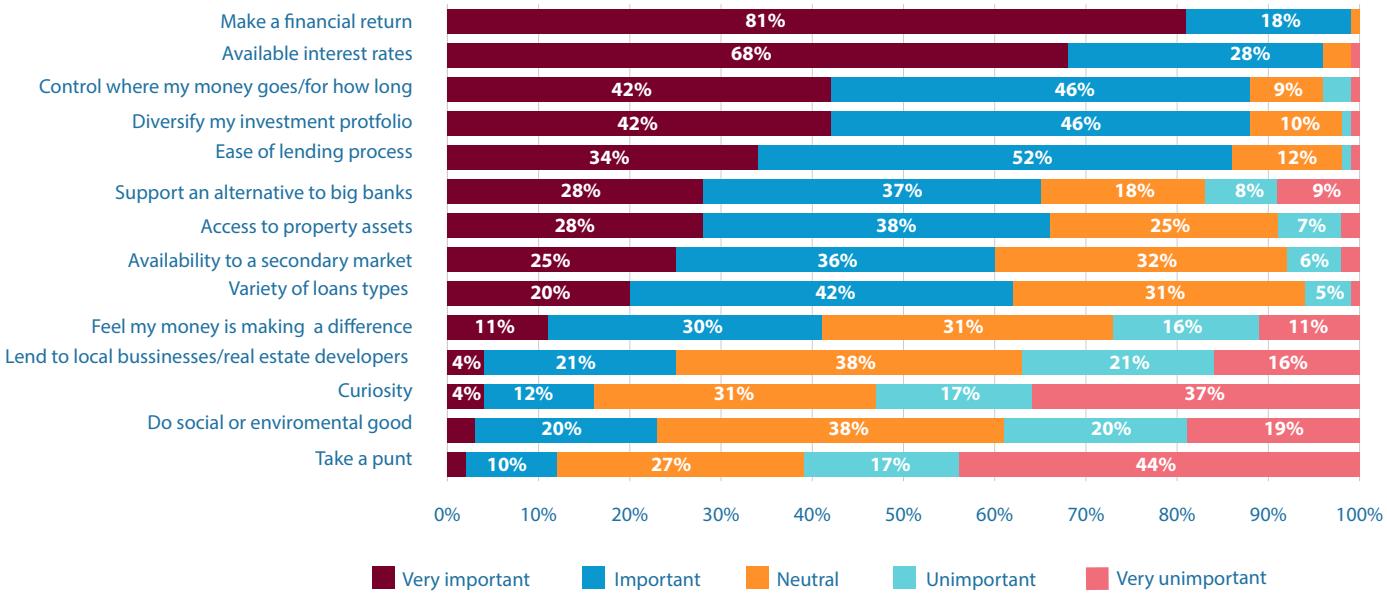
When considering deployed funds via a P2P Property platform, lenders tend to compare these funds to that of fixed income investing (38% viewing funds as completely like this and 35% as mostly like this), while fewer (a combined 59%) would consider their P2P Property lending funds as comparable to free cash or disposable income. 44% of these lenders completely or mostly viewed their funds as 'money towards retirement savings', while 34% view their lending activity as comparable to speculative, high-risk investment.

Figure 62: Lenders' Perceptions of Their Funds Relative to their Peer-to-Peer Property Lending Activity



When reviewing factors and considerations which motivate individuals to lend via this model, 99% of survey participants viewed financial return as 'important to very important', with 97% indicating available interest rates as a very important consideration. Ease of lending, the ability to diversify and monetary control all ranked as very important factors as well.

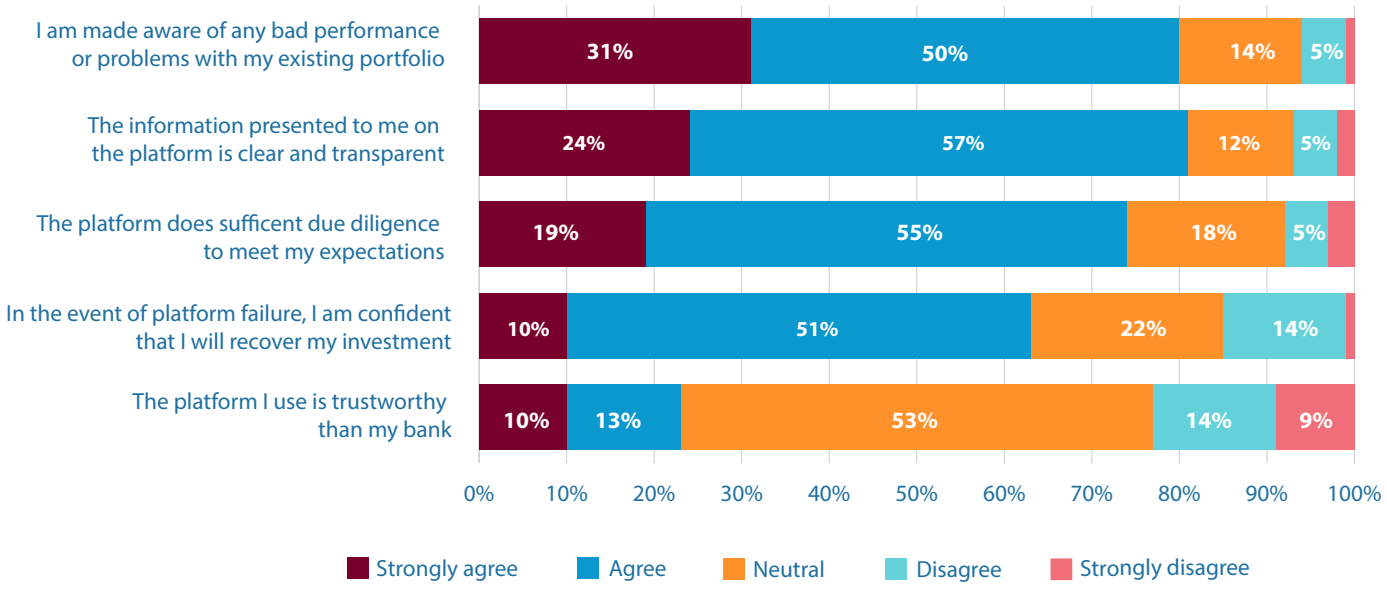
Figure 63: Factors that Influence Lender Behaviour for Peer-to-Peer Property Lending



Lender perceptions show that lenders are generally satisfied with the platform they use.

The chart below shows that 81% 'agreed to strongly agreed' that they were made aware of 'bad performance' and that 'information was clear and transparent'.

Figure 64: Trust Dynamics Between Lenders and Their Primary Platform



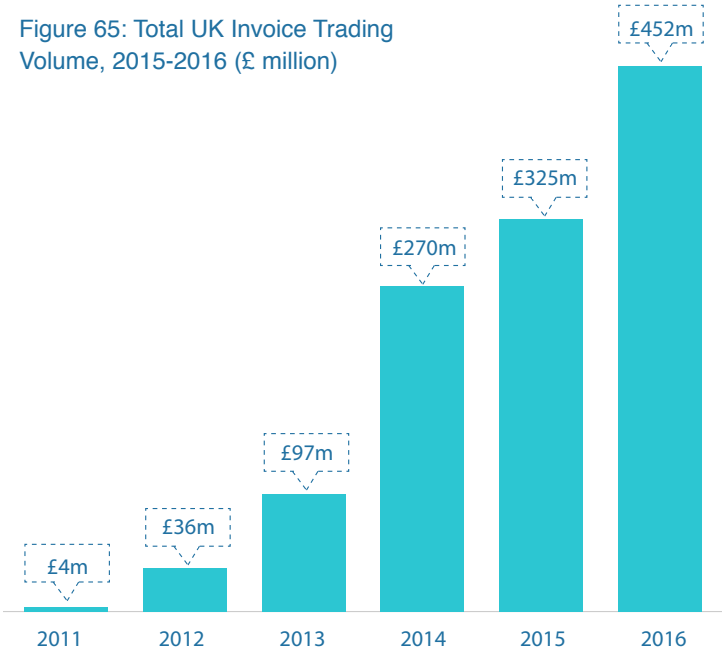
INVOICE TRADING

In 2016 invoice trading accounted for £452 million representing a 39% increase from £325 million in 2015. From 2011 to 2014 invoice trading experienced triple digit growth. However, annual growth stagnated somewhat between 2014 and 2015- falling from 178% to 20%.

There are several emerging trends which the most recent data elicits. One such trend is the decline in the number of repeat borrowers, which declined from circa 90% of all borrowers in 2015 to 50% in 2016. The profile of businesses that used invoice trading predominantly came from the construction, technology and retail & manufacturing sectors. With respect to platform qualification / onboarding, invoice trading platforms, on average, accepted 69% of firms which approached platforms to trade invoices, down considerably from the 85% rate the preceding year.

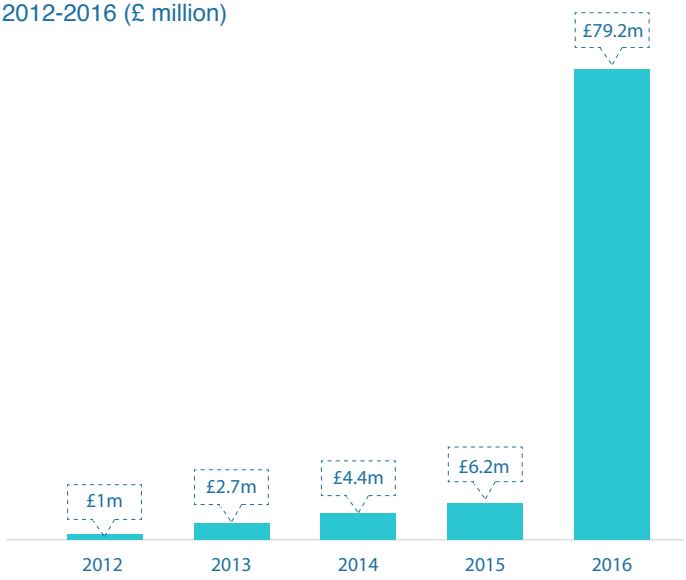
Reflecting the broader trend of corporate partnership integration observed across the industry, all of the invoice trading platforms surveyed indicated partnerships with external firms for the purpose of deal origination. Average deal size has also decreased – from £57,094 in 2015 to £43,644 in 2016. Simultaneously, the average number of investors has increased from 12 to 14 over the same period. Data on the number of investors utilizing auto-selection was not collected in 2015, but the total number of lenders who relied on auto-selection in 2016 was 41%.

Figure 65: Total UK Invoice Trading Volume, 2015-2016 (£ million)



DEBT-BASED SECURITIES

Figure 66: Total UK Debt-based Securities/Debentures Volume, 2012-2016 (£ million)



Debt-based Securities, which includes debentures and bonds issued via investment-based platforms, grew dramatically in 2016 to over £79 million from 2015's £6 million. These debt-based products are typically issued by companies for a fixed maturity and interest rate, with a bullet repayment upon maturity.

These products are often tradable and transferable, though it is typically the platform which facilitates such transactions.

This increase in total market volume can in part be attributed to the increase in the number of providers of this category of alternative finance, with several new platforms issuing corporate bonds. In fact, Debt-based securities was the only model which saw an increase in the total number of platforms in 2016. This, coupled with the increase issuances from veteran platforms, has led to a rapid increase and the total volume for debt-based securities has subsequently increased by a staggering 1,147%. The average deal size has also increased by nearly 40%, from £880,000 in 2015 to £1,389,923 in 2016.
Despite a dramatic increase in the volume generated, Debt-based Securities platforms have a low onboarding acceptance rate (14%). However, once platforms are onboarded the majority successfully raise finance (70%). The most popularly funded sector is 'Food and Drink', generating 36% of the volume from this model. Renewable energy (27%) and Community & Social Enterprises (14%) rank second and third.

Institutional investment within Debt-based Securities is low, with only 8% of the model's volume coming from institutional investors. The rate of auto-selection is also lower than that observed in other models (18%). Investors spent considerable time performing their own due-diligence, which is corroborated by the data showing that investors relied more heavily upon their own due diligence than that of the platform or co-investors.

INVESTOR MOTIVATIONS

When considering deployed funds via a DBS platform, investors tend to compare these funds to that of free cash / disposable income investing (37% viewing funds as completely like this and 34% as mostly like this), while fewer (a combined 58%) would consider their investable cash comparable to free cash or disposable income.

Investors through this model scored highest in the 'money I would use for charitable or social giving' category (10%), suggesting that there may be slightly more altruistic motivations behind investment activity through this model.

Figure 67: Investor Perceptions of Their Funds Relative to their Debt-based Securities Activity

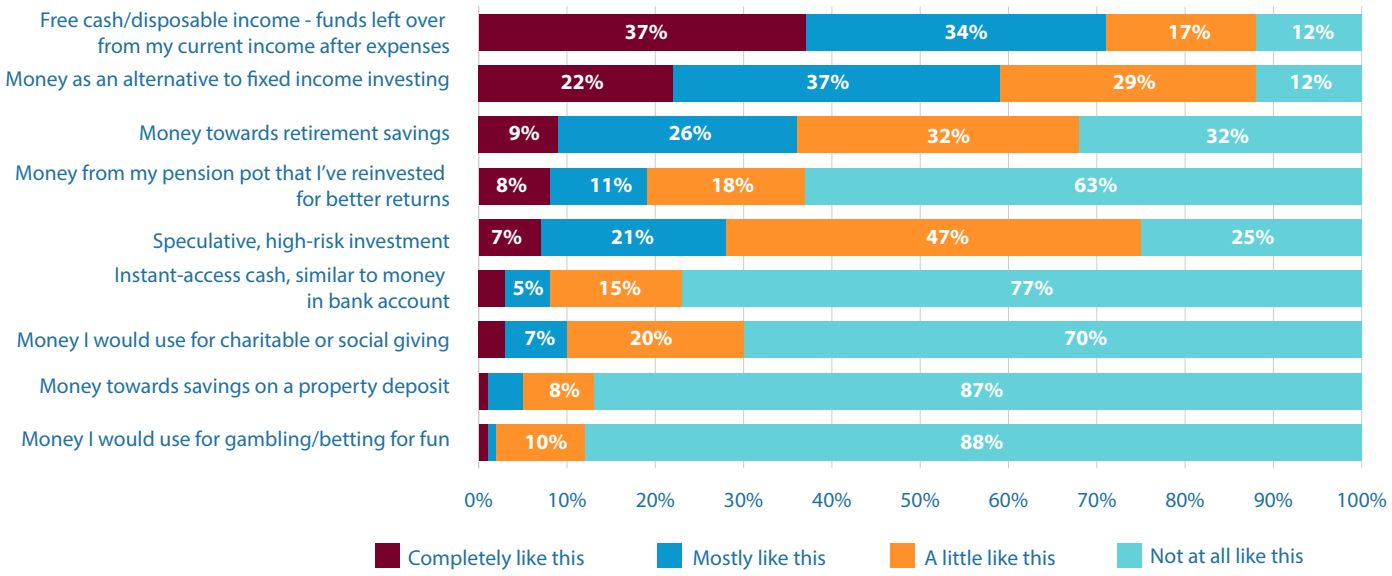
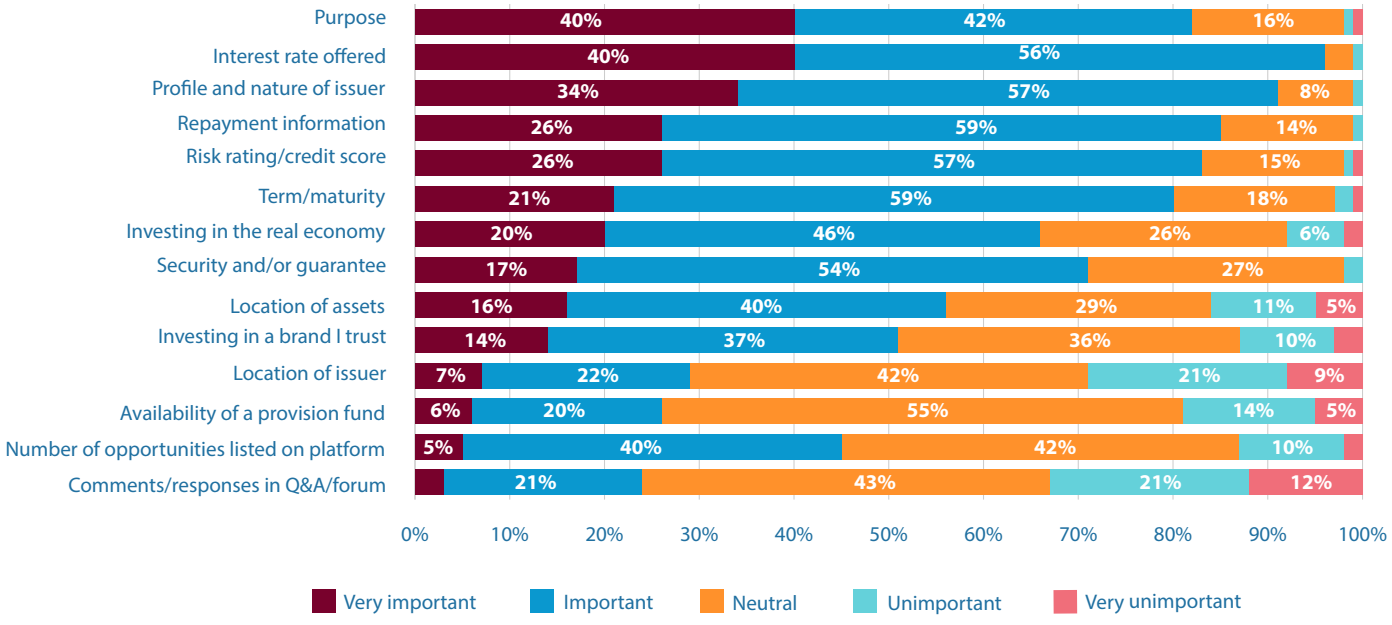


Figure 68: Factors that Influence Investor Behaviour for Debt-based Securities

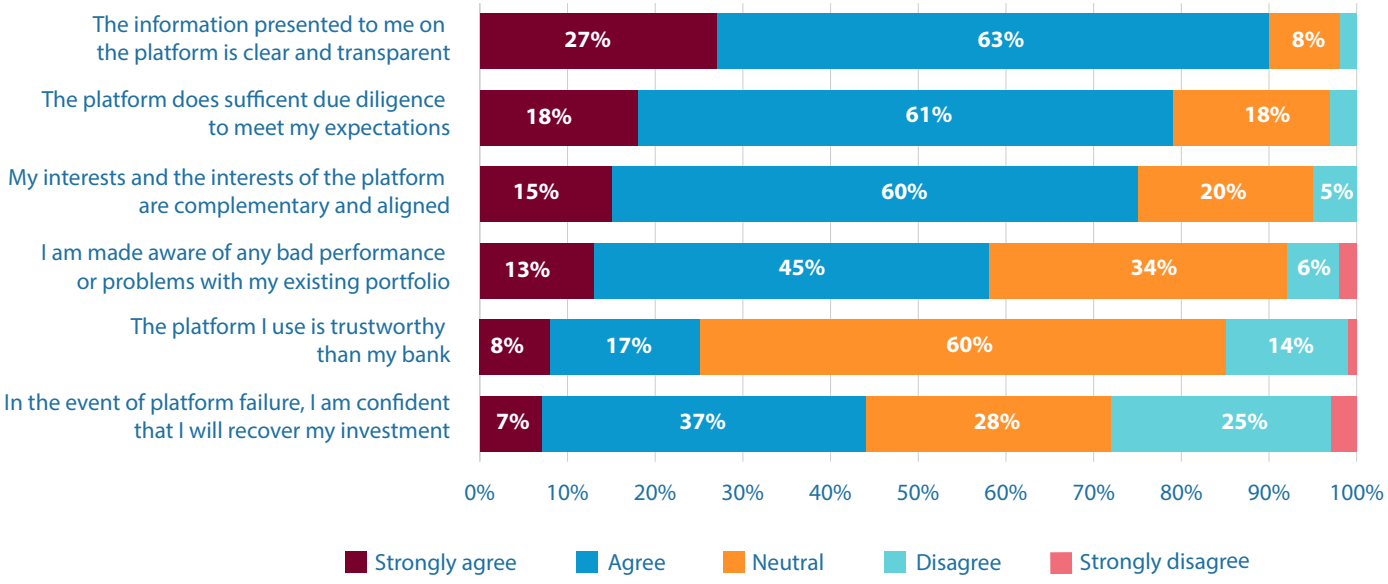


As with all previously reviewed models, the leading motivator was making a financial return. For 96% of DBS investors, interest rate was also a critical motivator. Yet, when investors were asked to express which factors were 'important to very important' this cohort noted finance purpose (82%) and the profile and nature of the issuer (91%).

Being able to 'invest in the real economy' also scored highly, with 66% noting this as important or very important to them.

Finally, when reviewing investor perceptions towards the platforms, 90% 'agree to strongly agree' that information is clear and transparent', and 80% perceive platform-led due diligence as satisfactory against their expectations.

Figure 69: Trust Dynamics Between Lenders and Their Primary Platform



EQUITY-BASED CROWDFUNDING

Since 2011, equity-based crowdfunding has generated a cumulative £634m. In 2016, this model totalled £272 million, growing a modest 11% against the previous year.
This was the first year that volume through equity-based crowdfunding has experienced such a decline of this magnitude in annual growth.

Despite modest year-on-year growth, equity-based crowdfunding also met a number of milestones. This was the first year for the model to cross the £250m mark and a reported six successful exits occurred in 2016, delivering returns to investors . Within the wider equity finance context, equity-based crowdfunding continues to contribute a sizable proportion of UK seed and venture stage equity investment (17.4%); data from Beauhurst shows that there was just over £1.5 billion of announced seed and venture stage equity funding in the UK in 2016. Therefore, while the pace of equity-based crowdfunding has slowed, this is a consistent trend with the overall level of announced seed and venture stage equity finance over the course of 2016.

In 2016 approximately 500 new businesses successfully raised finance, which is down from 720 in 2015. Despite this decline the average deal size increased by 35%, from £523,978 to £807,214. Approximately 216 investors participated in successful campaigns.

The average qualification/onboarding rate across platforms was 30%, with 65% of platform-listed campaigns successfully securing investment. The most funded sectors were Technology (28% of total funding), Finance & Payments (13%) and Content and Information (12%). Finally, whilst institutional investing is on the rise, this model remains heavily retail oriented; circa 27% of investors are either classified as High-net worth or Sophisticated Investors, compared to 73% that are categorised as ordinary retail investors.

Figure 70: Total UK Equity-based Crowdfunding Volume, 2011-2016 (£ million)

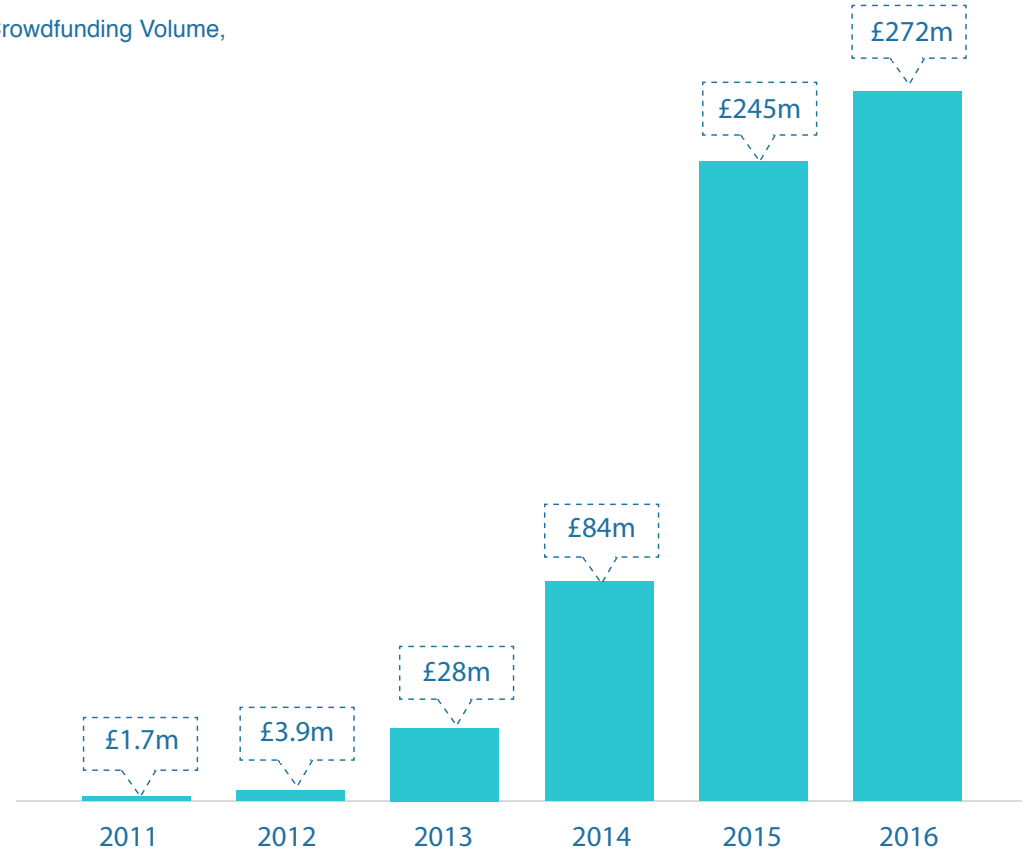
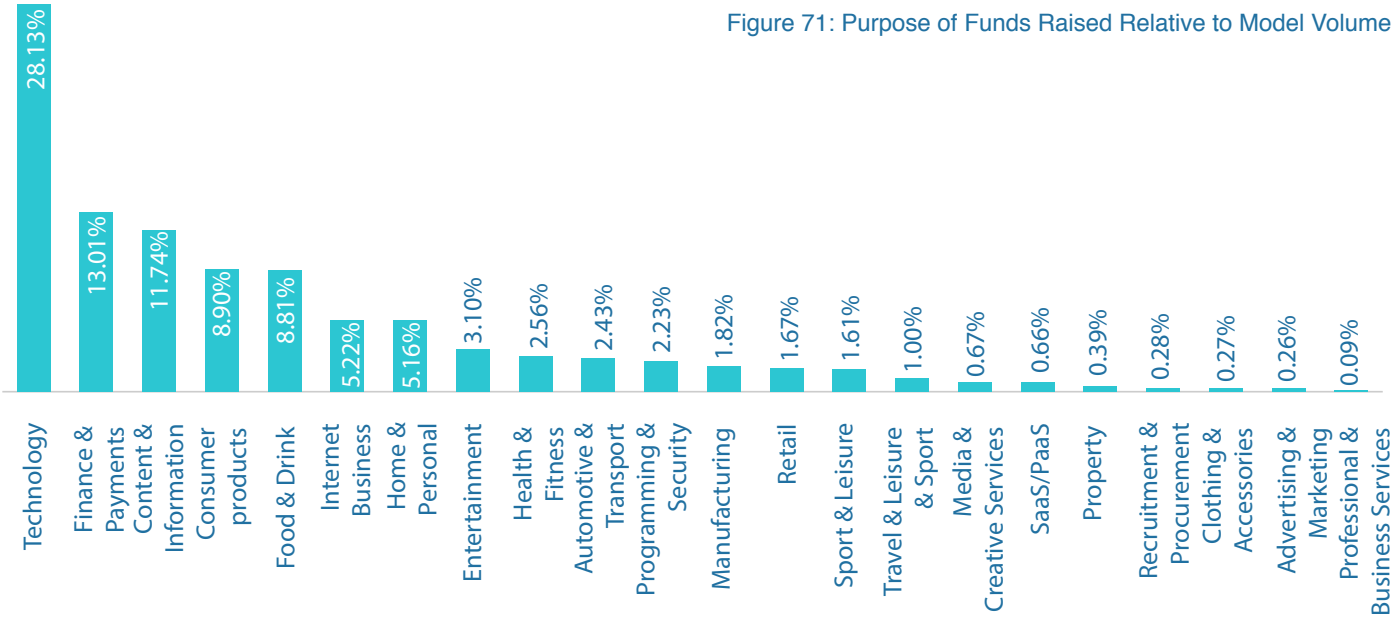


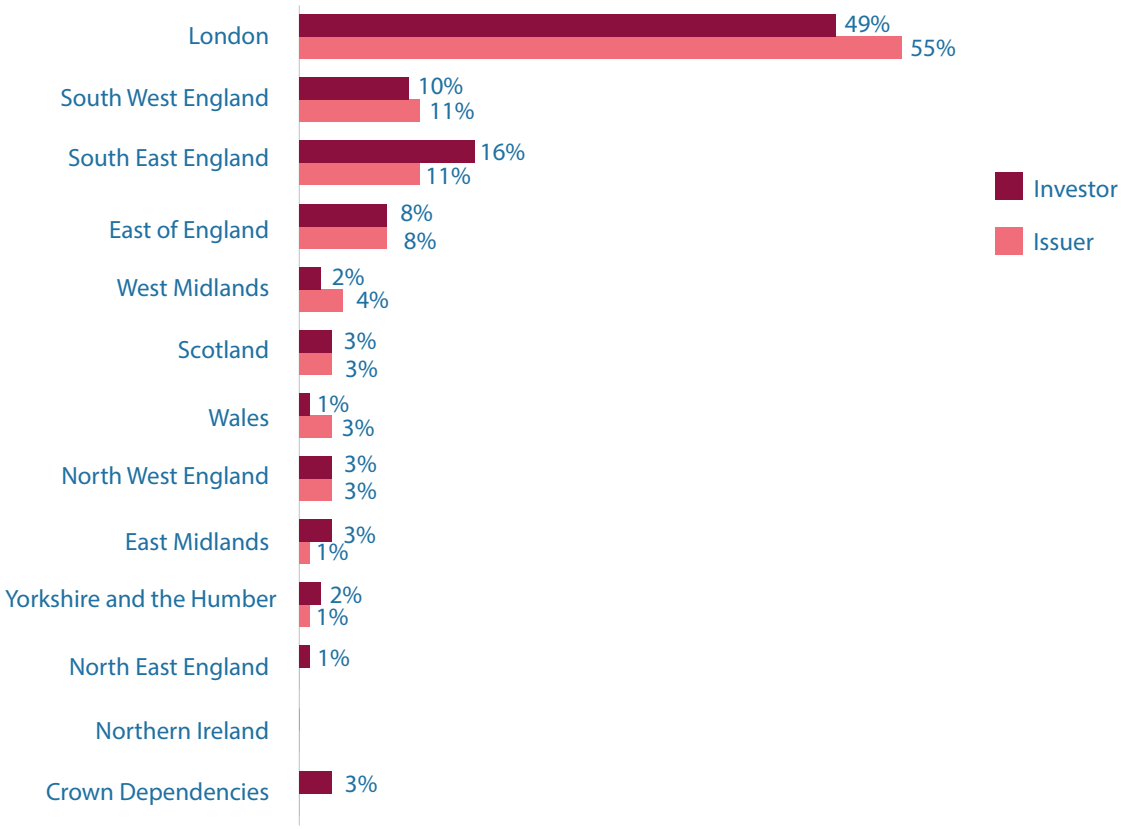
Figure 71: Purpose of Funds Raised Relative to Model Volume



INVESTOR AND ISSUER DYNAMICS: GEOGRAPHY

The locations of investors and issuers mirror one another, suggesting a location-bias between funders and fundraisers. The most significant concentration of funding in terms of both providing and receiving remains in London. When comparing the geographic breakdown of investors and issuers of this model to the models previously assessed, one might recall that in all cases, there were greater proportions of funders from London than fundraisers, In the case of this model, London retains 55% of all finance raised from the model.

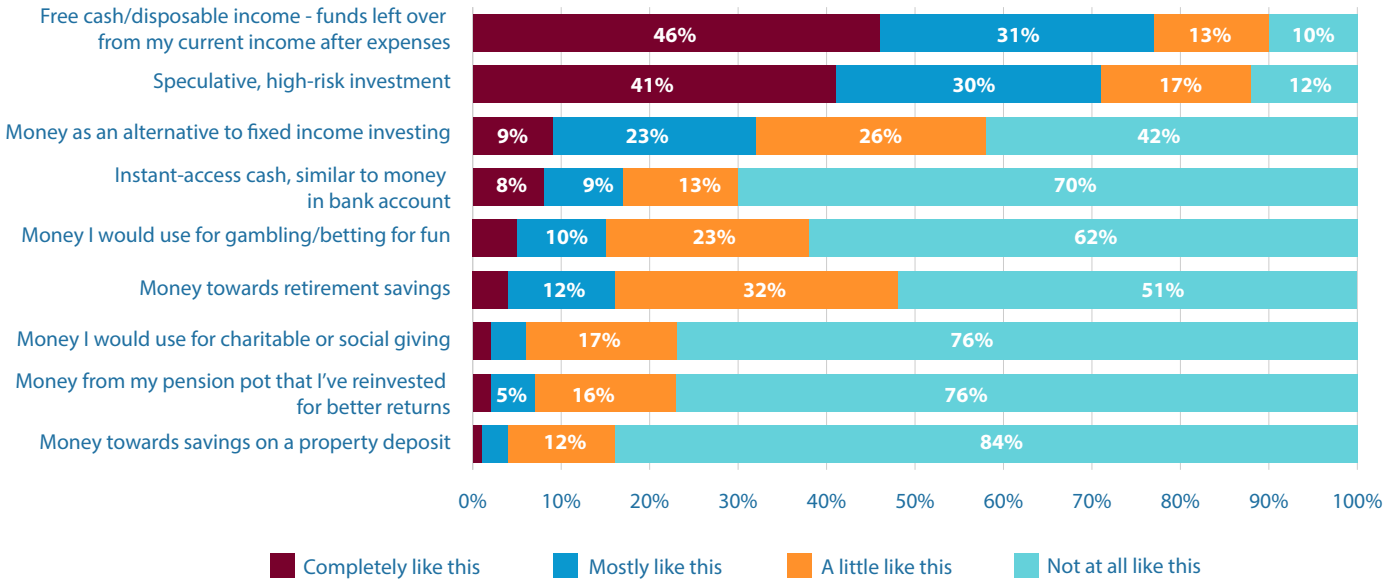
Figure 72: Investor and Issuer Location by Region



INVESTOR MOTIVATIONS

Investors were asked how they viewed their funds in comparison to other funding options. In general investors tended to view the funds that they deploy via an equity-based crowdfunding platform as free cash, or disposable income, relating to funds left over after expenses (with 77% viewing it as 'completely to mostly like this'). Investors also perceived these funds as monies they would use towards 'speculative, high risk investment', with 71% of investors stating so. 32% viewed their funds as a viable alternative to fixed income investing, which is the lowest proportion across all alternative finance models. 84% of investors agree that the money utilised for equity-based crowdfunding should not be in lieu of money used towards savings on a property deposit. Equally, 76% do not view this as money applicable to one's pension, and 70% do not view this as money like their instant access cash.

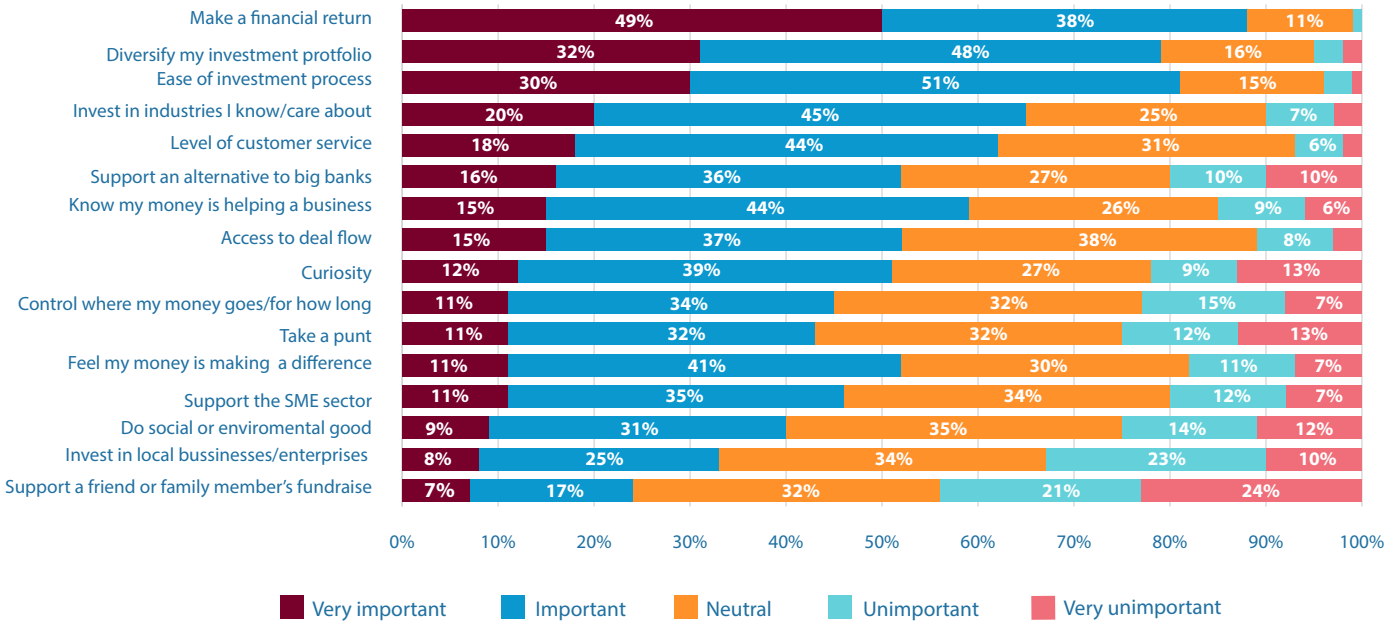
Figure 73: Investor Perceptions of Their Funds Relative to their Equity-based Crowdfunding Activity



When considering factors viewed by the investor as key motivating factors informing their investment activity, 88% of investors viewed making a financial return as 'important to very important'. 81% and 80% view 'ease of investment process' and 'diversification of investment portfolio' as key factors to consider when deciding to invest.

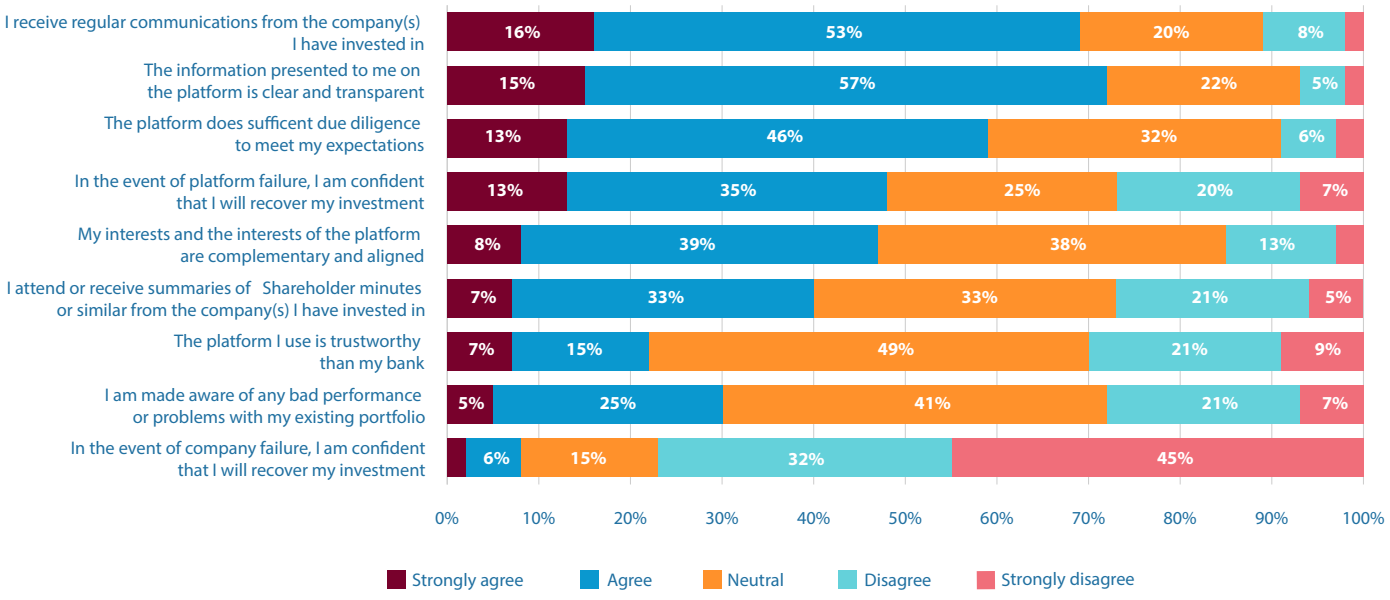
Given that equity-based crowdfunding is perceived as the riskiest of alternative finance models, it is somewhat comforting that the survey results indicate investor understanding of how their equity crowdfunding funds should not resemble certain more crucial funding categories. For instance, 84% of investors agree that the money utilised for equity-based crowdfunding should not be in lieu of money used towards savings on a property deposit. Equally, 76% do not view this as money applicable to one's pension, and 70% do not view this as money similar to their instant access cash. Aside from these motivations, 66% also viewed 'investing in industries I know & care about' as important to very important and 62% viewed the level of customer service received (from the platform) as a significant factor. 59% of investors are motivated that their 'money is helping a business' and 52% view 'their money making a difference' as a significant factor.

Figure 74: Factors that Influence Investor Behaviour for Equity-based Crowdfunding



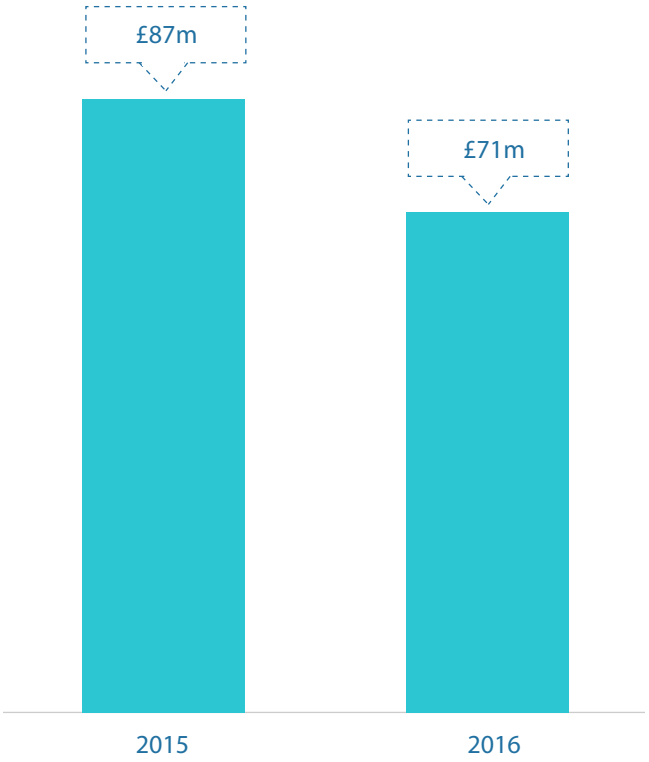
Finally, when considering investor perceptions towards the platforms they utilise, 71% 'agree to strongly agree' that information is clear and transparent', and 69% indicated receiving regular communications from the companies they have invested in through the platform.

Figure 75: Trust Dynamics Between Lenders and Their Primary Platform



REAL ESTATE CROWDFUNDING

Figure 76: Total UK Real Estate Crowdfunding Volume, 2015-2016 (£ million)

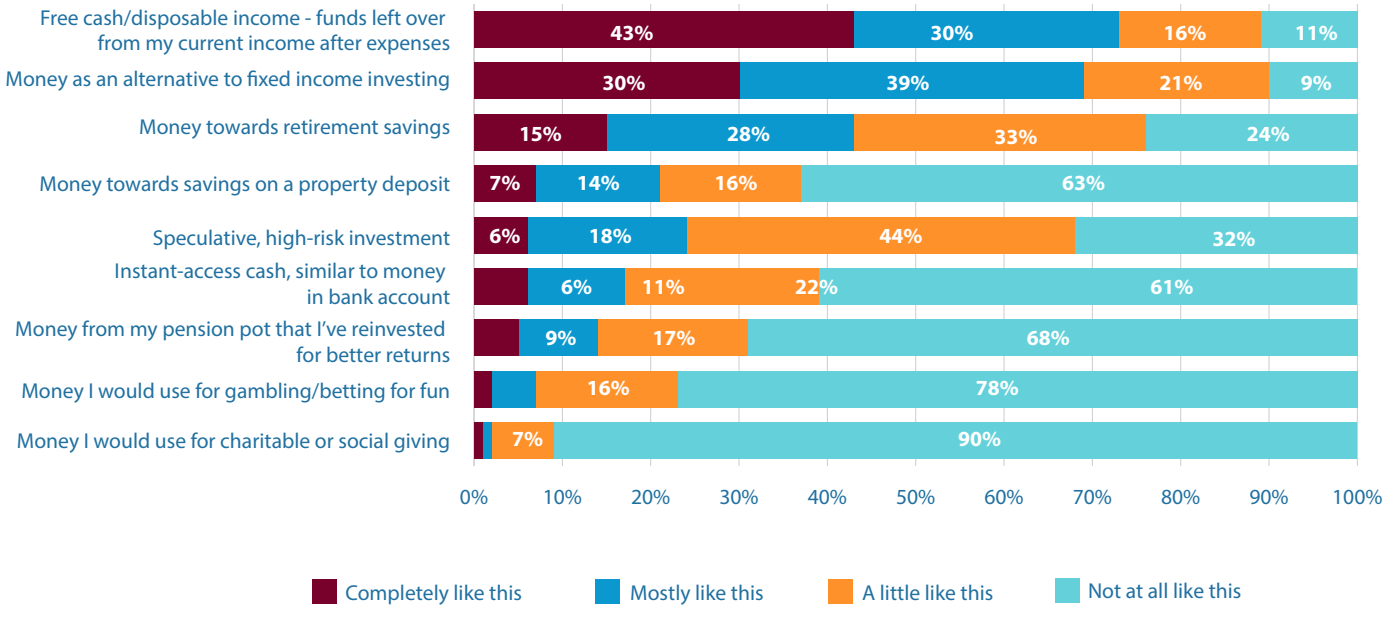


The Centre first began recording Real Estate crowdfunding transactions and data in 2015. This investment-based crowdfunding model enables investors to acquire ownership of a property-asset via the purchase of shares in a single property or a number of properties. In 2016 volumes in real estate crowdfunding fell by 18%, from £87 million to £71 million.

The average deal size was circa£3.25 million, which is the largest average transaction size across the models. The weighted average platform onboarding/qualification rate was relatively low, with less than 2% of potential deals making it onto the platform. Many platforms caveated this, however, by stating that many deals are originated by the platform itself rather than from external parties. Of those deals on the platform, there was an 87% success rate in successfully financing projects.
75% of funders were individual investors, with the rest coming from institutional investors. A notable dynamic within real estate crowdfunding is the distribution location and source of funding. The platform survey data shows that most of the funding came from investors based in the South West, North West and London but went to fund properties based in the North West, North East & London. Real estate crowdfunding was the only alternative finance model in which two North English regions received the highest proportion of model funding. Only 19% of investors are motivated by investing locally, thus enabling investment from the south to more easily flow to areas which require the funding and fall outside of traditional location-bias.

INVESTOR MOTIVATIONS

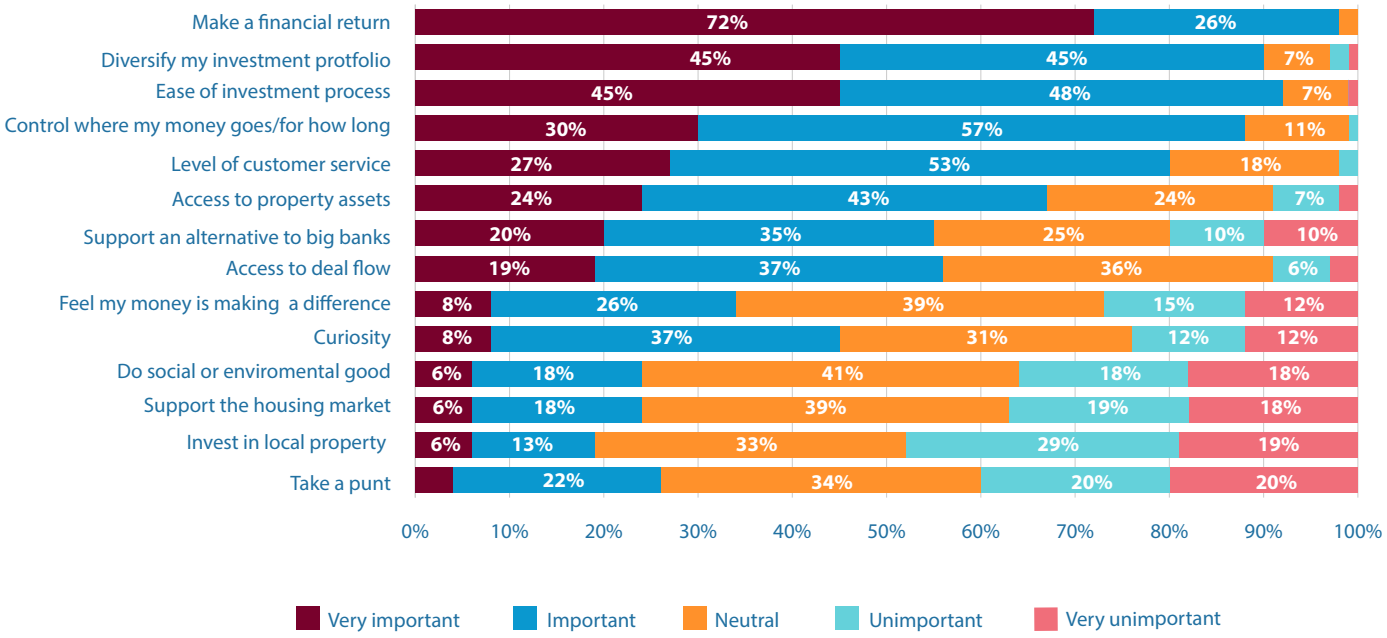
Figure 78: Investor Perceptions of Their Funds Relative to their Real Estate Crowdfunding Activity



Investor motivations vary, but for the most part investors are not tapping funds away from retirement savings, savings towards a property or pension monies.

For 73% of investors the funds they deploy via this model are viewed as 'completely or mostly' like free cash/disposable income left after expenses. This figure drops to 69% when compared to 'money as an alternative to fixed income investing'.

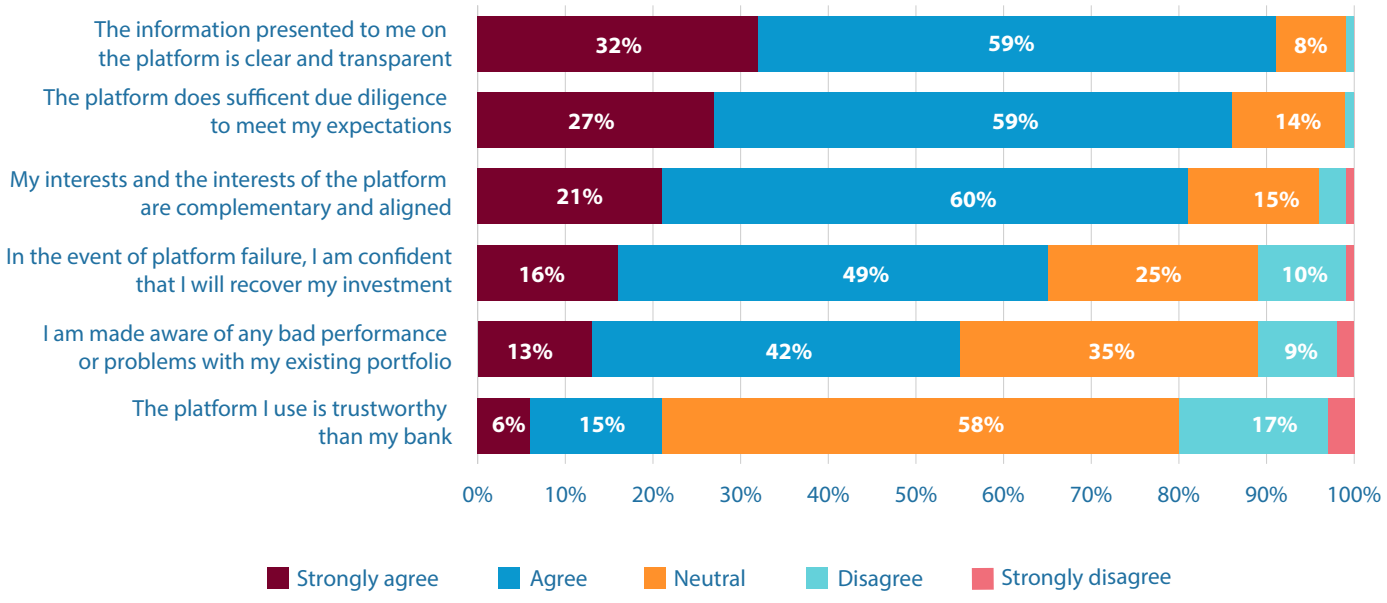
Figure 79: Factors that Influence Investor Behaviour for Real Estate Crowdfunding



Investor motivations are consistent within real estate crowdfunding to other alternative finance models, with those relating to financial returns scoring highly. Some of the prevalent factors that were specific to this model include 'access to a property asset' (with 67% of investors strongly agreeing to agreeing with this factor), 'supporting an alternative to big banks' (55%) and 'curiosity' (44%).

91% of investors agreed or strongly agreed that the platform they were investing on presented information clearly and in a transparent nature, with 85% claiming that their due diligence expectations have been met by their platform and 81% viewed their interests aligned and complimentary to those of the platforms.

Figure 80: Trust Dynamics Between Lenders and Their Primary Platform



COMMUNITY SHARES

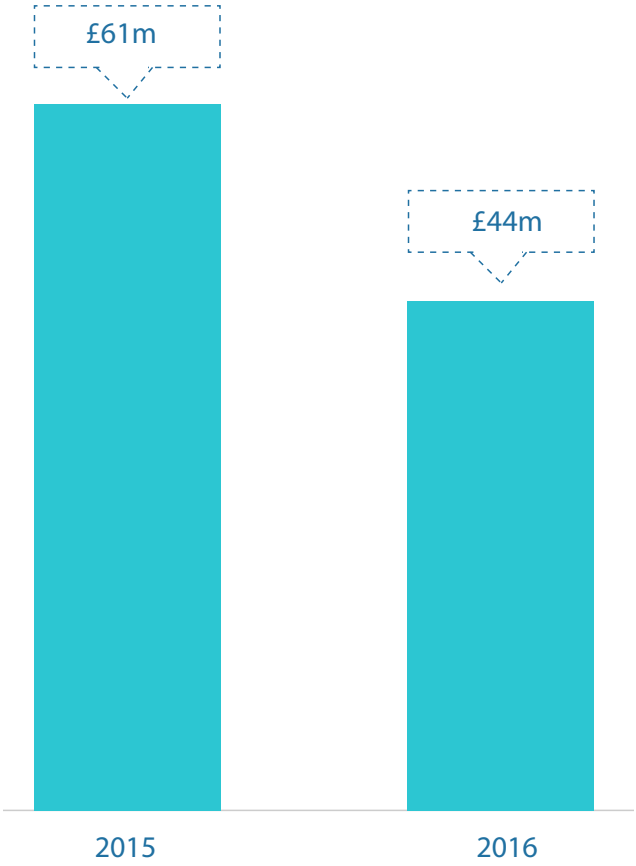


Figure 81: Total UK Community Shares Volume, 2015-2016 (£ million)

The Community shares model accounted for £44 million in 2016, which represents a 28% decrease from £61 million in 2015. The total is still significantly larger than funding in 2012 (£0.3 million) and 2013 (£0.8 million),

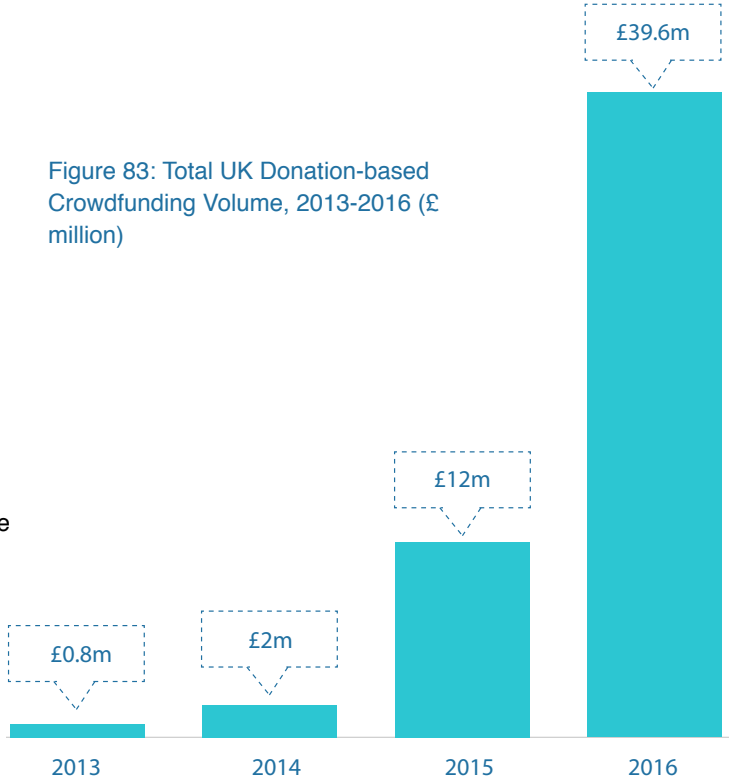
DONATION-BASED CROWDFUNDING

Donation-based crowdfunding raised £39.6 million in 2016, which represents annual growth of 230%. This is the largest annual growth rate across all alternative finance models. For projects on these platforms, the donation crowdfunding campaign funding success rate was 56% in 2016.

From 2015 to 2016 the average deal size has increased – from £1,379 to £1,516. Simultaneously, the number of investors has also increased from 41 to 52.

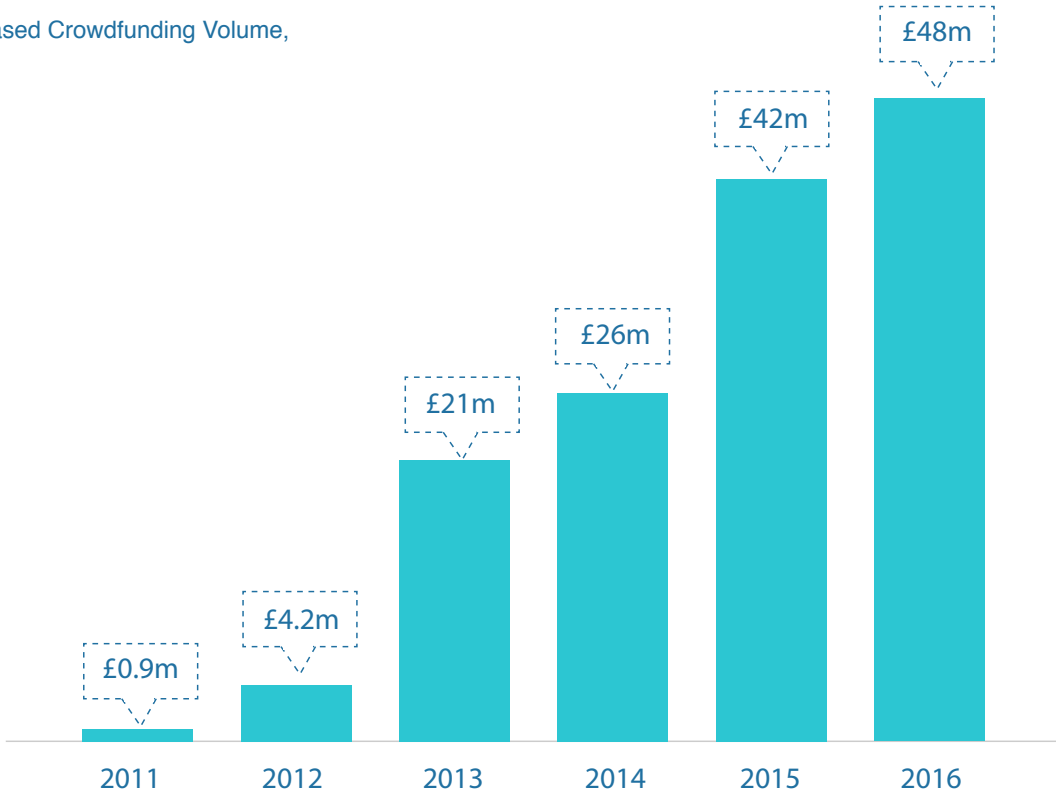
For all Donation-based funding, the regional location of funders and fundraisers were predominantly in London – followed by the North West and the South East respectively.

Figure 83: Total UK Donation-based Crowdfunding Volume, 2013-2016 (£ million)



REWARD-BASED CROWDFUNDING

Figure 82: Total UK Rewards-based Crowdfunding Volume, 2011-2016 (£ million)



In 2016 Reward-based crowdfunding accounted for £48 million, a 14% increase from 2015. From 2011 to 2013, Reward-based crowdfunding increased at triple digit rates. However, while the model continues to grow, it is doing so at a considerably slower rate, by 24% in 2014 and 62% in 2015

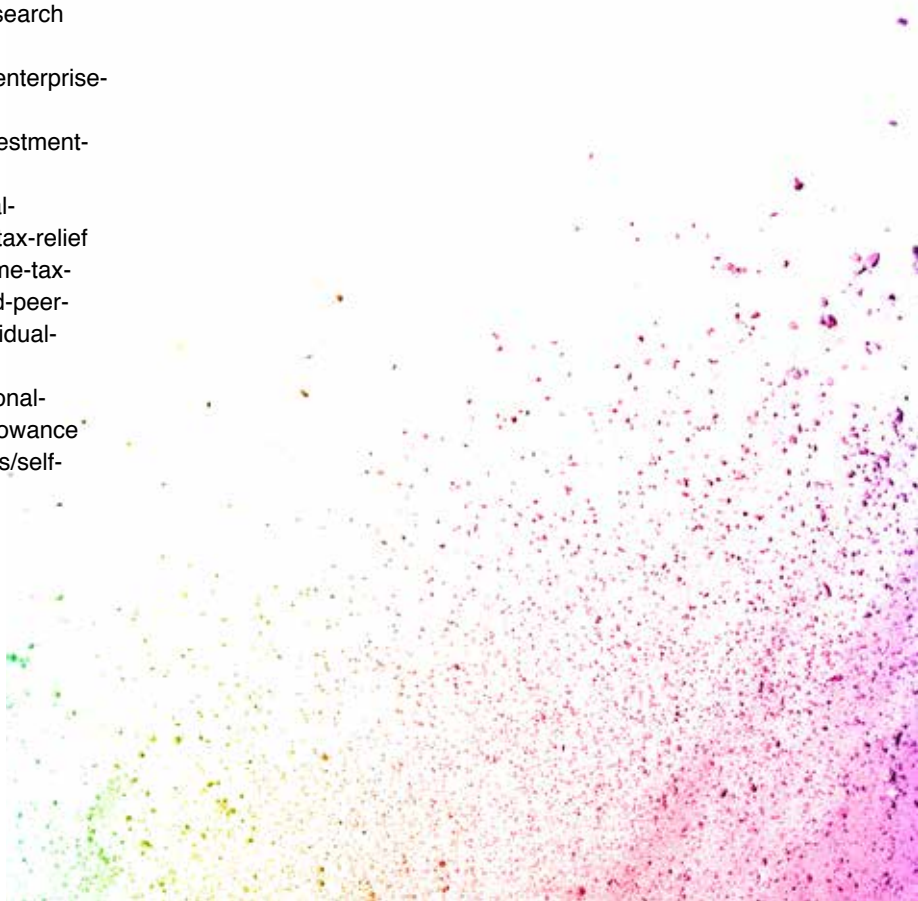
The successful funding rate has increased in 2016 – from 34% in 2015 to 42% in 2016. The average deal size for 2016 was £11,800. For each funding campaign, the average number of investors has decreased – from 326 in 2015 to 228 in 2016.

For all Reward-based funding, the regional location of funders and fundraisers were predominantly in London – followed by the South East and the South West respectively.

ENDNOTES

1. FSB data 2016 https://www.fsb.org.uk/media-centre/small-business-statistics
2. Business volume is derived from the applicable volume from P2P Lending, Invoice Trading, Debt-based Securities, Equity-based Crowdfunding, Real Estate Crowdfunding and Reward-based and Donation-based Crowdfunding. In the case of web-scrapped data, 35% of reward-based crowdfunding was attributed to Business funding.
3. Total Venture Capital includes VC funding to seed, start-up and early and later stage firms.
4. It should be noted that there exists some discrepancy in how the BoE and BBA define an SME, and a small business. The BBA makes the following distinction based on business turnover where the small-sized business segmentation for SMEs is up to £1m/£2m and the medium-sized business segmentation is up to £25m. For the purpose of this paper, we will adopt the BBA definition.
5. https://www.bba.org.uk/news/statistics/sme-statistics/
6. The CCAF estimates that 90% of P2P Business Lending borrowers pertain to the Small Business category. Participants came from the following six models.
7. Loan-based crowdfunding:
   - Peer-to-Peer Consumer Lending
   - Peer-to-Peer Business Lending
   - Peer-to-Peer Property Lending

   Investment-based crowdfunding:
   - Debt-Based Securities
   - Equity-Based Crowdfunding
   - Real Estate Crowdfunding
8. The UK tracking survey gathered data from UK alternative finance platforms over the course of 2017 gathering data on market activity in 2016.
9. The data on funders was broadly taken from a research survey of UK alternative finance funders.
10. https://www.gov.uk/government/publications/the-enterprise-investment-scheme-introduction
11. https://www.gov.uk/guidance/seed-enterprise-investment-scheme-background
12. https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet/social-investment-tax-relief
13. https://www.gov.uk/government/publications/income-tax-innovative-finance-individual-savings-account-and-peer-to-peer-loans/income-tax-innovative-finance-individual-savings-account-and-peer-to-peer-loans
14. https://www.gov.uk/government/publications/personal-savings-allowance-factsheet/personal-savings-allowance
15. https://www.moneyadviceservice.org.uk/en/articles/self-invested-personal-pensions
16. Default is defined as failure of payment beyond 90 days.
17. In contrast to the orthodox P2P Lending model, in an entirely balance sheet driven model (Balance Sheet Lending) the platform originates the loan (not matching retail or institutional funds to complete funding) and therefore assume the credit risk asso¬ciated with these loans. They operate with an intermediation model that is more akin to bank lending, by financ¬ing loans with equity and debt on their balance sheet and, like banks, periodi¬cally refinancing by securitizing pools of the loans they have funded. Retail investors or institutions function as a syndicate, funding the platform's dedicated balance sheet. Unlike regulated bank lenders, however, these balance sheet model platforms do not have access to deposits to facilitate their lending activity.
18. The following findings refer to the collected granular-level transaction data, representing approximately 80% of the existing UK P2P Business Lending landscape.
19. A substantial number of loan-use categories had very low proportions of total loan use and were not included in the analysis here.
20. For example via Self-Invested Personal Pension (SIPPs) -
21. Default is defined as failure of payment beyond 90 days.
22. At present, the data collected does not indicate the breakdown of products.
23. As indicated by participating platforms in the Industry-benchmark survey.



Cambridge Centre for Alternative Finance
10 Trumpington Street
Cambridge CB2 1QA
United Kingdom
Email: ccaf@jbs.cam.ac.uk
Tel: +44 (0)1223 339111