



# Alternative Finance in Australia

Private investment, disruption,  
fintechs & crowdfunding

# Executive summary

This paper looks at the current state of the Australian economy with regard to private company investment. It also highlights some of the future disruptive changes that are currently occurring in the financial services sector including both the introduction of alternative finance and the fintechs (financial technology). It will talk about the phenomenon of crowdfunding and what is happening in this sector around the world today.

Equitise and its partners together predict a significant shift in the way both equity and debt funding will occur in the short to mid-term in both the private company funding space and also the peer to peer lending space.

The purpose of this document is to educate key stakeholders whom we feel will be influenced by these changes. Equitise and its partners aim to discuss these changes in simple language and will elaborate on these findings with interested parties who wish to find out more about this very real form of digital disruption.

# Overview of Australian economy

## Introduction

The Australian economy is changing. Real GDP is low and slowing. Although relatively low compared with the rest of the world, our unemployment is hovering at its highest level since 2002 at 6.3% (ABS, Labour Force, Australia (February key figures), 2015). Although our terms of trade are 30% above 2004 levels, they have fallen around 25% since the 2011 peaks. Political uncertainty and regulatory scrutiny are also having a negative effect.

Much of this domestic challenge is the result of a lower appetite for our mining resources and subsequent decline in resource prices.

This contrasts with our savings pool ballooning out to more than \$2 trillion this year and continuing to grow with appreciation and inflows from superannuation.

Figure 1 Australian Terms of Trade

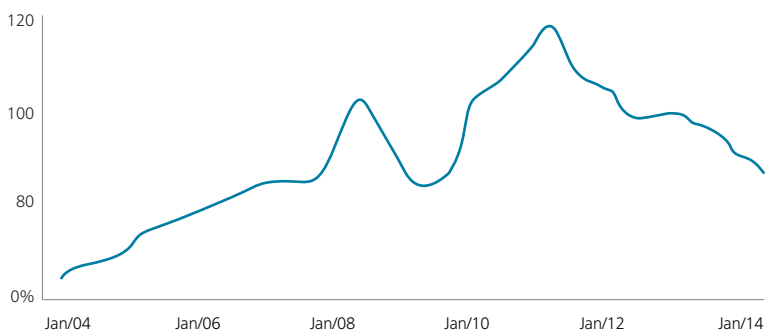


Figure 2 Australian Unemployment Rate



# Overview of Australian economy

## Public market snapshot

When considering the Australian investment market, the ASX is almost back to the all-time highs experienced prior to the Global Financial Crisis (GFC) and the Initial Public Offering (IPO) market is slowing off the back of a record 2014 year which saw 74 IPOs with a total market capitalisation of \$26bn (Deloitte, 2015, March).

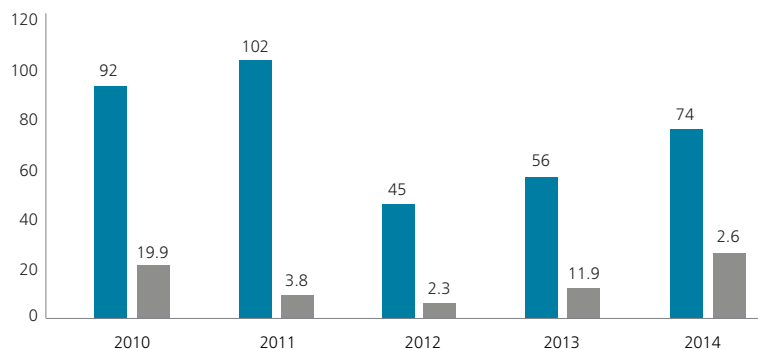
Deloitte Corporate Finance partner and Head of Transaction Services, Ian Turner recently stated that 2014 was a "strong one for public listings", however made the point that the underperformance of certain IPOs and the re-pricing of others toward the back end of last year does: "raise the question of whether the 2014 wave is sustainable". (Deloitte, 2015, March)

Finally, price to earnings (PE) ratios are also climbing in the Australian investment landscape. Taking into account this very brief analysis of the Australian public company market, we feel as though this asset class is beginning to look expensive and unattractive. Consistently strong yields and high PE ratios are quickly becoming a piece of ASX history – at least for the time being.

Figure 3 The ASX All Ordinaries Index (All Ordinaries - Australia)



Figure 4 Australian IPO Market (Deloitte, 2015, March)

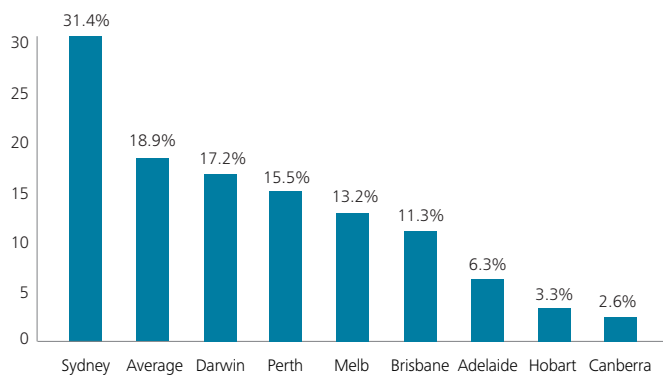


### Housing market snapshot

Australians are heavily invested in both the residential and commercial real estate markets.

Despite strong growth in the Australian housing market in recent years, many industry experts suggest this asset class is grossly over-valued. This is particularly evident in Sydney. House prices have climbed 30% over the past two years due to supply-side constraints. When you combine this with Australia's historically low interest rate environment, the global thematic of a search for yield is apparent.

Figure 5 Growth in Housing Prices Since 2011 (ABS, The Guardian)



# Overview of Australian economy

## Investor returns in Australia

Given the continued flow of funds into superannuation (which is subsequently driving our growing savings pool), we expect the market to continue to experience a problem achieving decent returns.

If you look at the composition of Self Managed Superannuation Funds in Australia, it is apparent that the reliance on ASX shares (31%), listed and non-listed trusts and funds (13%), cash and term deposits (28%), are all asset classes that are experiencing declining returns.

This means many Australians may have to be satisfied with lower returns or seek alternative places to invest. Peter Collins (Industry Super Australia Chairman) has said on record, that "super funds were forced to look offshore because of a lack of local investment opportunities."

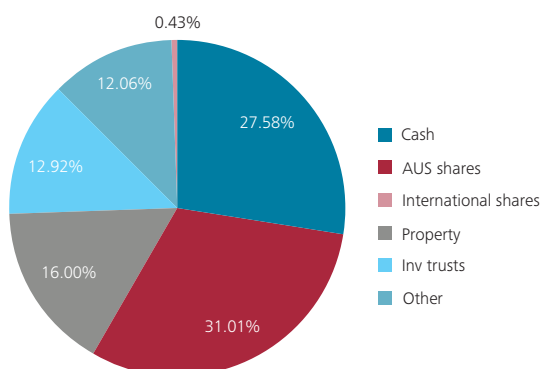
However, there are other approaches to steering these growing funds to the local economy to foster domestic growth and prevent the outflow of capital from Australia. For example, it is well documented that Small and Medium Enterprise (SME) and startups face several hurdles for obtaining capital. Deloitte Access Economics recently reported that:

10% of Australian SMEs (i.e. 200,000 businesses) have difficulty accessing expansion capital.

Further, an Australian Chamber of Commerce and Industry (ACCI) survey in mid-2013 reported that:

14.2% of small businesses and 11% of medium-size firms identified lack of finance as an obstacle to the growth and development of their businesses.

Figure 6 SMSF Asset Allocation (ATO, 2014)



<sup>1</sup>Investors Daily, see: <http://www.investordaily.com.au/superannuation/37074-super-funds-eye-overseas-property>  
<sup>2</sup>Wells Fargo, see: <https://accelerator.wellsfargo.com/>

# Private company funding

## Overview

The private business sector is the back-bone of the Australian economy. SMEs employ around seven million Australians (which is some 70% of total employment) and they make a significant contribution to the creation of new jobs. They also produce more than half a trillion dollars in output (almost 60% of private sector economic output), and make up almost 100% of innovative businesses with a spend of almost \$6 billion each year on research and development (R&D) (Deloitte Access Economics, 2013).

While the benefits of SMEs to the overall economy and innovation are evident, SMEs are experiencing extreme difficulty in accessing capital to expand their operations, to invest into R&D, and innovate their operations.

The issues around accessing capital include the perception of risk associated with SMEs and the illiquidity of shares.

## Funding options

This means that the capital choices currently available for private enterprise in Australia are limited.

The core areas are:

- **Banks:** through debt funding;
- **Venture Capital and angel funding:** through detailed due diligence processes.

The reality is that these avenues either have a low chance of success or come at significant cost of both money and time). Subsequently, funding rounds can be paralysing to the SMEs, with often little success in recapitalising their operations.

Moreover, the Australian Bureau of Statistics (ABS) reported that restrictions to capital are the most common barrier to innovation. Concerns were reported by 20% of businesses (around 400,000). Restrictions to capital are also the third largest barrier to general business activity. This is illustrated in Table 1.

*Table 1 Barriers to Innovation (ABS, Barriers to innovation)*

Barriers to Innovation	Percentage
Lack of Access to Additional Funds	19.9%
Cost of Development or Implementation	14.4%
Lack of Skilled Person in Any Location	17.8%
Lack of Access to Knowledge or Technology	4.2%
Government Regulations or Compliance	13.9%
Uncertain Demand for New Goods or Services	15.9%

# Private company funding

Prior to the GFC, credit was widely available and relatively cheap, although access for SMEs was scarce even then. Since the GFC, 'risk' has been repriced, and bank funding has been significantly restricted, to protect key stakeholders, and mitigate a reoccurrence of similar events. Credit conditions have tightened on both price and quantity. This is especially evident for smaller businesses as they can be especially vulnerable to the economic cycles.

Banks have now moved away from SME lending due to the increased costs of meeting revised prudential standards – Basel III (Deloitte Access Economics, 2013).

The goals of Basel III are to:

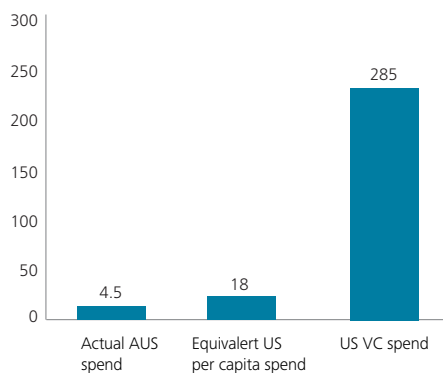
- Enhance the banking sector capability to manage economic stress.
- Enhance risk management and governance.
- Enhance bank's transparency and governance.

In essence, Basel III affects the bank capital requirement. The minimum capital adequacy ratio (CAR) increasing to 7%, is to be implemented in 2015 with an additional capital conservation buffer to be implemented in 2019 (Deloitte Access Economics, 2013). The Basel Committee are also in the process of developing significant changes to the Basel capital framework for banks this year.

Consequently, these requirements should continue to mean a reduction in the total loans issued, an increase in the cost of capital i.e. higher fees and rates, as well as credit distribution.

The NSW Business Chamber reported that 37% of loan rejections are due to lack of collateral and more than 40% of rejected applications were for amounts less than \$100,000, meaning that smaller businesses in particular find it very difficult to assess debt funding.

*Figure 7 Australia vs United States VC Spend (2003 - 2013)*





In terms of venture capital (VC) and angel funding, Australia's current level of VC activity is significantly lower than in other developed countries, which is hindering our innovation ecosystem. See Figure 7, where between 2003 and 2013 the United States invested US\$285 billion in VC funding (ABS, Venture Capital and Later Stage Private Equity, 2011-12), equal to four times more than Australia (per capita) which invested US\$4.5 billion over the same period of time (MoneyTree, 2013). This puts the Australian VC landscape in the bottom half of OECD (OECD Publishing (Paris), 2013).

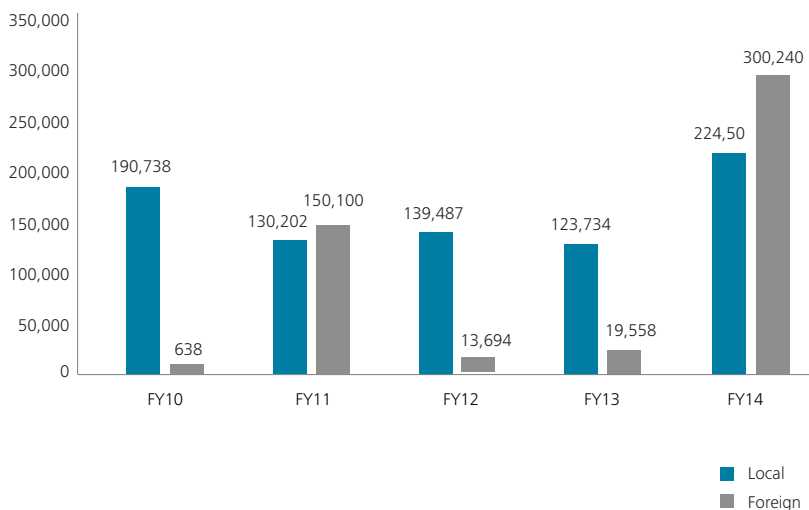
There are currently very few Series A deals funded by Australian VCs, and even fewer Series B/C investments. The driving catalyst of this situation is the sheer lack of scale in our local investment funds, resulting in successful Australian high growth businesses relocating their larger cornerstone funding rounds overseas.

A recent example of this is Campaign Monitor, which received \$US250m investment from US-based Insight Venture Partners in April 2014. This is the largest ever single VC investment in an Australian tech company (The Australian Business Review, 2014).

The level of local VC investment in Australia can be seen in Figure 8 where it is evident that spending from both local and international VC funds has increased significantly.

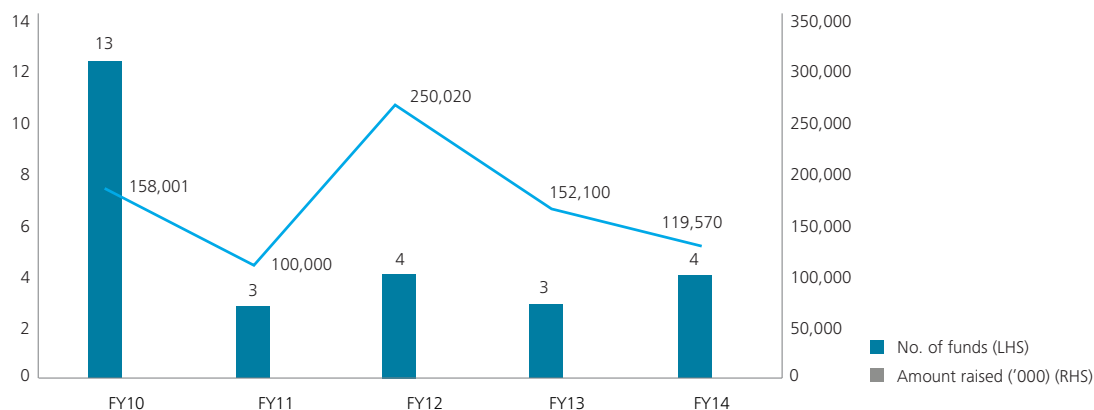
However, when considering the amount of capital being raised by VC funds, it is evident that this increased spending can not be sustained. An overview of the number of new funds in Australia and the corresponding amount of capital these funds have raised can be seen in Figure 9. What is immediately evident from looking at these figures is the large decline in total funds raised by VCs since 2012 from \$240m to \$120m in FY14. In addition to this, the average amount raised by individual funds had also decreased from \$60m in FY12, to \$51m in FY13 and \$30m in FY14.

Figure 8 VC Spend in Australia (FY10 - FY14) (AVCAL, 2014 Year Book, 2014)



# Private company funding

Figure 9 VC fundraising (FY10 - FY14) (AVCAL, 2014 Year Book, 2014)



To improve the local VC space, Australian VC funds need to have enough capital committed to support both initial Series A investments, and also 'follow on' in later funding rounds. Through increasing the capacity of funds, investment activity in this sector of the economy should also subsequently flourish, increasing the likelihood of investors achieving big VC wins as experienced in other global markets.

Australia's small sophisticated angel investor population (when compared to the larger markets around the world) means that we require the commitment of institutional capital to support the evolution of a sustainable VC industry.

Until recently Australian institutions have failed to get involved in the VC funding space. Institutional investors (such as superannuation funds) will typically need to see a track record before investing in VC funds. The catch is, by the time this validation presents itself, these larger institutions may have missed the boat and local businesses (such as Atlassian and Campaign Monitor) may well have completed funding rounds offshore.

It appears as though this vicious cycle where the VC industry was suffocated may be gradually on the mend, with the two new institutionally backed venture funds (Reinventure Group and Oxygen Ventures) launched in 2014, giving hope to the beginnings of a changing local early stage funding landscape.

Reinventure Group is backed by Westpac with a \$50 million VC fund. To date they have made three investments totalling \$10m (Sydney Morning Herald). Oxygen Ventures, a \$50 million VC fund, is lead by internet entrepreneur Larry Kestelman (AVCAL, 2014 Year Book, 2014). This fund has made five investments to date, one of which based in Silicon Valley, for an undisclosed consideration.

A strong VC environment isn't just imperative for supporting the local early stage funding ecosystem, it is also hugely important and beneficial to the Australian innovation, employment and research and development spectrums (AVCAL, The Economic Impact of VC in Australia, 2013).

The 2013 Research from AVCAL on the Economic Impact of VC in Australia suggests that:

- For every dollar of assets owned, VC backed companies innovate at a much greater rate than other companies.
- VC-backed firms make up only 0.01% of GDP, but 10% of all business R&D expenditure in Australia.
- In Australia, VC-backed companies spend on average 200x more on R&D per employee than other businesses.
- Successful VC-backed companies have strong job creation rates and attract highly skilled staff.
- Top VC-backed companies Cochlear, ResMed and SEEK alone employ nearly 7,000 people.
- VC-backed companies are IPO-ready in half the time needed by non-VC-backed companies.

# The Australian finance system

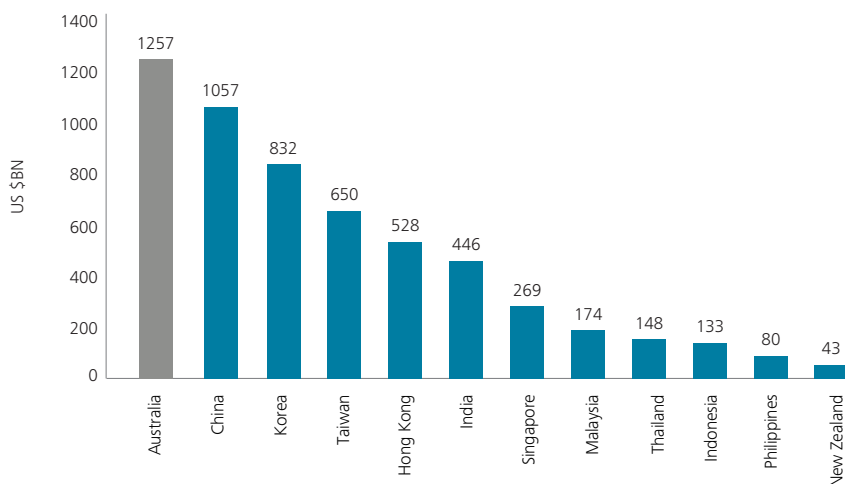
## Australia is in a strong position

In a post GFC market and under a Basel III regulatory environment, a bank's role in the global economy and its willingness to extend credit is changing. Despite this, Australia possesses an enviable position in the global financial markets. Our Big Four banks are underpinned by a robust and healthy system prudential regime that protected Australia from the GFC, and we've had 23 years of uninterrupted growth. When combined with our Superannuation and Funds Management industry, it is not surprising that our relatively small nation bats well above its average in the global stakes:

- The Australian Investment Pool is the third largest globally – refer to figure 11 (Investment Company Institute, Austrade, Q2 2014).
- ASX is the largest stock market (ex-Japan) in the region by free-float market capitalisation and the eighth largest in the world – refer to figure 10 (S&P indices, World by numbers, Aug 2014 (global rank in brackets)).
- Superannuation is continuing to grow, with 9.5% of income flowing in. This has also meant strong growth in SMSFs with some 545,000 funds with \$570bn in assets (ATO Stats).

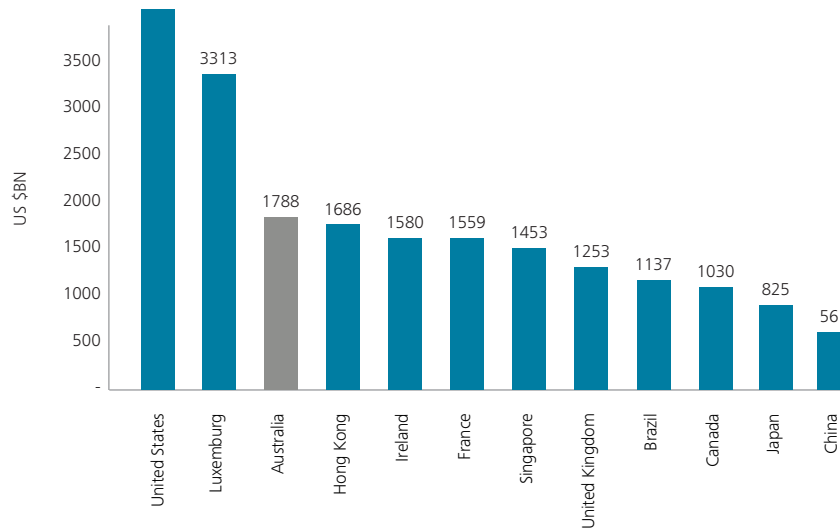
While this is the case, SMEs continue to find it difficult to access credit through the traditional finance network.

Figure 10 Size of Stock Markets in Asia-Pacific Region (ex-Japan) (S&P Indices , 2014, August)



# The Australian finance system

Figure 11 Global Investment Fund Assets (Investment Company Institute, Q2 2014)



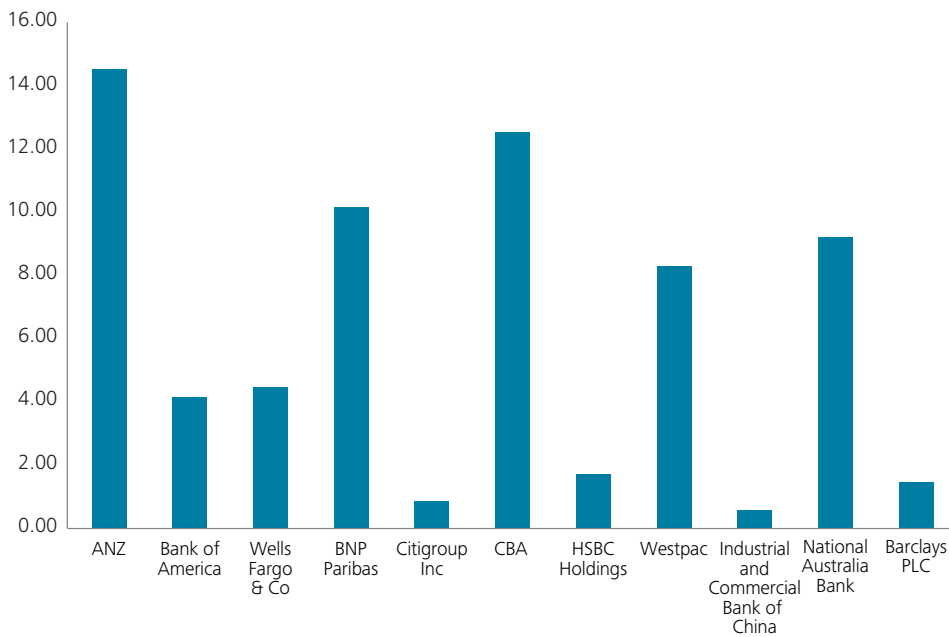
## The banking network structure

The Australian banks are recognised as being some of the most profitable in the world and this is in some part explained by the oligopoly they have, and control over the retail funds management industry. The strength of the big four banks is demonstrated in Figure 12 which depicts their market capitalisation per customer to their international peers.

The current network structure provides the big four banks defensibility against new entrants while competing with each other and innovating in similar 'copycat' methodologies. This structure creates complacency towards improving their technology innovation and customer centricity and tends to lock-in the status quo.

As a result, the competitive dynamics of the banking system are wide open for disruptive technologies. Furthermore, the current business models of the banking system that depend on quality of advice and on their own financial products i.e. owning the value chain, does not encourage ease of service and transparency. It can be seen from current consumer behaviour that consumers are shifting, if not already shifted, to e-commerce and digital technology.

Figure 12 Global Market Capitalisation per Customer (Adventure Capital, 2014)



### Asset management industry network

The Australian funds management space is largely unique as it has prospered over the last three decades as a result of compulsory superannuation. With the dominance of the big four banks and the industry superfunds, there has been strong growth in the industry. However Australian investors wear relatively high fees, some of the highest in the OECD countries.

The Murray Financial Systems Inquiry (FSI) noted that:

There is little evidence of strong fee-based competition in the superannuation sector, and operating costs and fees appear high by international standards, this indicates there is scope for greater efficiencies in the superannuation system.

The Australian funds management market is slowly changing. Competition is increasing and there has been an increase in flow of funds to Self-Managed Super Funds (SMSFs), with some 545,000 funds as at the end of 2014 - the highest number on record (ATO, 2014). This is largely due to the stock market volatility during the GFC as well as the 'Baby Boomers' increased interest in managing their own savings and the efficiencies and ability to access lower costs to establish and manage a fund, as well as the reduced costs to invest.

In 2015 innovation is apparent through automated investment advisers and fund managers like Stockspot (Australia's first) which utilises Exchange Traded Funds (ETFs) to create a diversified portfolio that is relevant to an investor's risk profile and objectives, delivered in a low cost, low fee structure known as Robo-Advice. This reflects the ways in which technology can be used to increase efficiency and drive down costs in the funds management industry.

These types of services are indicative of what the future might hold for the Australian investment market representing the growing trends in SMSFs and efficiencies in banking and funds management.

# Emergence of Fintech

## Fintech disruption

More than 80% of Australian business leaders believe innovation is the main driver of a competitive economy and the best way to improve our nation's productivity (General Electric, October 2013).

New technologies and the changes in consumer behaviour have put pressure on traditional business models, demanding rapid change from stakeholders to accommodate the new landscape. Fintechs (financial technology) are examples of this in the financial services space. They merge Information Communications Technology (ICT) with financial services. International financial hubs are leveraging the proximity between these two industry sectors to promote partnerships, producing efficient and tailored services to their customers.

There has been a global movement towards fintech investment. Examples include:

- The UK government has been one of the world leaders in embracing fintechs through producing different investment schemes, regulation reforms and overall collaborative support between innovative startups and the private sector.
- Banks including Wells Fargo in New York have also been accelerating collaborative efforts to partner with fintech startups and companies in Silicon Valley.
- Investment banks and investment management corporations, such as BlackRock, have been benefiting from the new technology by securitising Peer to Peer (P2P) loans.
- This has resulted in significant capital being invested in fintechs by some of the largest financial markets in the world. According to a KPMG report on fintech (KPMG, Unlocking the potential: the fintech opportunity in Sydney, 2014):
  - Silicon Valley has annual fintech investment of US\$1.5 billion
  - New York US\$600 million
  - London US\$66 million.

It is important for Australia to expedite its efforts in supporting new financial technologies to ensure it continues to remain a leader in the international financial hubs.

Sydney has been experiencing a modest growth in the fintech industry and is the capital of Australia in tech start-up activity with 950 businesses. There are three funds that invest directly in fintechs (AWI, Reinventure and Oxygen Venture), with limited support from established firms.

The main elements positioning Sydney as a dominant fintech hub in the Asia Pacific region are:

- Sydney is the capital of financial services in Australia, representing 42% of total national workforce in financial and insurance services.
- Sydney's financial services industry contributes \$57 billion to the state's economy and has the highest concentration of financial professionals throughout Australia (KPMG, 2014).
- NSW has the highest concentration of ICT workers in the country with almost 32% of total workforce, and the highest ICT annual university enrolments among the states (Australian Computer Science Society, 2013).

In March 2015, fintech start-up hub Stone and Chalk was launched in Sydney. The hub is a collaboration between the New South Wales government and other major players in the financial industry (22 in total) including AMP, Westpac, ANZ, Intel and KPMG. Stone and Chalk is a not-for-profit fintech hub with its goal to establish a world leading fintech industry (Stone & Chalk).

These developments combine to position the Sydney fintech environment as potentially the dominant force in Asia-Pac for the growth and progression of financial services.

<sup>2</sup>Wells Fargo, see: <https://accelerator.wellsfargo.com/>

<sup>3</sup>The Financial times, see: <http://www.ft.com/intl/cms/s/0/be8b6772-6365-11e4-9a79-00144feabd0.html#axzz3YUzJcGqU>

# Alternative finance

## Introduction

There is a growing movement afoot to revolutionise banking, investing and giving, by using technology to simplify the links between those who want to invest money and those who need it. Crowdfunding and peer-to-peer finance are at the vanguard of this movement. (NESTA Alternative Finance, 2014)

Technology, social media, internet and e-commerce, provide the opportunity for alternative finance to raise funds through the internet, reach a wider audience, and gain greater exposure and distribution than through traditional methods.

Given the interest in convenience and instant gratification, online payments services, cloud security and electronic identity verification providing simplicity and speed in the alternative finance space. With internet access and smart phone growth globally, alternative finance will continue to grow, especially crowdfunding.

## Crowdfunding explained

Jason Best and Sherwood Neiss, crowdfund capital advisors, co-authored the crowdfunding investing framework used in the JOBS Act to legalise securities-based crowdfunding in the United States and defined the term crowdfunding in its various formats as:

The pooling of the financial resources of many individuals to convert an idea into a project or business. Instead of relying on a few large donors, it requires many small ones. (DRESNER, 2014)

Further, the leading global research provider of crowdfunding statistics and research, Massolutions, defines crowdfunding as:

Any kind of capital formation where both funding needs and funding purposes are communicated broadly, via an open call, in a forum where the call can be evaluated by a large group of individuals, the crowd, generally taking place on the Internet.

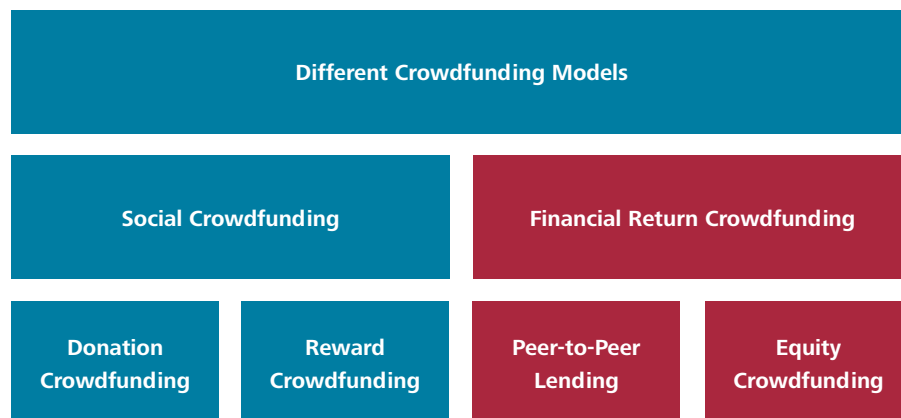
The Internet enables an issuer (project creator) to present a single pitch that can instantly access and be assessed by users all over the world. The flow of information across the Internet means that exponentially larger numbers of potential donors and investors can be reached through platform providers (intermediaries).

# Alternative finance

The evolution of crowdfunding:

- In 1876 the Statue of Liberty was financed through crowdfunding. The citizens of France paid for the statue and the citizens of the United States paid for the pedestal. In essence, crowdfunding converts everyday people, rich or poor, into micro angel investors to power ideas and business growth. (Dresner, 2014).
- The creation of social websites such as LinkedIn, My Space and Facebook are the foundation of the social web or WEB 2.0, where it is the norm for people to communicate, interact and share interests with friends through the internet.
- The social web has now built the foundation of crowdfunding or WEB 3.0, the evolution of the internet and social web applications that meet capital formation (Dresner, 2014).
- Debt, equity, rewards and donations are the main types of crowdfunding (see below). The donation's system laid the foundation for crowdfunding with the rewards based system emerging subsequently.
- The limitations to the legal framework recently hindered the growth of debt and equity crowdfunding. But these models are expected to grow significantly in the near future.

The two overarching types of crowdfunding are non-financial and financial. These differ primarily in the association of individuals' contributions to expectations of a financial return at some point in the future. (Massolution and Crowdsourcing.org, 2015)





### Crowdfunding growth

The crowdfunding market reached US\$16.2bn in 2014, reflecting a growth rate of 167% when compared with the previous year with its funding volume of US\$6.1m (Massolution and Crowdsourcing.org, 2015).

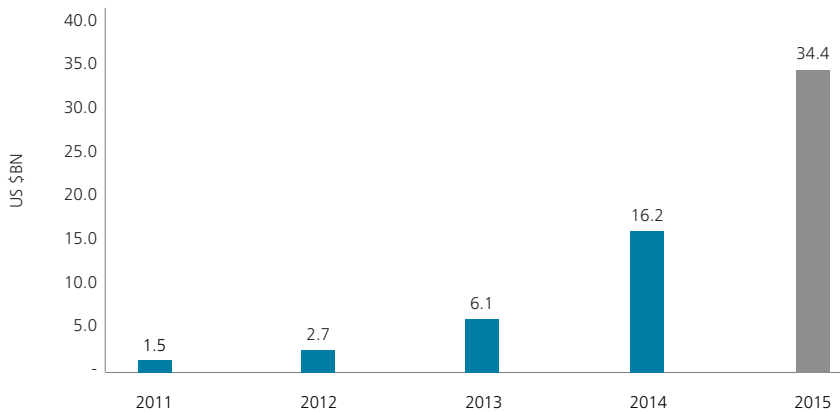
It is expected that this figure should be able to grow materially as the number of intermediaries offering crowdfunding services increases and the average size of the campaigns continues to grow.

Figure 13 illustrates the distribution of crowdfunding globally in 2014 and the expected market size by 2015.

The crowdfunding market is forecast to reach at least US\$34.4bn by the end of 2015 - an increase of 2,193% from the size of the industry just four years ago. Researchers predict that North America will remain the largest market in 2015, with Asia a close second. Further, it is expected the global lending platforms will reach a total market size of US\$25.1bn and equity platforms will turn over US\$2.6bn in 2015. (Massolution and Crowdsourcing.org, 2015)

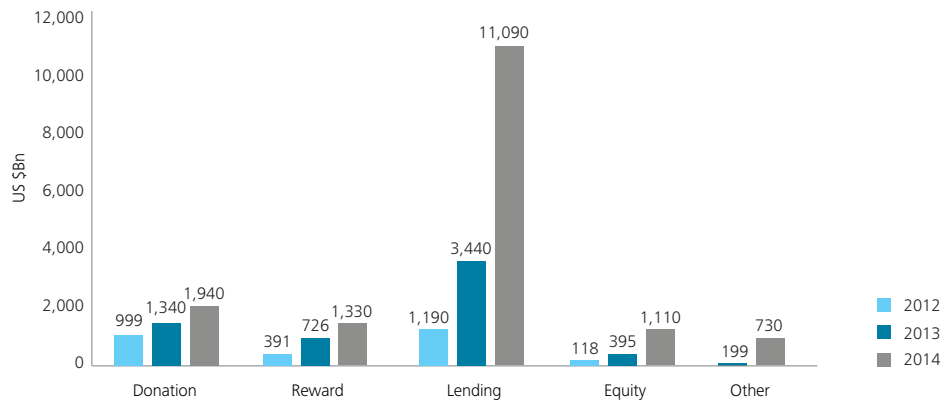
In 2014 lending based crowdfunding grew by 223% to reach a contribution of total worldwide crowdfunding of US\$11.1bn, representing 68% market share when compared to 57% in 2013. Over the same period equity based crowdfunding volume nearly tripled, with an annual growth rate of 182% to reach \$1.1bn.

Figure 13 The Global Distribution of Crowdfunding (overview)



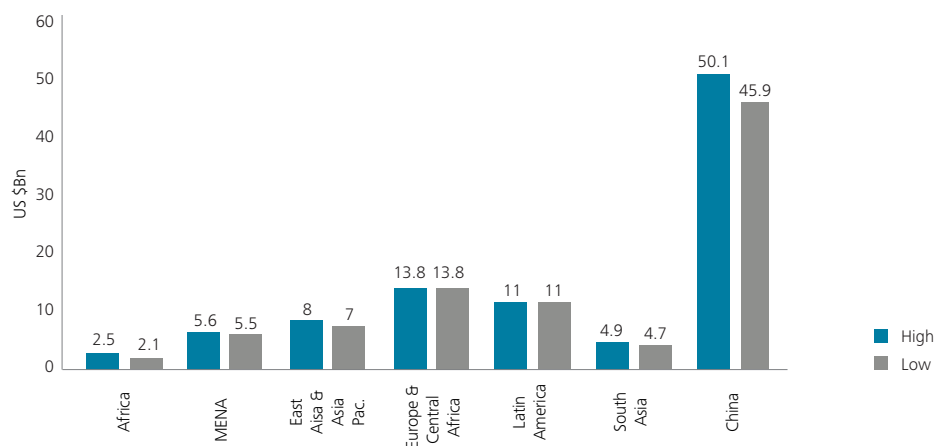
# Alternative finance

Figure 14 The Global Distribution of Crowdfunding (by type)



A recent study by CLSA, a Hong Kong based investment bank, estimated the total crowdfunding market size would reach US\$90 billion by 2025, with 51% coming from China.





Figure 15 Regional Crowdfunding Estimates in Emerging Economies



## The leading global players examples

See a snapshot of the leading players globally in the equity, debt, reward and donation crowdfunding categories.

Table 2 Leading Global Crowdfunding Players

Platform	Capital invested	Operations
	<ul style="list-style-type: none"> <li>– Raised: £5,000,000</li> <li>– Post money valuation: £19,500,780<sup>4</sup></li> <li>– Cornerstone investors: Balderton Capital, 'equity crowdfunding'<sup>5</sup></li> </ul>	<ul style="list-style-type: none"> <li>– Headquarters: UK</li> <li>– Founded: 2011<sup>6</sup></li> <li>– CrowdCube has raised successfully £67,485,030 for 207 businesses</li> <li>– 149,099 registered investors</li> <li>– 7 international partners.<sup>7</sup></li> </ul>
	<ul style="list-style-type: none"> <li>– Market Cap: US\$7.3bn</li> <li>– Listing valuation: US\$8.5bn<sup>8</sup></li> <li>– Cornerstone investors: Norwest Venture Partners, Canaan, Foundation Capital<sup>9</sup></li> </ul>	<ul style="list-style-type: none"> <li>– Headquarters: US</li> <li>– Founded: 2011<sup>10</sup></li> <li>– Issued loans of over US\$7.6bn since inception<sup>11</sup></li> <li>– Raised US\$900m in IPO on 10/12/14<sup>12</sup></li> </ul>
	<ul style="list-style-type: none"> <li>– Raised: \$10,000,000<sup>13</sup></li> <li>– Cornerstone investors: Union Square Ventures, Jack Dorsey, Zach Klein<sup>14</sup></li> </ul>	<ul style="list-style-type: none"> <li>– Headquarters: US</li> <li>– Founded: 2009<sup>15</sup></li> <li>– US\$500m to date</li> <li>– 3.3 million pledgers in 2014</li> <li>– US\$1,000 per minute invested</li> <li>– 80,028 successfully funded projects<sup>16</sup></li> </ul>
	<ul style="list-style-type: none"> <li>– N/A</li> </ul>	<ul style="list-style-type: none"> <li>– Headquarters: AUS</li> <li>– Founded: 2010</li> <li>– 57% success rate</li> <li>– US\$26m raised to date</li> <li>– 8210 projects launched<sup>17</sup></li> </ul>

<sup>4</sup>Crowdcube.com, see: <https://www.crowdcube.com/investment/crowdcube-limited-16278>

<sup>5</sup>Crunchbase, see: <https://www.crunchbase.com/organization/crowdcube>

<sup>6</sup>Crowdcube, see: [crowdcube.com](https://www.crowdcube.com)

<sup>7</sup>Crowdcube, see: <https://www.crowdcube.com/infographic>

<sup>8</sup>Bloomberg, see: <http://www.bloomberg.com/news/articles/2014-12-11/lendingclub-surges-in-debut-after-870-million-u-s-ipo>

<sup>9</sup>Crunchbase, see: <https://www.crunchbase.com/organization/lending-club/funding-rounds>

<sup>10</sup>Lendingclub, see: [lendingclub.com](https://www.lendingclub.com)

<sup>11</sup>Lending Club, see <https://www.lendingclub.com/info/statistics.action>. As of December 2014.

<sup>12</sup>Forbes, see: <http://www.forbes.com/sites/navathwal/2014/12/18/lendingclub-ondeck-ipo-billion-dollar-valuations-are-just-the-beginning-for-the-online-lending-market/>

<sup>13</sup>Allthingsd, see: <http://allthingsd.com/20110317/kickstarter-fesses-up-the-crowd-sourced-funding-startup-has-funding-too/>

<sup>14</sup>Crunchbase, see: <https://www.crunchbase.com/organization/kickstarter>

<sup>15</sup>Kickstarter, see: [Kickstarter.com](https://www.kickstarter.com)

<sup>16</sup>Kickstarter, see: <https://www.kickstarter.com/help/stats?ref=footer>

<sup>17</sup>Pozible, see: <http://www.pozible.com/about>

# Alternative finance

## Equity-based crowdfunding

Equity crowdfunding involves companies raising money by issuing equity, and enabling the crowd to become shareholders. Companies essentially sell shares for money to grow their business. It is predominantly used by start-ups and SMEs.

**Average campaign:**  
The average capital raising size in 2014 for equity based crowdfunding was US\$307,474 in the Oceania region.

**Average pay out:**  
The global average for equity crowdfunding 'pledged versus paid out' ratio sits at 75%.

### Key considerations:

- Financial returns: occur via dividends or a capital gain from the divestment of a business or listing.
- Diversification: investors should be able to more easily access the new asset class of private companies through online exchanges, and more easily and transparently diversify investment portfolios.
- Ownership structure: intermediaries providing private company exchange services largely operate under two share ownership models. The first being a nominee approach where the business holds the shares for the investors and represent the shareholder interests. The second approach enables investors to hold direct shares (either voting or non-voting rights) in the business.

- Investor accreditation: in some countries (including Australia), investors are required to be accredited to invest in equity crowdfunding opportunities (pending changes are imminent – refer to the section Regulatory Considerations for Crowdfunding section). In other countries (e.g. the UK and New Zealand), a framework for equity crowdfunding has been established by the regulators, and projects are completely open for the public to invest in much like a public market exchange.

### News and statistics:

- In August 2014 the Crowd Funding Institution of Australia was founded (CFIA). The CFIA aims to unify the voice of Australian Crowdfunders;
- FundersClub (a US platform for sophisticated investors) claims that an investor investing equally across all their partnership funds, would have an unrealised net Internal Rate of Return (IRR) of 104.8%;
- As of March 2015, US\$753,615,571 was the total amount of funds raised in equity-based crowdfunding (FundWisdom, 2014).
- According to Massolutions 2015CF – Crowdfunding Industry Report:
  - The average capital raising in 2014 for equity based crowdfunding was US\$175,000 in the United States.
  - The average capital raising in 2014 for equity based crowdfunding was US\$309,124 in Europe.
  - The average capital raising in 2014 for equity based crowdfunding was US\$342,260 in Asia.

## Debt-based crowdfunding

Also known as Peer-to-Peer lending, debt crowdfunding is where an individual or a company use a crowdfunding platform to borrow money from a group of people. As it has low overhead costs and removes the bank's margin, it is considered a better alternative to traditional bank loans. It is a faster, simpler process and borrowers do not need to provide a guarantee or security.

**Average campaign:**  
The average loan size in 2014 for business lending based crowdfunding was US\$103,618.

**Average pay out:**  
The global average for lending crowdfunding 'pledged versus paid out' ratio sits at 90%.

### Key considerations:

- Participation: open to the public.
- Financial returns: lenders receive interest payments and the principal.
- Diversification: lenders are able to create large portfolios consisting of hundreds of borrowers ranging from businesses to consumers.
- Lending Structure: three types of business models exist:
  - i) Client segregated account model: lenders bid on loans in an auction style. Lenders and borrowers are matched, loan money received, contract and legally segregated client account are formed.

- ii) Notary model: lenders bid on loans in an auction style. Lenders and borrowers are matched, loan money received and deposited in a bank, intermediary platform issues a note instead of a contract to the lender
- iii) Guaranteed return model: lenders invest money in an intermediary platform. Platform originates the loan, lenders receive a guaranteed rate of return on the investment.

### News and statistics:

- Data shows that default rates are less than 1% and there is less systematic risk as platforms do not create nor leverage money. The money is provided purely by the funders (CLSA, 2015).
- On average it takes 796 micro-transactions from individual lenders to finance one loan. Sixty three percent of business had profit growth with 53% increasing employment (Baeck, Collins, & Zhang, 2014).
- According to the UK Alternative Finance Industry Report, 91% of borrowers noted that P2P business lending is an easier way to get funded than the traditional methods.
- In 2014 Westpac bought a stake in the Australian online lending platform Society One for \$5m along with private investors including Justin Reizes, the Australian head of global private equity giant KKR (The Australian Financial Review, 2014).
- In February 2015 Society One raised more than \$10m in capital from Rupert Murdoch, James Packer and Kerry Stokes (The Australian Financial Review, 2015).
- In March 2015 Ratesetter raised \$10m in the Sydney based local business, taking a combined 20% equity stake which will put the valuation of Ratesetter Australia at \$50m (P2P Banking, 2015).
- The average loan size in 2014 for consumer lending based crowdfunding was US\$3,399.

# Alternative finance

## Rewards-based crowdfunding

The most popular model to date is rewards crowdfunding, where the contributors to businesses and causes receive a tangible nonfinancial return such as a CD, DVD or a T-shirt among other perks.

**Average campaign:**  
The average campaign size in 2014 for reward based crowdfunding was US\$3,189.

**Average pay out:**  
The global average for rewards crowdfunding 'pledged versus paid out' ratio sits at 82%.

### Key considerations:

- Model: Some platforms use an all-or-nothing funding model (Kickstarter). If the campaign does not reach its goal, the campaign is deemed as a failure and funders would not be charged. Other platforms use a 'take what is raised' model.
- Time of delivery: For successful campaigns, rewards may take considerable time to get to the end user (in some cases three months) due to lack of scalability in production and usually excessive demand for products (Esposti, 2014).
- Fraud: Surprisingly fraud is less than 1% in rewards based campaigns as mentioned in a study of 48,500 Kickstarter projects by the Wharton School of business in 2013 (David M. Freedman, 2015).

### News and statistics:

- Oculus Rift had a successful campaign in 2012 on Kickstarter where it was able to raise US\$2,437,429 - 975% above its target goal of US\$250,000 (Kickstarter, 2014). Oculus Rift was acquired by Facebook for US\$2bn in 2014 (The Guardian)
- One of the most recognised and publicised Kickstarter projects, was the Pebble E-Paper Watch. The campaign ended on May 18, 2012 and generated a total of US\$ 10,266,845- more than the original fund target of US\$ 100,000 (Kickstarter, 2014).

## Donations-based crowdfunding

Charitable organizations were collecting donations online long before the crowdfunding concept was established. This model is a non-financial return i.e. the contributors do not expect a financial gain from their contributions. These interactions establish a connection between the participants and the social cause they are supporting.

Donation based crowdfunding has become more popular recently allowing people to create very targeted campaigns. For example rather than the ubiquitous 'orphans in Africa' donations can be funnelled to e.g. a specific orphanage in a specific village in Tanzania.

**Average campaign:**  
The average campaign size in 2014 for donation based crowdfunding was US\$3,363.

**Average pay out:**  
The global average for donation crowdfunding 'pledged versus paid out' ratio sits at 85%.

# Regulatory considerations for equity crowdfunding

## Overview

Government policies are an integral tool in shaping the digital landscape and promoting the growth of the digital economy. This is particularly relevant when considering the financial services industry in Australia which does have 'legacy' regulation, some dated security processes and retains cumbersome protocols which in some cases are decades old.

Australia currently needs to design and implement strategies that will optimally support economic growth, productivity, innovation and employment, while also ensuring balance by mitigating core risks (Deloitte Access Economics, 2015).

**A strong policy framework will facilitate the growth of the digital economy and ensure it plays a role in providing employment, adding to productivity growth and generating consumer benefits. (Deloitte access economics, 2015)**

Currently, there remain some significant regulatory constraints on private companies that wish to participate in public fundraising. The options are tightly regulated, costly and burdensome.

A regulatory framework that accommodates equity crowdfunding within the Australian corporate landscape will have positive effects on the entrepreneurial industry and more broadly, the SME landscape by increasing the flow of funds from investors not currently available or easily able to invest in private companies.

## Current barriers in the Australian framework

Proprietary companies are capped at 50 non-employee shareholders:

1. With average shareholder numbers in international equity crowdfunding campaigns equalling 96 (CrowdValley, 2015) in the US and 104 (Crowdcube, 2015) in the UK, the current cap of 50 non-employee shareholders is a material restriction in the ability to encourage meaningful amounts of capital (CAMAC, 2014). This information is from limited historical data skewed towards sophisticated deals. We anticipate the average number will be much higher over time.

### Disclosure to Investors:

2. The current disclosure requirements imposed on private companies are costly, cumbersome and time consuming. Proprietary companies are prohibited under the Corporations Act from engaging in any activity that would require disclosure unless the offer is being only made to existing shareholders of the company and employees .

3. Proprietary companies are able to make offers which do not require disclosure under the s 708 exemption for small scale offerings. This restricts the issuer to making a transfer of securities to a maximum of 20 retail persons and raising no more than A\$2million in any 12-month period. .

4. A private company could also make an offer of securities for sale or issue to a sophisticated investor, which does not require disclosure. However, investors must meet high financial thresholds to be considered sophisticated.

These types of exemptions do not accommodate the type of fundraising facilitated by crowd-sourced equity funding models, which typically involve a retail class of investors.

# Regulatory considerations for equity crowdfunding

## So.... What is happening to change this?

The Corporations and Markets Advisory Committee (CAMAC) summarised the current state of play in its report to government in 2014 . On the back of these proposals the Australian Government has made significant progress towards a proposed system that should work for all key stakeholders, without being overly restrictive to limit innovation and growth.

Milestones since the CAMAC report release include:

- **October 2014:** The Government announced that it would consult on a potential regulatory framework for equity crowdfunding in Australia in its Industry Innovation and Competitiveness Agenda. .
- **December 2014:** The Government releases a discussion paper, inviting core stakeholders to respond to a series of questions pertaining to the rollout of equity crowdfunding legislation .
- **December 2014:** Special mention was made of the need to accommodate equity crowdfunding in The Financial System Inquiry chaired by David Murray. (Financial Systems Inquiry, 2014).
- **February 2015:** A series of round table discussions directly relating to the core elements of the proposed legislative changes. This was hosted by Bruce Bilson the Minister for Small Business.
- **February 2015:** The Minister for Small Business announced the Federal Government will be releasing the new model for equity crowdfunding in the Spring Session of Parliament.

If executed properly, in line with overseas market practice, the legislation will assist private businesses to have the best chance to use the opportunities that CSEF can offer, without dramatically increasing their costs or regulatory burdens. This will bring Australia up to date with other developed economies.

## Considerations of crowdfunding and potential risks

There are risks for investors in crowdfunding. However, its open and transparent nature when combined with the efficiencies of early stage markets equate to an effective and safe medium for pooling funds to achieve collective goals. Some of the risks include:

5. **Risky investments:** The inherent nature of investing in private companies. It can be risky as the securities are illiquid and there is significant reliance on the founders. There is also the potential loss of all funds.
6. **Fraud:** The director laws in both Australia and New Zealand provide significant protection and recourse for investors. Also the crowd has proven to be able to weed out fraudulent companies.
7. **Lack of education:** Both investors and entrepreneurs might not know exactly what they are getting involved in or the expectations of the other parties.

Equitise has built into its platform many measures and structures to mitigate as much risk as it can throughout the process. Remembering risk = reward!

<sup>18</sup>Corporations Act 2001 (Cth) s 113(3).

<sup>19</sup>Ibid s 708(1).

<sup>20</sup>Ibid s 708(8).

<sup>21</sup>Corporations and Markets Advisory Committee, Parliament of Australia, Crowd sourced Equity Funding Report (2014).

<sup>22</sup>The Treasury, see: <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Crowd-sourced-Equity-Funding>.

<sup>23</sup><http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Crowd-sourced-Equity-Funding>.

<sup>24</sup>Smart Company, see: <http://www.smartcompany.com.au/finance/45508-bruce-bilson-equity-crowdfunding-framework-will-be-on-the-table-by-spring.html>



# Conclusion

## In summary

Alternative finance and fintech is taking hold and the way in which technology is being utilised to invest and manage our assets is like never before. Australia is at the precipice of potential change and can be a part of a growing global phenomenon, we just need to act and capitalise on this opportunity before we are left behind.

Big multinational corporations are beginning to use crowdfunding to better connect with their end users. Companies like Dell, Chrysler, Nike, Coca-Cola and Honda have taken up crowdfinance and crowdsourcing to improve customer feedback and participation on a direct basis, rather than waiting for slow and less accurate commentary from layers of distribution. (Massolution and Crowdsourcing.org, 2015)

Large enterprises are now pursuing crowdfunding as a means to market test innovation portfolios and validate R&D outputs.

Venture investors are also becoming increasingly supportive of the crowdfunding model with funding into platforms exceeding well over US\$250m (Massolution and Crowdsourcing.org, 2015).

Crowdfunding has the potential to democratise capital and allow Australia to utilise its growing savings pool to help invest in the innovative high growth businesses that underpin our economy, creating growth and employment. Equity Crowdfunding specifically has the potential for this and Equitise is keen to be a part of this future.

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## About Equitise

We enable Aussie ([www.equitise.com.au](http://www.equitise.com.au)) and Kiwi ([www.equitise.co.nz](http://www.equitise.co.nz)) startups to raise capital in an intuitive, simple and social way.

Bringing investors and entrepreneurs together, the Equitise crowdfunding platform simplifies the investment marketplace. It removes traditional barriers to investing and sourcing capital by making the process quick, easy and safe.

In doing so, we help businesses to grow and thrive.

Equitise will be the first Australian platform to complete a crowdfunding campaign using retail and sophisticated investors (via New Zealand operation).

Specialties:

Crowdfunding, Equity crowdfunding, Capital raisings, Startups, Innovation, Venture capital, SME's, Investors, Private company

## Analysts & partners

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