Crowdfunding

The Scottish Perspective

Prepared by twintangibles for

GLASGOW CHAMBER OF COMMERCE

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Introduction

This report was commissioned by Glasgow Chamber of Commerce to examine the overarching scope and nature of crowdfunding, its key characteristics, and the levels of awareness, appetite for it and attitude towards it in Scotland. Glasgow Chamber of Commerce recognised the emerging phenomenon of crowdfunding and wished to examine its relevance to, and role in, the Scottish business community.

This report was produced in order to provide information on the current status and opportunities offered by crowdfunding in the context of the need for alternative finance for business. It is intended to offer both an overarching view of the practice of crowdfunding and specific insight into the Scottish experience, with particular reference to the levels of awareness of crowdfunding, how it is perceived and the appetite to make use of it.

The report is based on the findings of a literature review, extensive interviews with key contacts and the collection of survey data. The report includes content from all of these sources and its narrative is informed by the content of the interviews and analysis of the survey data. Further details of the methodology can be found in an appendix to this report.

Executive Summary

The financial crisis has resulted in a contraction in the availability of bank finance for business. This has profound implications for SMEs in the UK which rely heavily on bank finance. The Breedon Report estimated that the gap between supply and demand for SME finance in the UK is between £26 billion and £59 billion over a five year period.

56% of Scottish SMEs in our survey are actively seeking finance, predominantly for innovation and new product development, but are struggling to secure this. Does alternative finance provide some answer to this problem of constraint and if so, how well set is Scotland to take advantage of it?

Crowdfunding is one form of alternative finance that is becoming increasingly mentioned and this report sought to understand the Scottish perspective.

Crowdfunding is a rapidly emerging form of alternative business finance that raised US $2.7 billion globally in 2012, with a projected growth to US $5 billion in 2013. Crowdfunding is a method of raising money by collecting a large number of small investments together to form a significant sum, typically using the internet and social media. It is bringing a new group of investors into the finance market who bring with them both funds and new ideas and often different expectations of return than more traditional investors.

Whilst awareness of the term 'crowdfunding' is reasonably high, our research suggests that Scotland is not making full use of this opportunity, probably raising less than £1 million in 2012 when it could reasonably have been expected to create a £16 million fund.

NESTA estimates that the UK market was worth £200 million in 2012 and should grow to £300 million in 2013. Based on these figures, the Scottish economy, being c. 8% of the UK economy, could have created some £16 million worth of funds in 2012 and £24 million in 2013. Our research suggests that probably less than £1 million was raised in 2012 and, whilst the figure is growing, it is well short of the sums potentially available. In addition, no Scottish company has succeeded in running an equity based campaign on any of the main platforms. This is in spite of the fact that a Scottish company, Brewdog, is widely regarded as having been at the forefront of pioneering the concept of equity based crowdfunding in previous years.

The UK is an acknowledged leader in crowdfunding and operates all forms. These are:

- Reward – where a reward, typically a product or service, is offered in return for a pledge of money;
- Equity – where small parcels of non tradable shares are offered to the crowd in return for an investment;
- Peer 2 Peer (P2P) lending – a loan is made up of many small contributions and made available to a borrower;
- Donation based – where money is pledged for no specific tangible return.

The UK government is directly involved with crowdfunding and is using £30 million from the Business Finance Partnership to directly invest in companies through the P2P platforms Funding Circle and Zopa, meeting the first 20% of any eligible loan that manages to find the remaining 80% from other lenders on the platforms. We also found evidence that match funding bodies such as the West of Scotland Loans Fund are increasingly prepared to match against funds raised through crowdfunding.

Other civic bodies are also getting involved in crowdfunding, including Universities and Councils who see it as a highly effective mechanism of targeted investment with other beneficial outcomes.

Scottish SMEs seem to have a reasonably high level of at least basic awareness of the term crowdfunding, with some 76% of our survey having said they had heard of it. 54% said they would consider crowdfunding as a mechanism for raising finance but at present they do not appear to be using it.

The typical sums sought by Scottish firms in our survey were in the range £5,000 to £50,000. These sums are well within the commonly raised totals by crowdfunding campaigns in its various forms, and so it seems a well suited mechanism to provide funds for the market.

Scotland has only one active crowdfunding platform at present – BloomVC, a reward based platform – but there are at least two new Scottish platforms, ShareIn and Squareknot, due for imminent launch. That said, all UK platforms are open to Scottish firms.

There are no clearly defined causes for the apparent under-utilisation of crowdfunding in Scotland. We recommend that further work is undertaken to identify more clearly any factors underlying the apparent under-usage of crowdfunding in Scotland.

Whilst grant funding remains the most commonly sought finance option, some 54% of respondents said they would consider using crowdfunding as a financing scheme. When asked what might build their confidence to do this, our respondents suggested that more information, support and advice would build confidence to make greater use of crowdfunding.

We have found in the course of the research that crowdfunding does not enjoy universal approval with a small number of trenchant critics. That said, there was little appetite amongst the respondents to our survey for any additional regulatory steps to be put in place. Indeed, the regulators, whilst keeping a close eye on developments, are not as yet proposing any significant adjustment to existing framework. P2P lending will fall under the regulation of the Financial Conduct Authority (FCA) in 2014, a move lobbied for by the P2P platforms themselves. There seems to be an understanding that for crowdfunding to expand, the principle of low transaction costs on crowdfunding platforms needs to be maintained and that overburdensome regulation would put that at risk. A balance is therefore being sought between managing risk to investors and nurturing an emerging sector. The direct Government involvement in P2P lending through the Business Finance Partnership does seem to have created some level of confidence in the concept of crowdfunding as a valid and appropriate method of raising business finance.

Crowdfunding seems to have considerable possibilities to provide much needed investment to the Scottish business community being both a readily accessible route to organisations of many types, and one that seems to match many of the financial needs of SMEs, as captured in our survey.

In the interim, to encourage some additional take up of the opportunities provided we recommend that, where measures are taken, these should seek to build confidence and improve understanding of the opportunities, risks and fundamental principles that underpin crowdfunding. We recommend that this awareness and understanding is developed for all potential participants in the crowdfunding process including those seeking funds and investors, and that it is also developed in groups such as allied bodies and professions and, most importantly, in the governmental and public institutions responsible for shaping the environment within which crowdfunding operates.

Description and Definitions

Key Points

- Crowdfunding is a method of raising money from a distributed group of funders who provide a large number of small sums which form a significant sum when aggregated together.
- It has four main models – Reward, Donation, Equity and Peer to Peer (P2P) lending.
- It has become popular and viable with the growth and spread of social and internet technologies and the increasing acceptability of online transactions.
- It has clear philosophical and practical foundations.
- In common with other online-led developments, it allows new participants with novel expectations of return to become active in a sector they might otherwise not engage directly with, in this case funding.

Crowdfunding refers to a mechanism of raising money by appealing to a large group of people (a crowd) and collecting from them a large number of small contributions that, when aggregated together, becomes a usable sum. Whilst the principle is not new, its recent naming and explosive growth has been driven by the ubiquity of internet access and social technologies that extend the reach of crowdfunding campaigns, which rely on collective participation, to an ever-widening group of potential participants.

For the method to operate effectively at scale, the incremental transaction cost of collecting these small contributions must be low enough to make the process economically sustainable. To meet this need, service providers have sprung up to offer turnkey solutions for crowdfunding. These are typically referred to as "platforms". There are a growing number of platforms - more than 800 worldwide at the present time - and a select list of some of the currently larger and more popular platforms is provided in this report.

Financial contributors to a crowdfunding campaign can receive a range of returns for their money and, whilst the models are constantly evolving, we can typically categorise crowdfunding into four broad categories that are defined either by the type of return or by the nature of the transaction. They are:

Reward - In return for a contribution, a "reward" is redeemed by the contributor and provided by the party using crowdfunding to raise funds. The reward can be tangible or intangible but is typically a product or service.

Equity - In return for an investment, equity or some form of financial instrument is secured for the investor. In almost all cases these assets are non-tradable.

Peer 2 Peer (P2P) Lending - A redeemable loan that is brokered between a borrower and a "crowd" of lenders. The loan can be interest bearing or simply a commitment to return the lent sum at some future point. In some cases the individual loan parts can be traded between lenders. Typically the loan parts are "auctioned" with the borrower selecting the most preferential terms. Loans can be made to both individuals and to organisations.

Donation - Funds are collected for no return other than an existential one to the donating party.

In almost all cases, a crowdfunder sets a specific target they wish to raise and runs a campaign seek the funding usually over a defined period, the length of which can vary considerably.

Operating Models and Principles

Within the main crowdfunding categories, there is considerable variety of model and offer. Whilst we do not propose to describe all of the diverse propositions, it is useful to understand some of the more significant defining characteristics.

One of the most important distinctions is that between what are commonly known as the “Keep It All” and the “All or Nothing” models. In the “Keep It All” model, as the name suggests, the crowdfunding project owner receives and retains whatever funds are raised during a campaign, regardless of whether the target sum sought is reached or not. In the “All or Nothing” model, the crowdfunding project must reach its target sum in order to collect any of the pledged monies. In the event of the target not being reached, any pledged monies are either returned to the funders or pledges are not collected.

The equity models operate in a highly regulated arena and are currently only permissible or functioning in certain countries. The UK is regarded as a leader in this field with equity crowdfunding already taking place. Typically to satisfy the regulatory requirement and simplify what can otherwise be a costly process, equity platforms adopt one or a number of approaches. The platforms usually require a registration process, thereby both screening and seeking some self certification from potential investors before entry. Regulated activities are often managed by authorised third parties. The method of share allocation can be direct to investors, held by special purpose vehicles, through nominee or cooperative models. In the UK, two platforms, Crowdcube and Seedrs, are authorised to operate directly by the Financial Conduct Authority (FCA), the regulatory body.

In a P2P context, the major distinctions are: those that offer a return on investment and those that do not, and those that will loan to individual or consumer credit models and those that will loan to organisations - sometimes referred to as Peer to Business or P2B models. The P2P community has lobbied to be placed under a more heavily regulated environment to both reassure investors and to maintain standards in the marketplace. The FCA has made provisional recommendations as to the nature of a regulatory framework and the proposals are contained within the FCA publication 13/07. The proposal will see the P2P platforms fall under the regulatory umbrella of the FCA in April 2014.

The various models of crowdfunding do have prevailing characteristics and typical applicability. For example, the financial value of equity and P2P based projects are typically larger in target value than reward models. P2P based models are generally unsuitable for start-up businesses, as a start-up will lack the necessary credit rating required on most platforms. Reward based platforms are popular with creative and product based organisations, and donation models will see a higher proportion of civic and social or charitable projects.

The philosophical underpinnings of crowdfunding include the notion of “the long tail” distribution popularised by Chris Anderson, author and editor-in-chief of Wired Magazine, which represented a break with many traditional notions of how it is profitable and possible to operate economically. To be sustainable, long tail models must have low incremental transaction costs so as to make use of micro transactions.

Similarly it is bound into the notion that, in common with other changes brought about by wide low cost and ubiquitous access to digital and collaborative technologies, crowdfunding allows barriers to participation to be lowered, and for people to “re-imagine” themselves into roles that were previously denied to them or were not accessible to them. In this context, crowdfunding allows people to become investors, contributors, advocates and activists in projects that would once have not been available. With this comes the notion that a more diverse set of participants will bring with them non-traditional ideas. In the context of crowdfunding, this includes novel expectations of return on investments and what, in more traditional financial markets might be considered “irrational” motivations.

These types of behaviours have been demonstrated through the work of people such as Professor Yochai Benkler, Professor of Entrepreneurial Legal Studies at Harvard Law School, but they have also led some to regard aspects of crowdfunding, particularly equity crowdfunding, as risky. The defence of crowdfunding against these allegations of excessive risk is to emphasise the typically small nature of the individual investments which of themselves should not expose the investor to excessive risk.

It is important to understand these philosophical and practical underpinnings of crowdfunding as it means that when considering its use, operation, regulation and possibilities, we need to reconsider the applicability of frameworks and assumptions that are applied in more traditional funding contexts.

The Background

Overview

The financial crisis of the past few years has resulted in a contraction in the availability of bank finance for business. This has profound implications for the UK and Scottish economies which have a heavy reliance on bank finance for business. This is particularly so in the SME sector which is a significant part of the Scottish economy. Efforts are being made to address this at a Governmental level, including an examination of alternative finance approaches to both introduce greater liquidity to the market in the short term and to produce a more diverse and robust business finance marketplace in the medium to long term. Crowdfunding is a rapidly emerging form of business finance that is already providing resources and has the potential to become an increasingly useful source of business finance. The UK Government has taken the step of directly entering the crowdfunding market by investing alongside others through P2P platforms.

Key Points

- The financial crisis of 2008 has limited the availability of bank finance to businesses.
- Bank lending dominates SME finance in the UK.
- The estimated gap between supply and demand for SME finance in the UK is between £26 billion and £59 billion over a five year period.
- Efforts have been made by the UK government to find ways of expanding the availability of finance and there is increasing interest in the role of alternative finance to bring greater diversity and liquidity into the business finance marketplace.
- This activity was bolstered and supported by reviews such as the recommendations within the Breedon Report.
- Crowdfunding is an important form of alternative finance that may have a role to play in addressing the finance gap.
- Crowdfunding raised $2.7 billion globally in 2012 and is predicted to grow to $5 billion in 2013.
- The majority of P2P lending currently is lent without expectation of interest on the loan, demonstrating novel motivations and expectation for participants when compared to traditional lending models.
- Whilst the US represents the largest part of the market, Europe and the UK in particular can boast the most diverse crowdfunding market place with all the main forms operating including equity based models, whereas the US is struggling to operationalise equity crowdfunding.
- The estimate of the value of UK funds raised through crowdfunding in 2012 is £200 million which, if in line with broader European growth predictions, could reach £300 million in 2013.
- The UK government has launched a policy initiative that has channelled funding worth £30 million from the Business Finance Partnership into P2P lending. As this is match-funding which requires the majority of any lending to be more than matched by other commercial lending, it has the potential to leverage this sum considerably.

The Emergence of Crowdfunding

The financial crisis of 2008 has had a profound impact on the availability of finance to businesses globally. In the UK, where business finance is particularly reliant on banks and with around 90% of bank business lending[1] being controlled by five main banks, the impact has been particularly marked. As a result of this crisis, a fertile debate has developed concerning the most effective approach to deal with the immediate issue of restoring the supply of capital, and to endeavour to find approaches that reduce the risk of a similar contraction in the availability of bank finance, should a crisis occur again.

Crowdfunding is the process of raising finance by an open call to a crowd (typically via the internet) to make large numbers of small contributions that are then collected into a larger sum. Whilst its origins predate the onset of the financial collapse, its significant growth has occurred since that event and it can be argued that it emerged as a response to that dearth of finance and as the required technical and behavioural toolsets that underpin its use became more commonplace. In particular, the penetration of high levels of online connectivity, social collaboration and the familiarity and acceptability of micro payments are all key elements in enabling crowdfunding. It now forms a significant part of what is commonly referred to as “alternative finance”.

The bottom-up development of crowdfunding is typical of the empowerment associated with many changes driven by the availability of internet. Crowdfunding has experienced considerable growth and whilst still in its early stages it has developed sufficient maturity, scale and visibility for some to now see it as both a sustainable source of finance with the potential to bring significant liquidity to the market by attracting in new investors. And perhaps more importantly, in a European context, it could form part of a package of measures that will readjust the reliance on bank lending to finance business, bringing about a more diverse and resilient model.

It was in this context that this report was commissioned by Glasgow Chamber of Commerce, to examine the overarching scope and nature of crowdfunding, its key characteristics, and the levels of awareness, appetite for it and attitude towards it in Scotland.

The Challenge Faced

The SME sector of business has been severely affected by the constraints in the availability of credit and this has significant implications for Scotland. According to the SME Access to Finance report in 2011, there were approximately 305,000 small and medium sized enterprises (SMEs) in Scotland, comprising 99% of all businesses[2]. These businesses are central to the Scottish economy, accounting for 54% of private sector employment and 37% of output and a constraint on their establishment and growth is cause for concern.

1 Beyond the Banks Innovative ways to finance Britain’s small businesses NESTA P7

2 SME Access to Finance 2012 Office of the Chief Economic Adviser June 2012

A number of specific UK Government actions and interventions have sought to address the constraint in supply of finance to business including Project Merlin, Funding for Lending and the Business Finance Partnership (BFP). Of particular relevance to crowdfunding, the BFP is a £1.2 billion investment fund aimed directly at increasing lending to small to medium sized enterprises from sources other than banks. A matched funding project, it provides liquidity but requires others to co-invest and does not invest more than 50% of any loan and does so on full commercial terms. With two strands of work, one through fund managers and a second routed through non-traditional lenders, it is within this context that two P2P platforms have received an initial £30 million investment - £20 million to Funding Circle and £10 million to Zopa. In addition, reviews and recommendation schemes like the Breedon Report[3] have been commissioned in order to better understand the underlying issues constraining access to finance, to potentially identify alternatives and to, in the Report's own words, "Boost finance options for business".

Despite these efforts, the results are mixed. The FSB Small Business Index[4] suggests that 71.4% of businesses describe their perceptions of credit availability as either "poor" or "very poor". The SME Finance Monitor[5] tells us that 51% of all first time applicants for a loan or overdraft ended the process with no facility, compared to 21% of those applying for a new or renewed facility (but not their first) and 8% of those renewing an existing facility. Their surveys also suggest that overall 34% of their interviewees reported that their loan applications ended with no facility offered.

Eurostat figures also indicate that the UK has one of the highest SME loan rejection rates for the European area[6].

In sum, this presents a challenging set of circumstances as the predictions offered in the Breedon Report indicate a potential gap between the demand and supply of business finance in the five years to 2017 being between c£84bn and c£191bn, of which between £26bn and £59bn is estimated to relate to smaller businesses.

We now examine how and where crowdfunding could fit into this context.

The Size of the Market and Growth Patterns

The rapid growth of crowdfunding, its diverse and dispersed nature and its relatively recent emergence mean that there are few sources of comprehensive data about the industry. Whilst figures can vary markedly, particularly where predictions of growth are concerned, what is undeniable is that the sector is growing very rapidly. At least 800 platforms are currently operating[7] around the world with the most recent global survey suggesting that the industry raised $2.7 billion in 2012, an 81% growth rate over the previous year.

3 Boosting Finance Options For Business (Breedon Recommendations)

4 The FSB Small Business Index Q1 2013

5 SME Finance Monitor Q4 2012 Full Report - BDRC

6 epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics

7 The Crowdfunding Industry Report 2013 - Massolutions

Whilst growth predictions vary significantly, all agree that there will be continued growth. By way of example, Deloitte predicts that crowdfunding will raise US$3 billion in 2013[8], whereas the Massolutions prediction is for a US$5 billion total[9].

Whilst North America accounts for the largest proportion of the sum raised through crowdfunding, European campaigns account for nearly US$1billion[10] of the 2012 total and are active across all of the forms of crowdfunding, leading particularly in the equity based models.

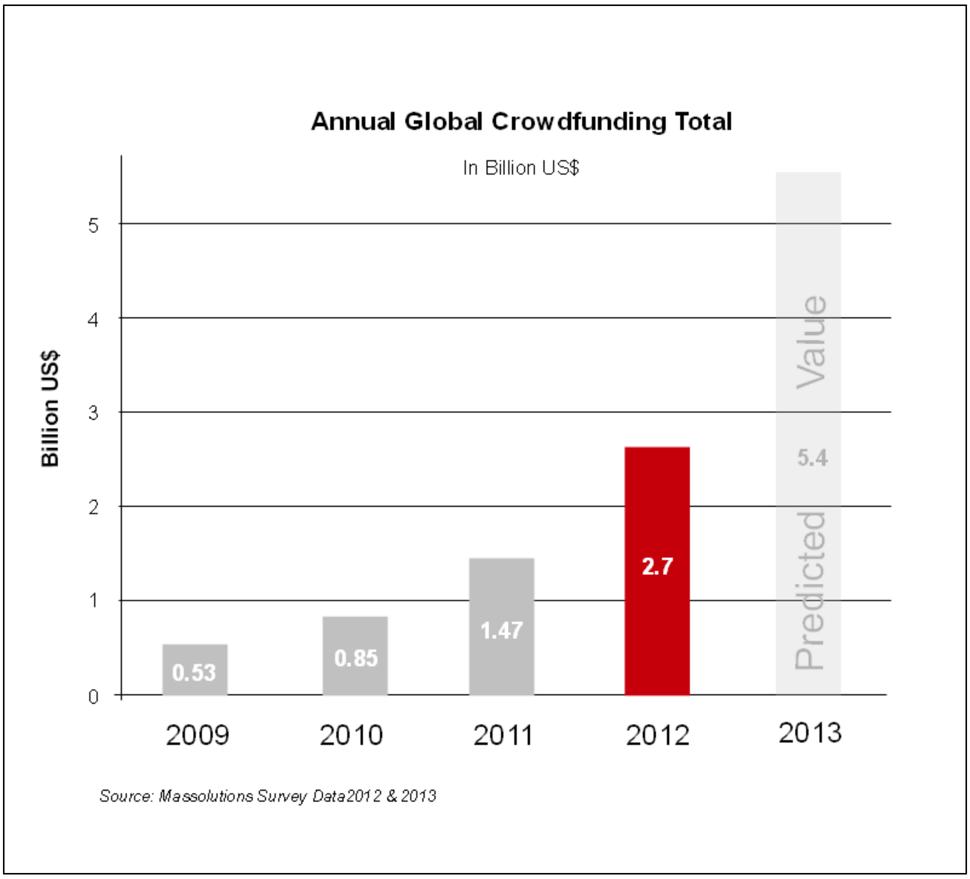

Figure 1 Annual Global Crowdfunding Total

The 2012 total of US$ 2.7billion can be broken down into the main types of crowdfunding, shown in Figure 2, below. The reward based model does perhaps attract the majority of attention in the media but it is worth noting, however, that the greatest sums raised in crowdfunding globally are found in the Peer to Peer (P2P) lending sector, accounting for $1.2billion globally in 2012.

8 Technology, Media & Telecommunications Prediction 2013, Deloitte P16

9 The Crowdfunding Industry Report 2013 - Massolutions

10 The Crowdfunding Industry Report 2013 - Massolutions

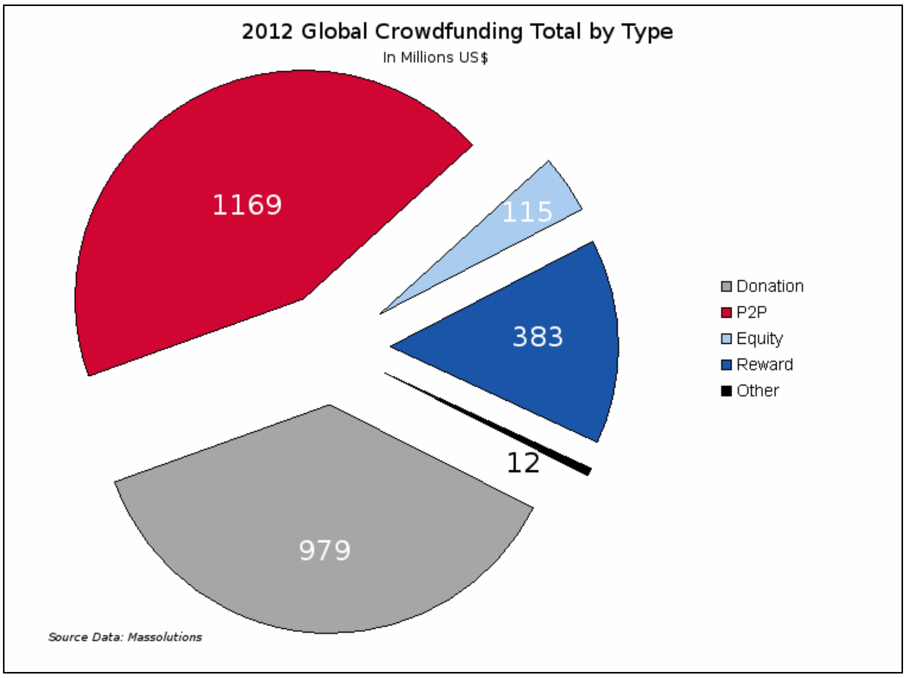

Figure 2 2012 Global Crowdfunding Total by Type

It would be simple to suggest that this success is the result of a coming together of an established credit demand and a ready supply of small individual investors looking for better returns, but this would be to misunderstand the dynamics of this market. In keeping with the notion that crowdfunding attracts a group of investors, many of whom have unconventional or non-traditional expectations of return to the traditional financial market, the larger part of P2P lending is made with no profit expected or given, simply a return of the capital sum.

One of the key motivations for those seeking funding via P2P platforms is the speed of the process of potentially securing funds, in comparison with what were often described in our conversations with participants as “bureaucratic” and “slow” alternatives.

The UK Position

Overview

The UK plays a leading role in crowdfunding, not least because all forms of crowdfunding operate in the country, including the equity based models and P2P models which are prohibited in some other countries. The UK government has been proactive in entering the crowdfunding market through its investment in P2P lending via the Business Finance Partnership and this sector will fall under the regulatory remit of the Financial Conduct Authority (FCA) in 2014. Estimates put the value of the UK crowdfunding sector at £200 million in 2012, with potential growth to £300 million in 2013.

Key points

- The UK has a diverse crowdfunding sector with all major types of crowdfunding taking place and many novel, niche and hybrid platforms emerging.
- The UK government has launched a policy initiative that has channelled funding worth £30 million from the Business Finance partnership into P2P lending.
- The market is estimated to have raised £200 million in 2012.

The Market

The UK enjoys a strong position in crowdfunding from the perspective that it operates platforms in all the four main types of crowdfunding.

NESTA has estimated that £200 million was raised through crowdfunding in 2012 and predicts ongoing growth[11]. If we accept the Massolutions Report prediction of European growth[12] rate, we could expect the figure to reach c. £300 million for 2013.

In our conversations with crowdfunders, they regularly point to its "lack of bureaucracy", its accessibility as a method of financing and, particularly, the speed with which they can access funding as reasons for its attractiveness. Speed was often emphasised by those advocating the P2P approach, where it is possible for funding to be made available within 14 days of an initial application to a P2P platform. In many cases, we found that those using crowdfunding had neither sought finance via their bank, believing that it would not be available, nor considered other methods of funding.

Equity

In a global context, the UK has a strong reputation in equity crowdfunding in that two platforms, namely Seedrs and Crowdcube, have received approval from the regulatory body, the Financial Conduct Authority, without any legislative changes being necessary. These platforms have found a mechanism of satisfying the regulators within the existing frameworks, whereas elsewhere, equity based crowdfunding is usually deemed illegal and outlawed, or requires specific legal frameworks to be enacted to permit it to take place. One platform, Crowdcube,

11 Working the Crowd Peter Baeck and Liam Collins NESTA p.3

12 The Crowdfunding Industry Report 2013 - Massolutions

has already begun to explore opportunities to operate outside the UK with interests in Sweden and a recently declared intent to open in Canada.

Between them, these two platforms have funded more than 60 businesses and raised more than £9 Million over a two year period from 2011.

Other UK equity and hybrid[13] platforms operate and more are close to launch, presenting a vibrant and diverse offering in this sector in comparison to many other countries.

This relative strength in equity based crowdfunding in the UK is particularly interesting given the historically low uptake of equity as a finance option amongst UK SMEs, with only 3% using equity finance[14].

Peer 2 Peer

In the P2P sector, the UK is again a significant innovator and enjoys the presence of numerous platforms.

NESTA recently released research suggesting that, based on certain assumptions, the P2P business lending model alone could achieve a £12 billion PA investment fund[15]. More recent research from rebuildingsociety.com, a P2P business lending site, shows that 17% of businesses (or up to eight million people) would currently consider P2P lending over the next 12 months, and that 16% of small businesses would consider applying for a P2P loan over the next year[16].

It is also in this area that we see direct intervention and activity in the crowdfunding market from Governmental and civic bodies. P2P lending can be consumer lending - that is to say to an individual who in a business context could be a sole trader - and a model that includes lending to a commercial organisation, sometimes referred to as Peer to Business (P2B) lending.

It is in this context that direct intervention by the UK Government is taking place with an injection of £30 million from the Business Finance Partnership through the Department of Business Innovation and Skills and made available through Funding Circle, a business lending platform who have received £20 million, and Zopa, a consumer lending platform who have received £10 million.

Other civic and public bodies are also engaging through P2P platforms, including examples like Lancashire County Council and Huddersfield University.

Whilst the specifics of each intervention model vary, typically these funds will support a limited percentage of any particular loan requests on a platform as long as it falls within certain criteria. By way of example, the Department of Business Information and Skills' approach on the Funding Circle platform is to meet 20% of a loan request of between £5,000 and £500,000 from a business with a turnover

13 A hybrid platform uses a mix of the crowdfunding models – for example reward and donation

14 Small Firms in the Credit Crisis: Evidence from the UK Survey of SME Finances

15 Banking on Each Other - Peer–to–peer lending to business: Evidence from Funding Circle – NESTA p.3

16 Research from ebuildingsociety.com

of less than £75million, that is UK-headquartered and that does not fall within certain sectoral constraints. The remaining 80% of the loan must be met by other lenders who bid sums at interest rates of their choice. The interest applied to the 20% provided by the Government investment is set at an average achieved after the auction closes so as not to distort the market place.

Motivations and logic for bodies to participate in this way include the ability to achieve highly targeted and rapid investment by both location and sector, the added liquidity it brings to the marketplace, and as a mechanism of leveraging available funds. There are other perceived potential benefits that include the platform operating as a filter to identify opportunities for interventions other than simply finance, and as a means of finding value added partnerships.

Whilst the Department of Business Innovation and Skills would not suggest their participation was an overt endorsement of P2P schemes, we have found through the conversations and interviews conducted in the production of this report that many outside of Government see it as a tacit approval and, as such, a confidence boost for them to participate. It is also worth noting that this type of Government intervention was suggested under the Breedon Recommendations. Other suggestions have included tax efficient investment vehicles to encourage others to engage in lending through P2P platforms.

Reward

Reward based platforms operate widely in the UK and received a considerable boost in visibility when Kickstarter opened a UK arm in 2012, making it easier for organisations to make use of that platform without a US settlement mechanism.

Multiple reward based platforms exist, each with specific and distinctive characteristics in model and focus. Increasingly, platforms seek to differentiate themselves through subtle differences of model and this presents the potential crowdfunder with what could be described as a bewildering and complex range of options to consider when choosing a platform. Four of the many diverse sites in the UK reward based sector are highlighted below:

- The sole Scottish reward based crowdfunding platform is BloomVC;
- Platforms such as Sponsume are distinctive for their international perspective and multiple currency support;
- Peoplefund.it, a platform associated with the Hugh Fearnley-Whittingstal River Cottage group, has a community focus, and has launched an interesting regional development scheme for Cornwall;
- Unbound is a reward based site focused on enabling publishing.

The Scottish Perspective

Overview

Scottish SMEs are seeking finance and struggling to do so, in keeping with the experience of the rest of the UK. Our survey suggests that £5,000 to £50,000 is the most common range of sum sought, with a median sum of £55,000 across the whole survey. Typically this funding is for innovation and product development.

However, Scotland is underutilising crowdfunding as a source of finance for business when considered as a proportion of the UK economy. With £200 million raised through crowdfunding in 2012 across the UK, we should expect to see c. £16 million raised in Scotland. Our research would suggest that the actual figure is probably less than £1 million for the same period and there are no examples of a successful equity based crowdfund on any of the major platforms. Awareness of crowdfunding is comparatively high and the appetite for using crowdfunding seems to be present, but this is not converting into activity.

Key Points

- Scotland is significantly under-utilising crowdfunding as a proportion of the UK total raised.
- Scotland is home to an early advocate and success story of the principle of equity based crowdfunding in Brewdog.
- 56% of the firms in our survey say they are currently seeking finance.
- The finance sought was principally for innovation and new product development.
- The most commonly sought sums were in the £5,000 to £50,000 range, and across all respondents the mean value was £55,000.
- 76% of respondents had heard of crowdfunding with the reward based model being the most recognised form.
- The typical sums raised by the various forms of crowdfunding would adequately service the types of sum sought by survey respondents.
- 54% of respondents said they would consider using crowdfunding as a means of raising finance for their business.

Professor Colin Mason of the Adam Smith Business School – University of Glasgow – has suggested that crowdfunding and alternative finance has a role to play in the financing of Scottish business, particularly so post the financial crash[17].

Our research suggests that there is ongoing demand for business finance amongst our survey respondents, and that the typical sums required do fall within those available across crowdfunding platforms. There is also a general level of awareness and willingness to investigate crowdfunding as a mechanism to raise funds, with many existing funding bodies becoming increasingly interested in investing alongside funds derived from crowdfunding.

17 The Risk Capital Market in Scotland 2009 – 2011 p.28

However, our research indicates that at present, Scottish businesses do not seem to be making significant use of crowdfunding. This is despite the fact that Scotland has played an interesting and important role in the development of crowdfunding. The two Brewdog share issues[18] are regarded as seminal moments in the development of the equity based crowdfunding model. Whilst Brewdog rightly receives much credit for its visionary approach, it is in many ways an atypical example, in that it did not utilise a platform – none were available at the time – and was as a result very costly to administer. As such, it was out of step with the fundamental proposition of crowdfunding and the typical models in use now. Despite this, it is widely recognised as having led the way in demonstrating the possibilities of equity crowdfunding and, at the time of producing the report, Brewdog are launching a third round of crowdfunding.

We will now examine in more detail these specific observations.

Demand for Finance

To set the role that crowdfunding might play within the context of a specific demand, part of our survey work sought to establish the typical financial requirements of respondents.

56% of our respondents told us that they were currently seeking some form of funding and that the most common purpose for that funding was for innovation or the introduction of a new product.

18 Brewdog is a Scottish brewery that has successfully completed two rounds of equity based crowdfunding, termed “Equity for Punks”.

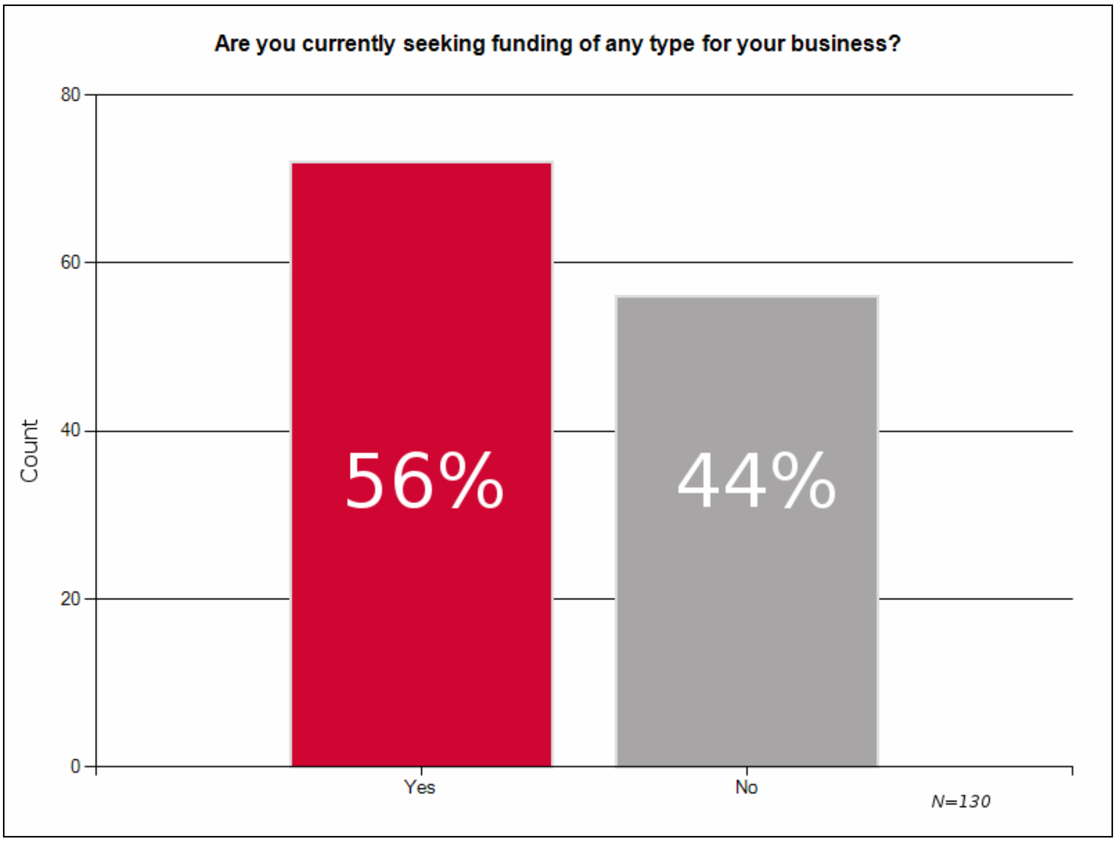

Figure 3 Survey Respondents Seeking Funding

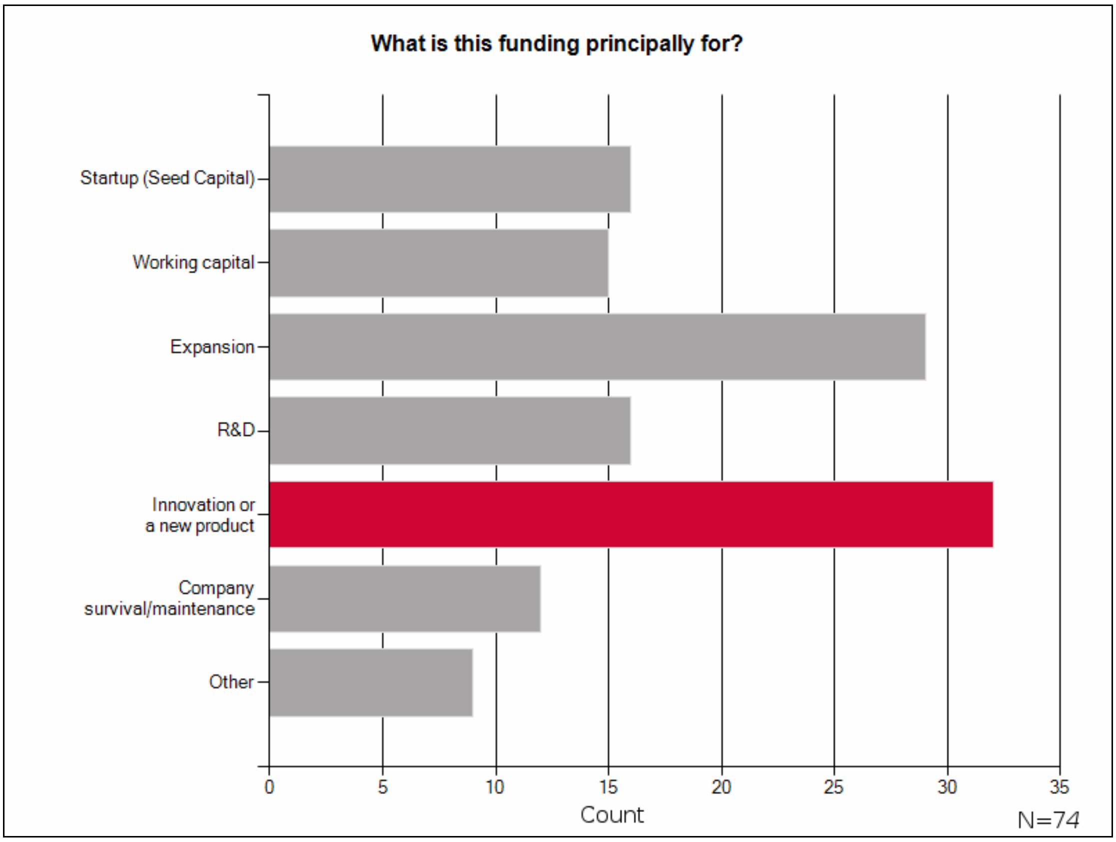

Figure 4 Principal Purpose of Funding

Beyond this, we were interested to understand the typical sum sought by the respondents. A range of sums was required with a median value of £55,000 across the selection, and significant demand in the £5,000 to £50,000 range.

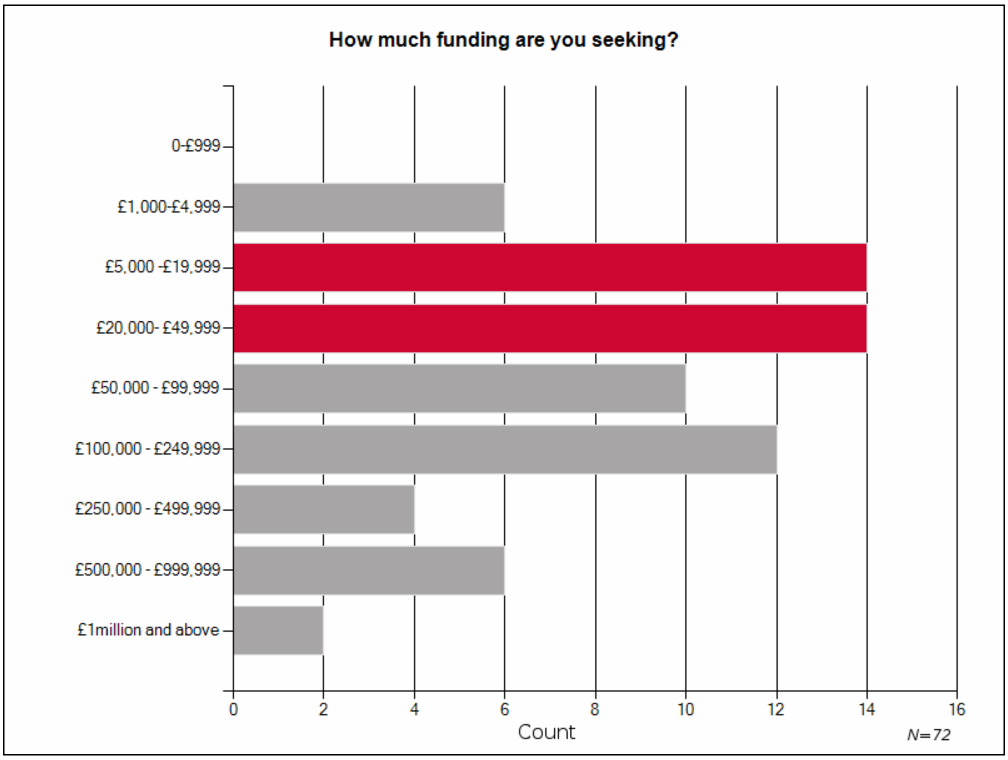

Figure 5 Size of Funding Required

For those who had already taken steps to source their required capital, we sought to understand which route(s) had been their chosen method. The most common approach emerged as grants.

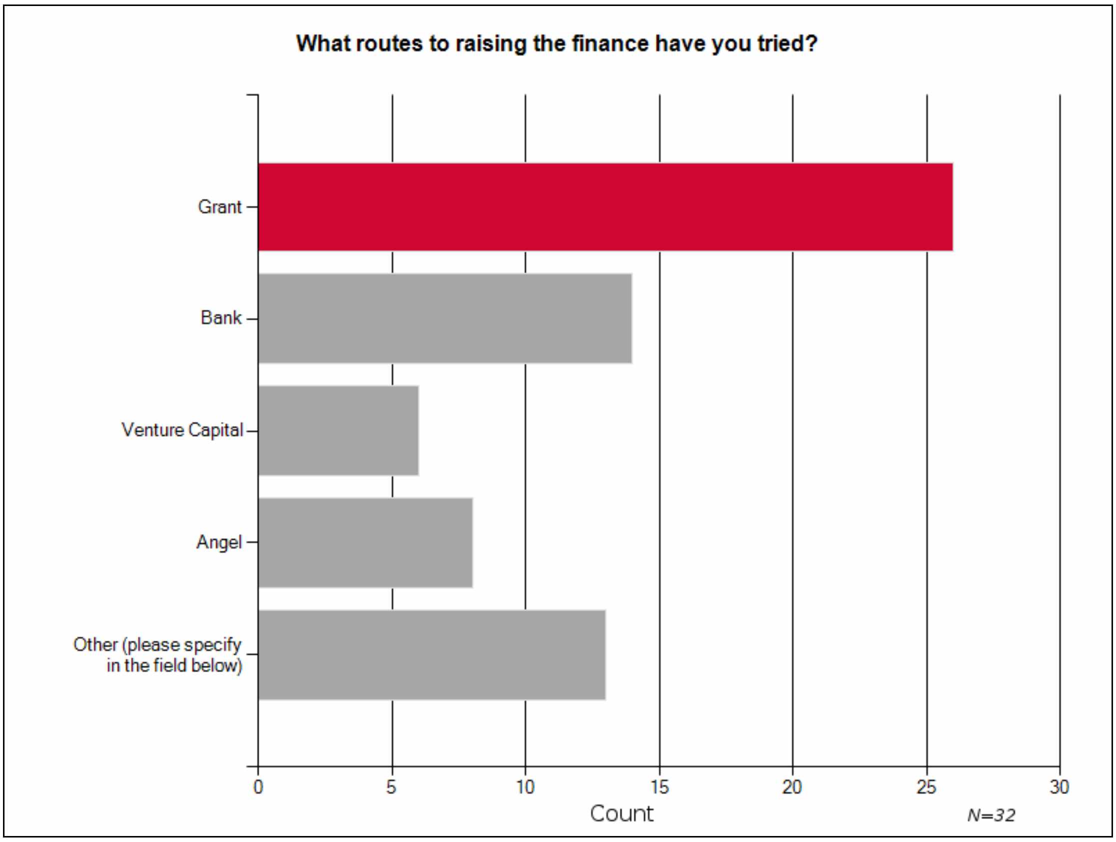

Figure 6 Routes to Finance Tried

Crowdfunding Awareness

As part of our survey, we endeavoured to establish what the typical awareness levels of crowdfunding were within the Scottish business community. Based on these responses, we found that some 76% of respondents had heard of crowdfunding which is, where UK data is available, an apparently comparable level to the rest of the UK.

Within this we sought to establish if there were distinctive levels of awareness of the four main types of crowdfunding as described in this report. The most recognised model of crowdfunding is the reward based model and the least recognised was the P2P model. Whilst this is not entirely surprising given that typical media coverage of crowdfunding does tend to focus on reward based models which can have compelling narratives associated with the projects, it is the P2P model that, as we have established above, is by far the largest element of the sector globally and also where direct intervention by the UK Government is taking place.

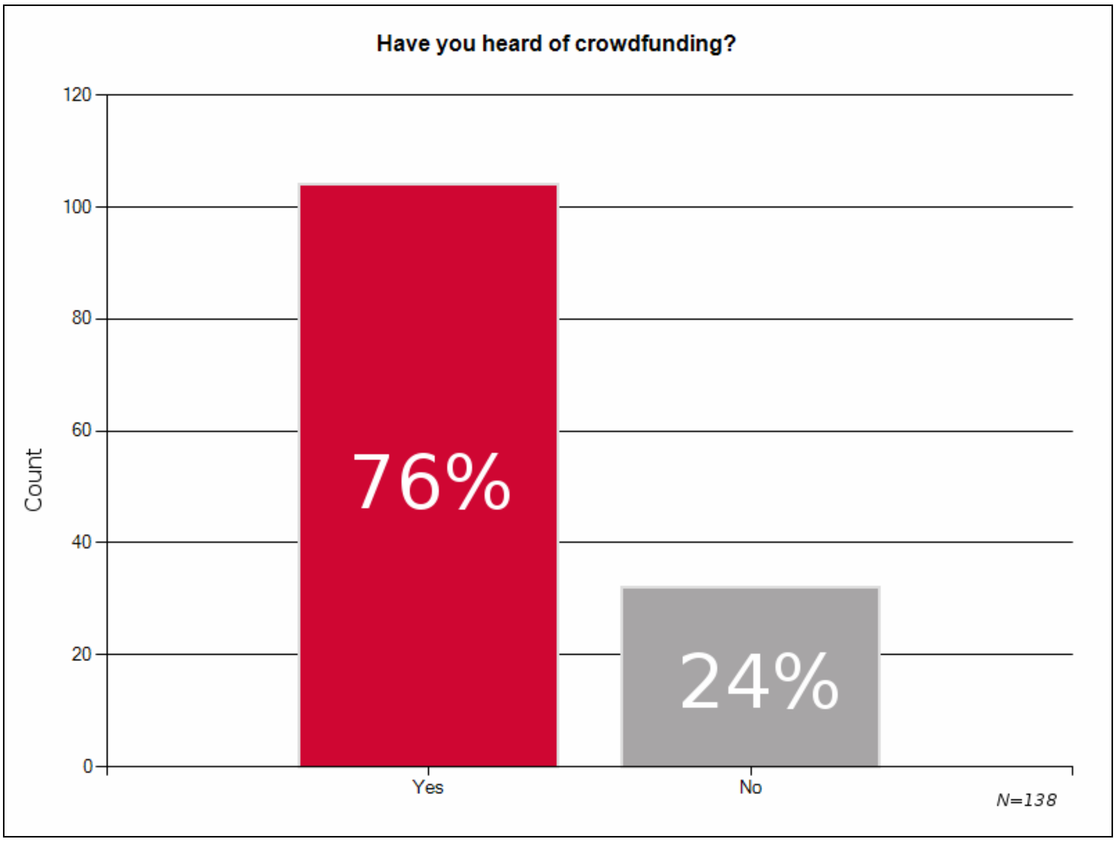

Figure 7 Crowdfunding Awareness Levels

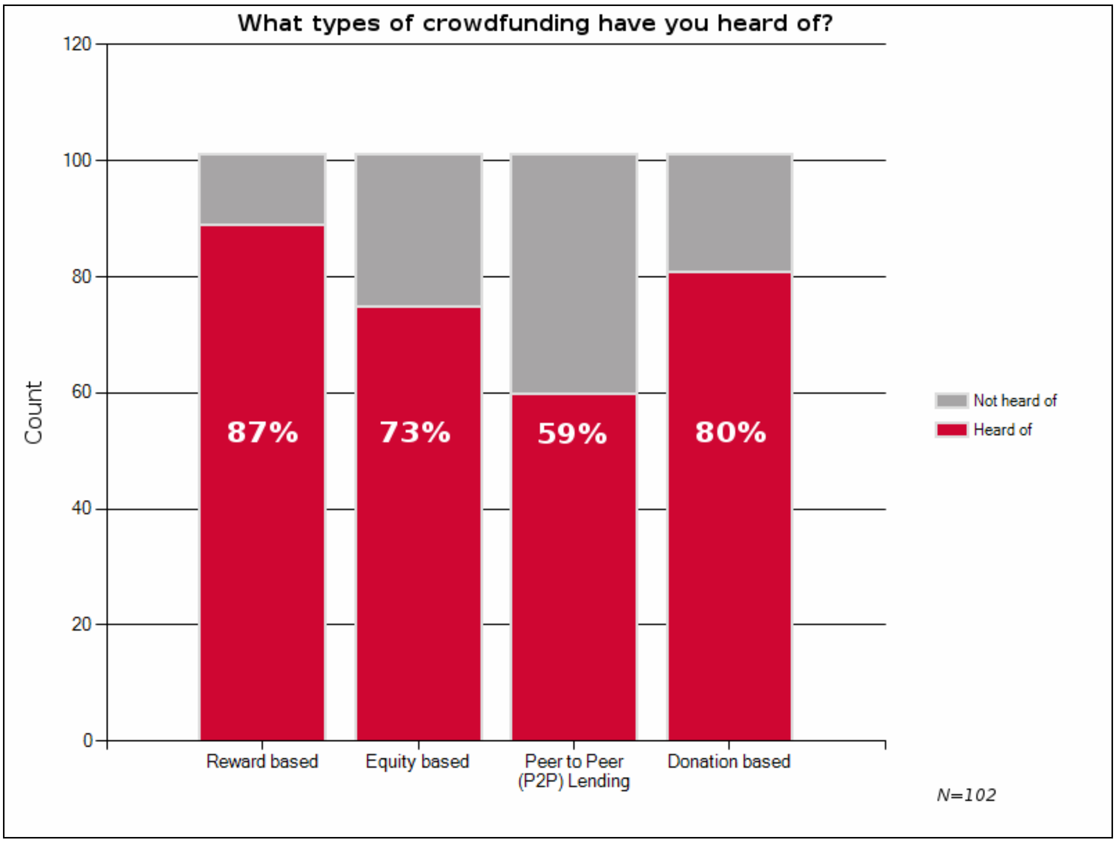

Figure 8 Crowdfunding Type Awareness

Current Crowdfunding Usage

No comprehensive figures on current crowdfunding usage are available for Scotland, as most platforms do not distinguish readily between Scotland and the rest of the UK when compiling data. However, a number of observations lead us to conclude that at present, Scotland is significantly under-using the opportunity presented by crowdfunding when compared to the rest of the UK, based on the proportionate economy size.

Despite having such a high profile champion of the equity based approach in the Brewdog example, no Scottish project has successfully raised equity crowdfunding on any of the main platforms.

The reward based sector does already have a Scottish platform in BloomVC which, according to our survey, does enjoy good visibility and recognition amongst the Scottish business community. Nevertheless, the sums raised in Scotland by reward based crowdfunding are comparatively modest. The major player in the reward market is the US-headquartered Kickstarter which, since opening a UK operation late in 2012, has seen nearly £700,000 raised for Scottish projects. That said, this figure is dominated by two or three large projects, notably the RunRev project[19]. The median value for projects is around £1,461 and average project value £21,800[20]. However, if we look at the sums raised on Kickstarter for 2012 as a whole, the year on which the NESTA crowdfunding total of £200 million is based, we find only £300,000 raised on Kickstarter by Scottish projects[21]. (As Kickstarter had a UK arm for only part of the year, we have included in this figure projects both based in Scotland and/or targeted on Scotland).

Our discussions with the major P2P platforms engaged in business lending suggest that Scotland is significantly under-using these platforms for business borrowing. If we consider the sums lent across the UK and the sums lent to Scottish businesses and compare that to the proportion of the UK economy that the Scottish economy represents (c.8%), we find significantly less than that proportion of P2P lending flows north of the border.

If we accept the NESTA figures as being accurate and that the sum raised in the UK in 2012 through crowdfunding was £200 million, we could reasonably expect to see Scotland raise in the region of £16 million. If we take into account the sum from the major reward platforms, evidence from the main P2P platforms, and the lack of an equity based example in Scotland during the same period, it is evident that Scotland does not begin to come close to the proportionate value it could reasonably be expected to raise. In fact, it appears to have raised less than £1 million for that period. If the growth projections for the sums raised in the UK prove correct and £300 million is indeed raised by the UK in 2013, we should expect Scotland to raise some £24 million. It is evident that this will not be the case based on activity thus far into 2013.

19 RunRev is one of the case study examples found in the appendices of this report

20 http://twintangibles.co.uk/kickstarter-the-first-six-months-in-scotland/

21 Research by twintangibles

From our survey findings, it seems that the reward and donation models have been the most actively used forms of crowdfunding in Scottish businesses, be that seeking or providing funding, but overall activity remains low despite awareness being at least comparable with the rest of the UK.

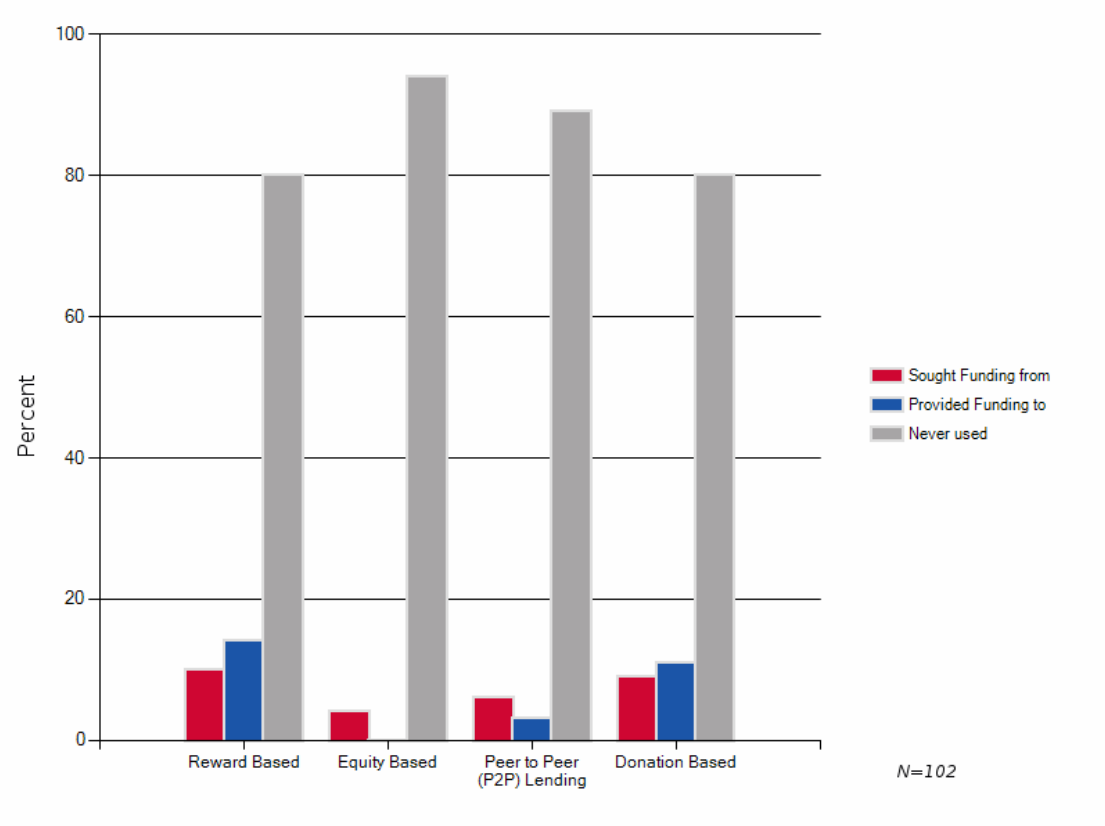

Figure 9 Crowdfunding Activity

Market Fit

Given that we have established that there is an ongoing demand for business finance, it is appropriate to consider whether crowdfunding is a mechanism that can address and meet at least some of that need, and if there is an appetite amongst the Scottish business community to make use of this approach.

In the course of the interviews carried out in the preparation of this report, it became apparent that, over and above the direct intervention in the crowdfunding market by the UK government and other bodies, other organisations concerned with the provision of funding to businesses in Scotland were becoming positively disposed toward crowdfunding. This took a number of forms. In the course of this research, we have found that many funding bodies that use match funding techniques where the investment is a shared one, for example the West of Scotland Loan Fund, are increasingly comfortable to match fund alongside funding derived from crowdfunding. This is of particular interest given that the application processes for many of these funding approaches are often quite extended and that some funds felt that it was entirely reasonable for an applicant to run a crowdfunding campaign in parallel with the application process. This has the advantage of potentially securing some funding during the application process and to accelerate the matching process by having those matched totals available by the approval date.

Similarly, some banks, whilst emphasising that they are "open for business", also recognised that there are occasions where they are not able to advance the funding required and that crowdfunding is a viable alternative. It was even acknowledged that a successful reward based campaign that generates significant order books and cash flow would both demonstrate some market validation of a product or service and viability that could be factored into the banks' subsequent assessment of the credit worthiness of a business.

As many finance rounds in a business are typically made up of a number of investors and lenders, it was interesting to learn that some tasked with creating these packages and brokering these deals are increasingly factoring in an element of crowdfunding as a valid option. However, it must be said that in all cases the push to do this was driven by the organisations seeking funds and not, at present, initiated by the deal brokers themselves.

Nevertheless, whilst we can consider crowdfunding as a part of a funding solution, what is the match between typical crowdfunding totals and the sums sought by business? We plotted the distribution of the funding needs of SMEs (businesses with less than 250 employees) as expressed in the survey data, against typical totals raised through the various crowdfunding methods.

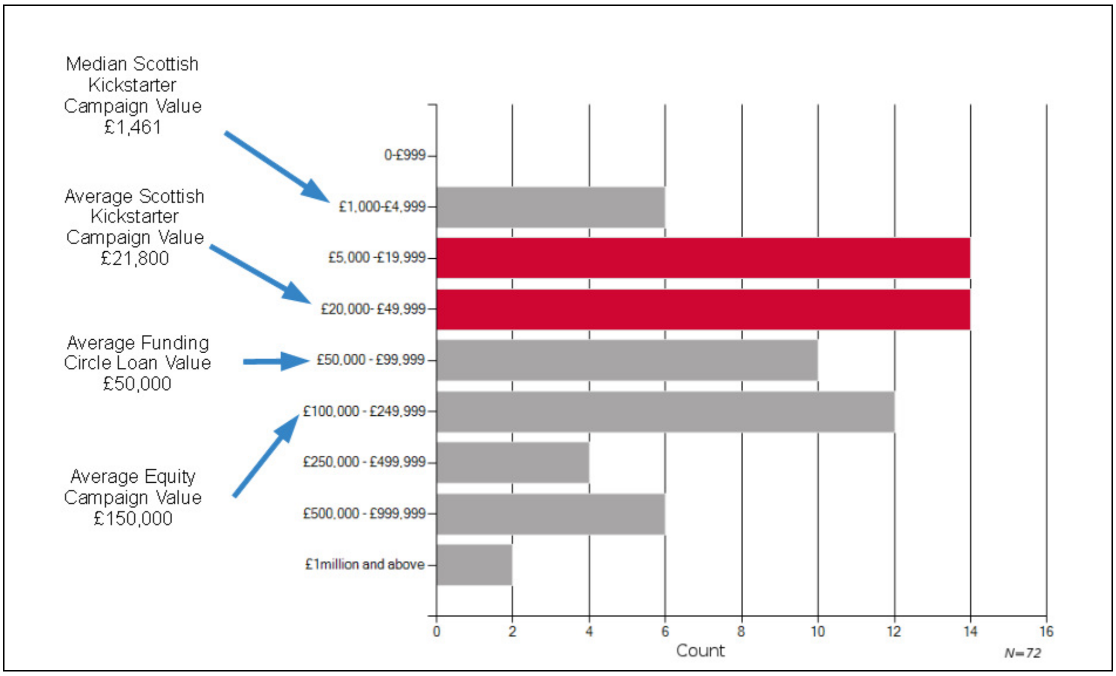

Figure 10 Funding Sought in Survey & Typical Crowdfunding Totals

What is immediately apparent is that crowdfunding is capable of supplying sums that would meet the needs of these organisations. Typically firms were seeking sums in the £5,000 to £50,000 range, with a mean sum when taken across the entire group of £55,000.

If we compare this to the typical sums raised in crowdfunding campaigns, we can see that the different forms of crowdfunding provide a range of sums that are capable of meeting most of the demands for funding.

Equity campaign values vary, with the Seedrs average value being £39,750 and Crowdcube being £177,500, but the average across the two platforms is c£150,000[22].

The average loan on Funding Circle is £50,000[23]. Like all P2P platforms, this average is determined to an extent by the maximum size of loan request permitted on the platform and the fact that the size of loan is progressively increasing on most platforms. That said, this average at present is very much in alignment with what is typically sought.

Whilst totals raised on reward based platforms are typically lower, the median Scottish Kickstarter campaign is c. £1,500 and the average is £21,800[24]. These sums are also capable of meeting a particular quantum of demand.

It is also worth noting that the key purpose in demand for funding in our survey data was for “Innovation and/or New Product”. The reward based model is well suited to product based campaigns and there is good evidence, even in Scotland, of this approach being successfully employed, albeit amongst a relatively low number of campaigns.

Appetite for Crowdfunding

If we accept then that there is a reasonable match between the practical use of funding and the quantum of funds available, what is the appetite to make use of crowdfunding?

Our survey data, as has already been identified, showed currently low levels of activity on crowdfunding but it did demonstrate that the respondents were not unwilling to consider it as a mechanism to raise funds. We asked which routes respondents intended to use to raise funding and, as might be expected, there was a strong correlation between the routes that had already been used by those respondents who have already begun to seek funding.

22 twintangibles research

23 Banking on Each Other - NESTA p.3

24 twintangibles research

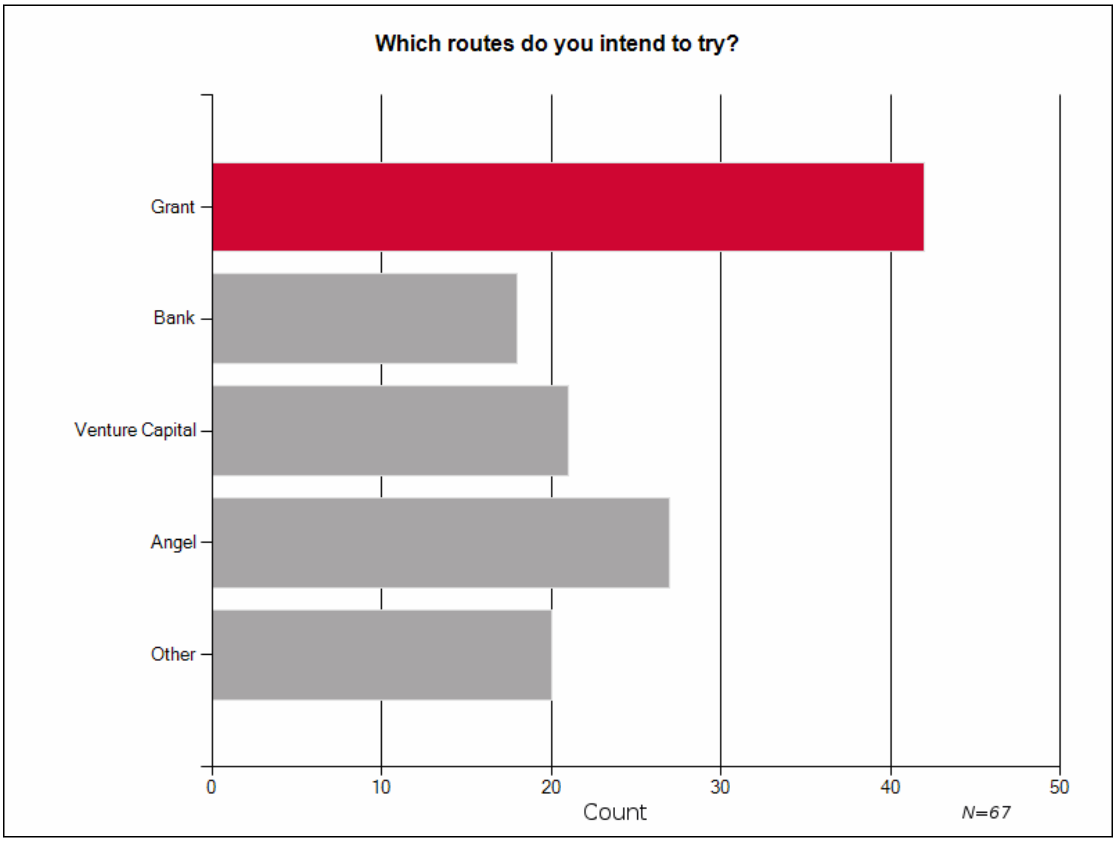

Figure 11 Funding routes to be tried

Some responded in the "other" field with explicit mentions of intending to use crowdfunding. When the group was asked if it would consider crowdfunding for future funding needs, 54% of all survey respondents said they would.

Of the models of crowdfunding available, the reward model proved to be the most popular.

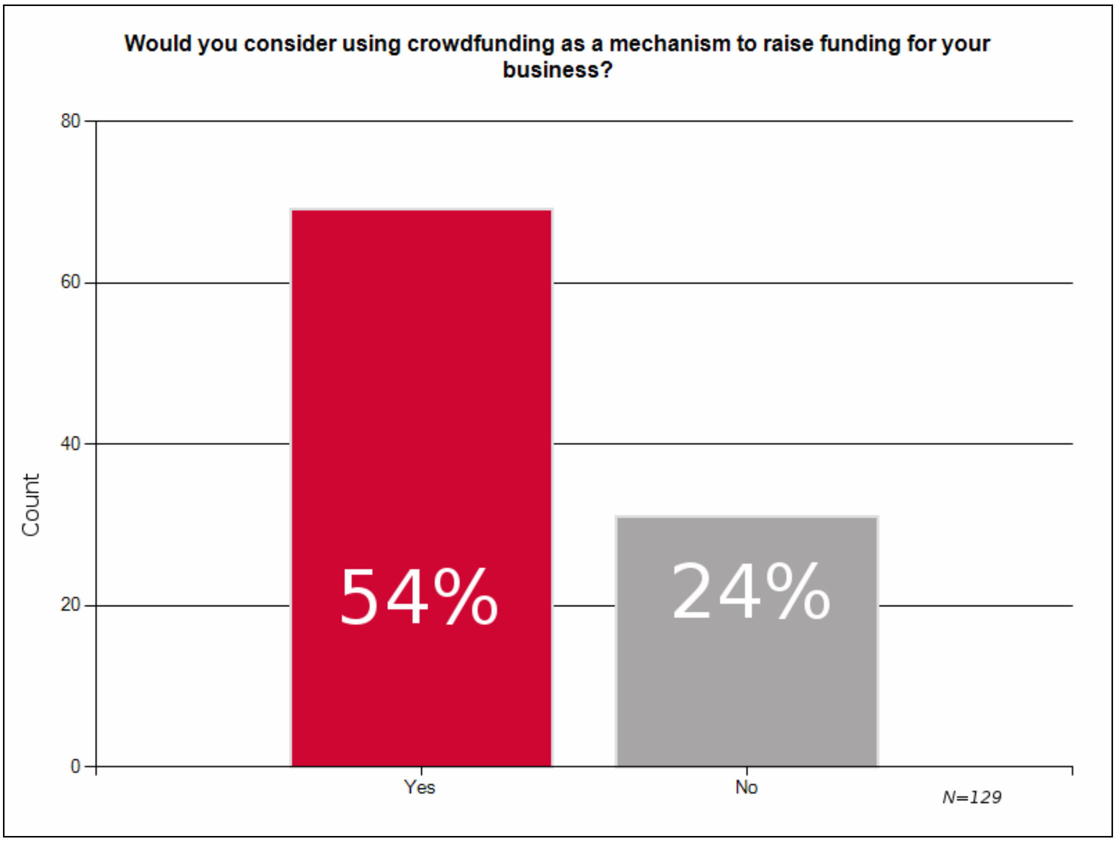

Figure 12 Would You Consider Using Crowdfunding

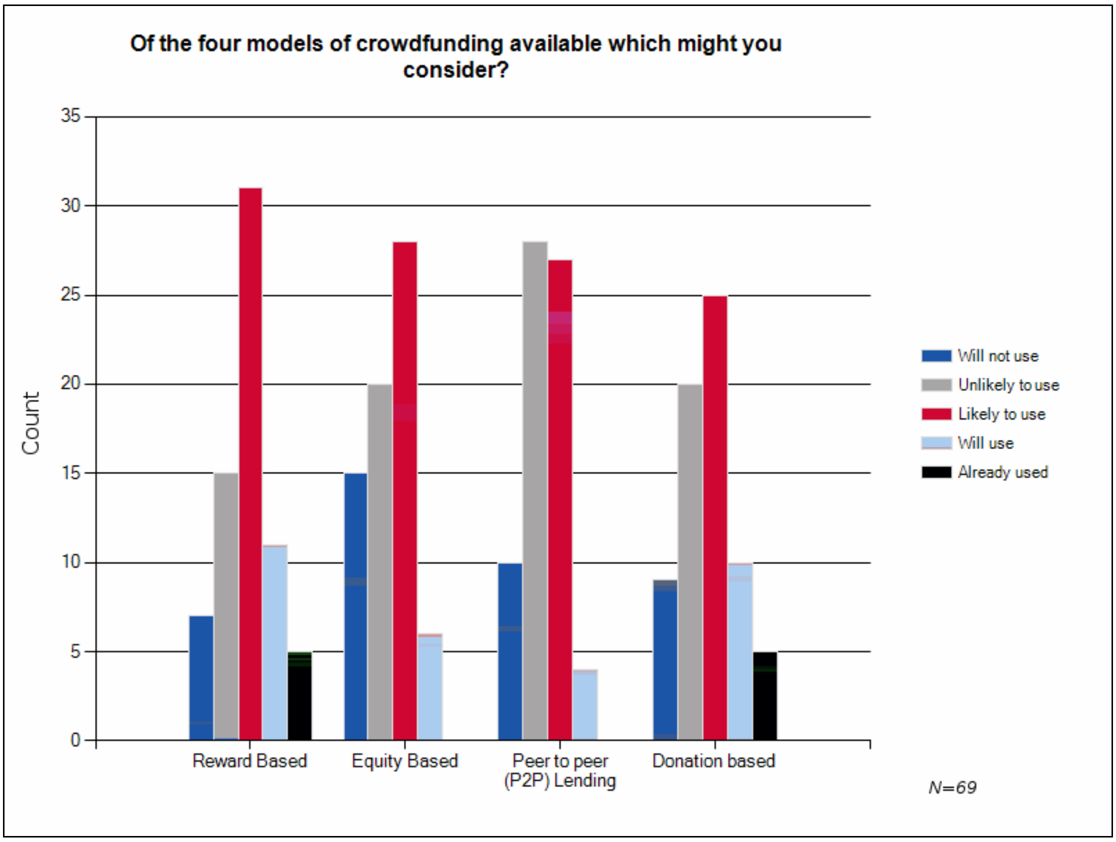

Figure 13 Preferred Crowdfunding Model

Observations and Challenges

Overview

Crowdfunding is not without its critics and, as an emerging activity, is likely to encounter challenges as it develops. The process of crowdfunding is challenging and difficult, and it confronts many notions of traditional financial thinking, not least in terms of motivations and expectations of return. It also exists within a complex regulatory framework which has evolved often in response to historical scandal and fraud and which is designed to protect participants from unscrupulous agents. This has the effect of creating certain constraints around who is permitted to operate in the finance sector and establishing views as to which competencies and skills are necessary in order to be permitted to do so.

Crowdfunding challenges much of this thinking by lowering barriers for participation and asserting the notion of "democratising capital." There are those that consider that by doing so, it also opens up considerable risk of fraud for the unwary investor. This view is particularly evident in the context of equity models, but exists across the entire crowdfunding sector. While crowdfunding advocates would contest some of these concerns, regulatory changes are taking place in response to some of the issues and some platforms are innovating to address specific concerns.

Nevertheless, there will undoubtedly be failure and loss in some cases and the main concern that has emerged in the course of our research is the generally elementary understanding of crowdfunding held by institutions, policy makers, regulators and participants. This, in our view, presents a risk that if and when challenges do arise in crowdfunding as a result of loss or fraud, the responses may be less well-informed than they could or should be and could result in actions that unwittingly and unintentionally constrain the development of crowdfunding.

Key Points

- Crowdfunding is not universally welcomed or endorsed, with some expressing considerable concerns over the risks posed to investors.
- Equity crowdfunding, in particular, creates debate about the potential risks posed to "unsophisticated" investors making poorly informed investment decisions.
- Crowdfunding advocates claim that the approach of crowdfunders is novel and that existing regularity constraints models and frameworks are less useful or poorly formed for this sector.
- There is some evidence to support that philosophical risk mitigation approaches are developing for crowdfunding.
- As the sector develops, platforms are evolving approaches to mitigating some concerns.
- There is evidence that "sophisticated" and traditional investors are already active in the crowdfunding sector.
- The general level of understanding of crowdfunding is quite elementary, representing a risk of poorly informed responses to potential incidents.

Whilst we found generally positive views towards crowdfunding, it should be borne in mind that not all responses were supportive or without concern and caution. Indeed, crowdfunding is controversial and a subject for considerable debate, not just in the UK.

Survey responses included comments such as, “the next financial disaster waiting to happen”, and concerns over potential fraud and intellectual property infringement issues were also cited by those who expressed a view that they would “never use crowdfunding”.

Whilst concerns of the impact of potentially fraudulent campaigns are relevant to all crowdfunding models, it is perhaps more effective to consider the particular concerns and challenges in each model of crowdfunding.

Equity

As the pace of equity based crowdfunding in particular picks up, it attracts mixed views from the more established participants in the finance sectors. It is fair to say that many of the more traditional capital market participants, regulators and commentators have articulated considerable caution about equity based crowdfunding. Typical concerns include:

- perceptions of over valuation of offers;
- poor financial reporting standards;
- lack of clear exits;
- overly complex and difficult company structures resulting from crowdfunding rounds;
- the exposure of “unsophisticated” participants to the perils and risks of this type of investment, with some going so far as to refer to crowdfunders as “dumb money”.

In a global context, many countries are struggling to find a mechanism that would permit, in particular, equity based crowdfunding to take place within what they consider acceptable risks. This process is proving particularly challenging in the US, where the provisions of the Jumpstart Our Business Startups (JOBS) Act, which introduced a specific intent to permit equity based crowdfunding within certain limits, are significantly delayed as the Securities and Exchange Commission (SEC) struggles to enable them. So much so in fact, that individual states are now beginning to pass state-centric legislation to enable some local activities, with sunset provision included, to be triggered when ultimate federal provision is made.

Let us consider a few of the challenges more closely. Firstly, the notion of the “unsophisticated” investors who, it is asserted, will be permitted to invest significant sums in a venture that they are unable or ill-equipped to effectively asses for risk, or worse still, are unaware of the risk, resulting in potential loss and crippling financial exposure should the investment fail. This does result in often heated debate, with crowdfunding advocates contesting what constitutes a sophisticated investor and the fallibility of existing accredited investors. Amongst this often noisy debate, one assertion that is often advocated by crowdfunders is that the existing regulatory framework is formulated to address the needs of investors with somewhat different motivations, approaches and expectations of return to the traditional investment models. So, for example, crowdfunding advocates would assert that in some cases an unconventional expectation of return motivates investment rather than a pure profit motive, and that investors manage down their risk exposure through investing relatively small sums which are often widely dispersed. There is evidence to suggest that legislators overseas are conscious of this and are building into enabling legislation a low maximum investment total for individuals who invest in this form of funding.

Is there any evidence to support these claims of unconventional motivations? If we examine the largest section of the crowdfunding market, the P2P lending sector which is worth more than $1 billion globally of the $2.7 billion total, the largest part of this sector is not for profit, in that the loans are not interest bearing and only receive the sum loaned back. This would seem to suggest that there is at least some validity in the idea of unconventional expectations.

Similarly we can find cases of rewards being purchased which cannot be redeemed, suggesting a more existential satisfaction and return being derived by the act of purchasing a reward.

If it is in fact the case that there are examples of non-traditional expectation of return even in equity based crowdfunding, then perhaps it can be argued that the more traditional diligence processes of traditional investors, who may have a more profit-focused expectation of return, will become less useful.

In terms of the risk mitigation, it should be remembered that crowdfunding is founded on the principle of aggregating many small investments. Consequently, the individual exposure is relatively small and should not be catastrophic financially in the event of failure. Again it is worth noting that typically on a P2P platform, without regulation or mandating of this behaviour, most loans are made up of many small loans averaging around £100 each, which suggests that this risk mitigation pattern is emerging naturally. It is also worth noting that the repayment rates on micro-lending statistically tend to be higher than many more formal lending practices.

On the UK equity platforms, we can also observe a relatively low average investment size emerging of £585 on Seedrs[25] and £2,427 on Crowdcube[26]. This which would appear to give at least some credence to the assertion of the risk mitigation models inherent in crowdfunding.

A commonly used analogy is that online gambling is widely promoted and permitted without the need for participants to demonstrate any particular expertise in the breeding of horses, while there is a strong probability of gamblers losing their stake. The regulators of the financial markets would, perhaps understandably, contend that their remit does not run to that sector.

Another typical concern amongst those active in investing as angels and VC groups includes what they perceive as unrealistic valuations of offers made on equity platforms. It is worth noting that platforms are responding to this: notably, a German platform, Innovestment, operates an auction based approach where the market sets the value of the equity. It is also worth noting that it is increasingly common for successful equity based projects to return for second round funding and to date most have been successful, demonstrating some sustained

25 http://blog.seedrs.com/tag/infographic/

26 http://www.crowdcube.com/infographic

confidence in the valuations. Similarly, drawing upon the idea that expectations of return may indeed be slightly different, is it reasonable to be less concerned with valuation models as a crowdfunder?

The potential complexity of shareholding arrangements that result from equity crowdfunding is also cited as a reason for investors not to become involved with companies that have sold equity through crowdfunding platforms. It would be fair to say that the crowdfunding community is aware of these concerns and some models seek to address these issues directly. For example, the Seedrs nominee model, where the equity is held by a single entity (the nominee), is clearly intended to address the perceived complexity of working with a large number of small individual shareholders.

The lack of examples of successful "exits" for investors should also be borne in mind. Equity crowdfunding, as we describe it here, is still a relatively new phenomenon and it is therefore not entirely surprising that there is little record of successful exits for investors. This may also contribute to a lack of clarity as to where crowdfunding sits within an investment cycle. It is commonly assumed that this is suitable only for early stage investment, with traditional capital markets considering becoming involved following a crowdfunding round. As we see the sums raised through equity crowdfunding grow, this may not continue to be the case. Similarly, we are now witnessing firms moving to second round funding through crowdfunding platforms, so the scope for development and change is considerable.

For all that caution, there is also evidence that established investors, who may already be active via angel and other groups, are becoming involved with crowdfunding platforms. The importance of Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) eligibility for most successful equity based crowdfunding projects seems to indicate at least some level of financial sophistication amongst the generality of the equity crowdfunding investors.

Despite these reservations, we have found in the process of speaking to investors and project holders that traditionally recognised sophisticated investors are happy to look again at previously passed over investments when a crowd has begun to validate its model by investing via a crowdfunding platform, and that some are already active on crowdfunding platforms, investing as part of their wider investment portfolio.

P2P

For the P2P platforms, their successful lobbying to be brought under regulatory purview of the FCA is, in part, driven by a desire to be seen to be credible and approved and so build confidence with lenders and borrowers. There is also evidence, based on our research and on evidence published by the platforms themselves and NESTA, to suggest that, notably on the P2P platforms, the atomised "long tail" distribution to investments and the associated reduced risk exposure is naturally emerging without regulatory requirement that it should.

Reward

On the reward based models, it should also be borne in mind that the majority of reward campaigns are unsuccessful and the naïve expectation that crowdfunding is a sure thing and a simple approach to fundraising is likely to lead to considerable disappointment. Rumblings of discontent over delayed delivery of rewards on some high profile campaigns are also attracting attention, but cases of outright fraud are thus far hard to identify, and indeed there is evidence of attempts to launch fraudulent reward based campaigns being spotted and thwarted, as the “wisdom of the crowd” identifies the tell tale signs of an attempted swindle.

Nevertheless, one area of concern that does emerge from this survey is the relatively elementary level of understanding of crowdfunding. This is not confined to any particular group and exists in all the bodies we approached, with the exception of the platforms themselves. This raises the question that, in the event of problems arising in the sector as they are sure to do at some point, be that a fraud or failure, what will the institutional response be? A poorly informed response, based on incorrect and ill-informed understanding of the dynamics and philosophical and practical underpinning of crowdfunding, runs the risk of bringing about interventions and actions that could harm or stifle a sector which shows promise but is not yet mature.

Under-Utilisation Factors

Overview

In the course of compiling this report, it became apparent that Scotland is proportionally under-using crowdfunding and that Scottish businesses are not taking full advantage of this avenue to finance when compared to the rest of the UK.

Having identified this trend, we believe that this is an area worthy of further investigation, as there is both a need for finance and a potential appetite to use crowdfunding, which is reasonably matched by crowdfunding in terms of the size of funds sought and those on offer from the various forms of crowdfunding activity. Therefore, uncovering and addressing the reasons for the lack of uptake of crowdfunding is worth consideration. However, this phenomenon was apparent from an early stage and we endeavoured to gather some thinking and views on what might underpin this behaviour, testing each idea in as much as we could. None of the suggested reasons offered below provide a sufficiently compelling case to explain this behaviour of low uptake alone. However, given the desire for more information and support on crowdfunding, as expressed in the survey, and the generally elementary levels of understanding of crowdfunding we encountered, we would suggest that education and awareness would be a sensible starting point to begin to address some of the lack of uptake.

Key Points

- Scotland has had, until recently, only one indigenous crowdfunding platform, but others are emerging.
- Awareness levels are comparable with the rest of the UK. Whilst sophisticated understanding of crowdfunding is not common, there is no evidence to suggest that this is worse that the rest of the UK.
- Poorly prepared financial statements have been cited as a reason for low success in accessing finance including crowdfunding, but we have no evidence to suggest that this is more of a problem in Scotland than the rest of the UK.
- Scottish SMEs' demand for finance seems comparable to the rest of the UK.
- Scottish firms do not appear to have a particular aversion to debt based finance.
- Grants are the preferred form of finance, but again we have no evidence to suggest that this is necessarily different elsewhere in the UK.

We have identified that the pattern of proportionate under-utilisation of crowdfunding as a mechanism to raise funding for Scottish business was a regular and common feature of our discussion with platforms. This was common in all sectors of crowdfunding, including reward based, equity, P2P and donation on civic platforms and is apparently borne out by the available data.

We considered why this might be and, as this trend emerged, sought views to account for this through the course of the investigation.

Below, we assess each of the main reasons suggested to account for this apparent under-use.

Lack of distinctly Scottish platforms - This is not possible to readily quantify as an influencing factor based on the information available, and it is not something that was mentioned as a barrier in the survey. However, it is a fact that at the time of writing there is only one operational Scottish crowdfunding platform of which we are aware, BloomVC, and two others with imminent launch plans. If this were to be the case, it would be a concerning factor as crowdfunding is intended to reach widely, and naturally constraining your potential investor groups by geography would be, in our view, unwise. However with at least two Scottish based equity crowdfunding platforms in development, Share-in and SquareKnot, it is a potential issue that could soon disappear.

Lack of awareness - This was raised in the Breedon Report as a common issue across the UK and mentioned consistently in our interview process. Whilst our survey suggests there is still work to be done in this area, Scotland seems to bear favourable comparison with the rest of the UK. Our survey responses suggest some 76% of respondents had heard of crowdfunding and only 24% had not. If we compare this to an Experian survey in September 2012, they found crowdfunding was the least well-known of all alternative finance options amongst the 290 SME respondents, with 69% never having heard of it[27].

We would point out that in the wide ranging conversations we had in the course of preparing this report, we found that the level of detailed awareness of crowdfunding was generally quite low outside those directly involved in the industry. People had heard of it but, in our experience, the level of sophisticated understanding was low, and surprisingly so in some instances. In many cases, institutional awareness, notably amongst finance professionals, had been driven by approaches from those seeking funding raising the subject.

Poorly prepared financial statements - The suggestion here is that smaller firms do not have a finance professional in place in the business which can both mean that awareness of finance options is more limited (although there is no sustainable evidence that we found that the finance professions are sophisticated in their awareness of crowdfunding) and that the quality of financial documentation and forecasting can be a barrier to securing finance. This was also raised as a potential issue in the Breedon Report. However, whilst there may be substance in the allegations, and we did find evidence for the notion that poor financial records can be an issue, we are not aware of any evidence that suggests that this is a bigger issue in Scotland than elsewhere in the UK.

Demand for finance is proportionately less in Scotland than the rest of the UK - Whilst it can be difficult to draw direct comparisons between different reporting evidence, we found no indication that there is a significant difference between the demand for finance in Scotland and the rest of the UK. Indeed, the evidence we found seems to suggest that if there is a difference at all, then the demand may be higher in Scotland. According to SME Access to Finance 2012[28], 45% of firms sought finance (either renewing existing facilities or new/additional

27 http://press.experian.com/United-Kingdom/Press-Release/many-smes-unaware-of-alternative-financing-options.aspx

28 SME Access to Finance 2012 from the Office of the Chief Economic Adviser Scottish Government

borrowing) over the three year period to 2012, compared to 43% in the three years to 2010. This compares to 41% on Q4 2012 across the UK as a whole, based on figures from the SME Finance Monitor[29].

However, the same document issued by the Scottish Government noted that the percentage of firms who applied for finance and have been rejected outright has decreased from 24% of all firms in 2010 to 17% of all firms 2012.

Scottish firms are averse to debt finance - Notwithstanding the fact that crowdfunding is not entirely debt based, even if it were there is apparently little evidence to support this based on the findings of the most recent SME Access to Finance 2012[30], which indicates that many debt based finance schemes are commonly used, including overdrafts and loans and even credit cards.

An overdependence on grant and public funding – It was suggested that Scottish firms were disproportionately inclined to look to public funds as a finance mechanism. Whilst our survey does seem to indicate a preference for grant based funding, we have no evidence to suggest that this is disproportionate to the rest of UK.

In sum then, if it is indeed the case that Scotland is not making as much use of crowdfunding as the rest of the UK, there is no obvious apparent reason for it.

Encouraging Growth

If we accept that crowdfunding has a role to play in the business finance landscape in Scotland, it is important in the face of this current under-use to consider what might be done to encourage a greater uptake of this facility.

Evidence from our interviews and from the survey both seem to point towards similar actions to encourage the use of crowdfunding. We have already mentioned that a level of awareness is in place in almost all groups, but not what we would consider a sufficient level of sophisticated understanding. The survey evidence would suggest that developing a better understanding would be a motivating factor for businesses to become more readily active in crowdfunding. We would suggest that this is appropriate not just for those seeking to use crowdfunding for fundraising purposes, but also for those who may be co-investing alongside crowdfunds, investors becoming involved with crowdfunding, and regulators and administrators who are increasingly being brought into contact with crowdfunding.

29 SME Finance Monitor Q4 2012 full report

30 SME Access to Finance 2012 from the Office of the Chief Economic Adviser Scottish Government

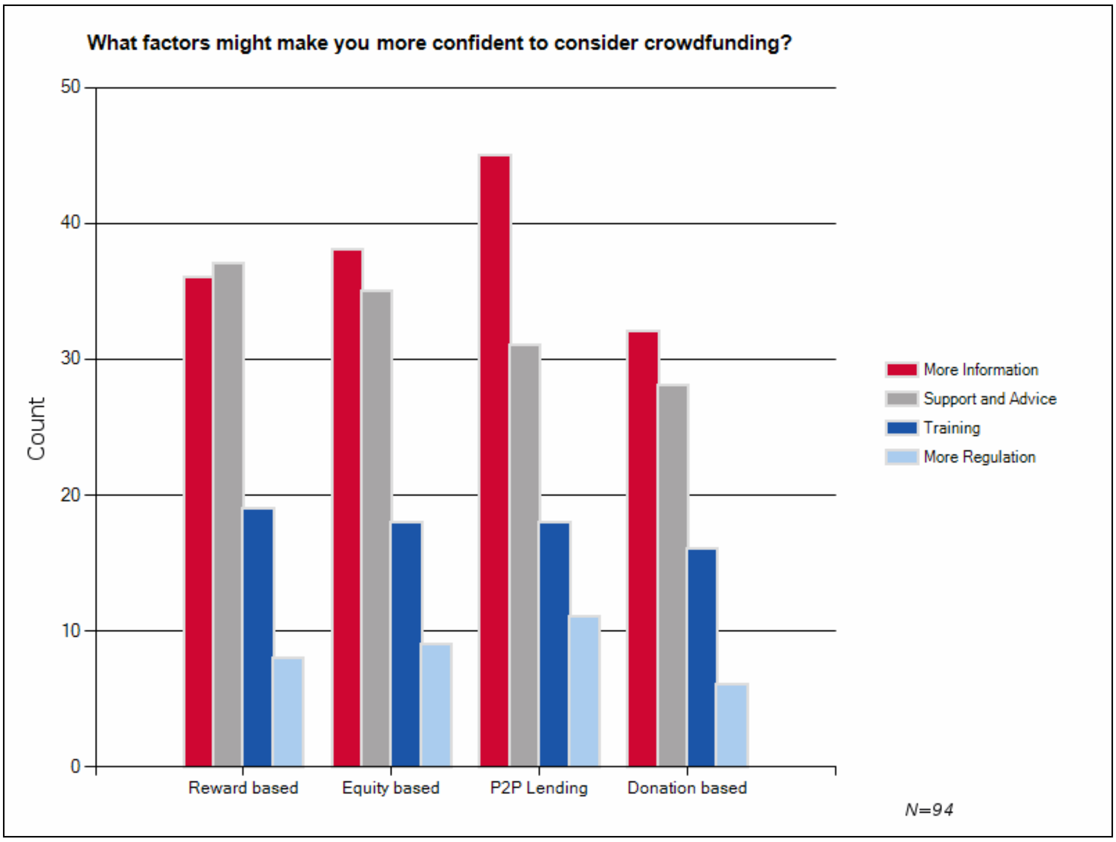

Figure 14 Crowdfunding Confidence Building Factors

From the survey results the clear desire is for Information, Support and Advice. There is little appetite for additional regulation, at least from those seeking funding.

Conclusions

It is clear that crowdfunding is a rapidly developing alternative finance mechanism with specific characteristics that offers businesses novel ways to create funding streams. Its growth demonstrates that it is meeting a need, and the post-financial crisis environment has provided both supply- and demand-side incentives that are driving its growth. It would seem to be a phenomenon that is here to stay. The UK benefits from having some of the most progressive approaches to crowdfunding with all forms permitted and with active and growing engagement from national and local Government and civic bodies building confidence in the sector.

The various forms of crowdfunding available mean that it could reasonably fulfil part of the financing need for many businesses at many stages in their life cycle. As it is currently operating, the sums generated seem of particular relevance to SMEs and well suited to start-ups and entrepreneurial activity. Whilst it is not a simple process, it presents finance options that would not have been available previously and, by diversifying supply, could go some way to reducing the current dependence on bank lending and build some measure of additional resilience into the business finance market.

Based on our survey findings, it is apparent that the Scottish SME community continues to need to find sources of investment and that it is keen to use these to innovate and bring more products to market. Despite the fact that they have reasonable awareness levels of crowdfunding and the sums available from crowdfunding projects in their various forms seem well matched to the sums in demand, there is a marked under-utilisation of crowdfunding in Scotland.

Part of the purpose of this report was to identify these trends, but it was beyond the scope and methodology to deeply investigate the causes behind this particular phenomenon. Nevertheless, we did endeavour to uncover some possible reasoning behind the trend in the course of the work, and subject each idea offered to some testing. The evidence we have gathered offers no clear reasons why this under-use is occurring. There is an ongoing need for finance, much of which falls well within the current typical figures available though crowdfunding in its various forms. We see a substantial proportion of respondents stating that they are prepared to consider the use of crowdfunding as a mechanism for raising finance, but this does not seem to be translating into its active use.

Awareness levels seem to be comparable to elsewhere in the UK but at the same time, there appears to be a need for a greater level of understanding and greater sophistication of understanding before the confidence in this method is sufficiently high enough to see its widespread use.

The lack of a deep understanding of crowdfunding is a common feature across many institutions, and to an extent, this is inevitable when such an emergent and bottom-up phenomenon develops. Institutions, be they civic, governmental or allied groups or regulators, are always having to catch up. However in this circumstance, there are several implications. In many cases this elementary understanding manifests itself as a level of caution and a mode of reactivity rather than proactivity with regards to the sector. This could be interpreted as distrust and so hinder the building of confidence. Similarly based, but of much greater danger, will be how this lack of knowledge will shape the response to events when they go wrong, as they inevitably will at some point. Without doubt there will be cases where not all participants are happy, from something as simple as an undelivered reward, to poor investment returns, through to outright fraud. We should expect that all of these things will occur at some point, as they do in all financial markets; however the key to the long-term future of crowdfunding will be the response. If the response is poorly informed and based on a misunderstanding of the fundamental principles of crowdfunding, the danger could be a response that damages the development of the sector.

We would suggest that the development of crowdfunding as an alternative funding source for Scottish businesses would be a positive outcome, as it seems well suited to the specific needs of the economy and has sufficient variety to be of use at many levels and in many sectors.

We would recommend that further work is undertaken in order to develop greater insight as to why there is an apparent low take-up of crowdfunding in Scotland and to develop further specific interventions based on those findings.

In the interim, to encourage some additional take up of the opportunities provided, we recommend that, where measures are taken, these should seek to build confidence and improve understanding of the opportunities, risks and fundamental principles that underpin crowdfunding. We recommend that this awareness and understanding is developed for all potential participants in the crowdfunding process, including those seeking funds and investors, in groups such as allied bodies and professions and, most importantly, in the governmental and public institutions responsible for shaping the environment within which crowdfunding operates.

Appendices

I - Survey Data
II - The Regulatory Environment
III - Advice and Guidance
IV - Case Studies
V - Crowdfunding Sites
VI - Bibliography
VII - Methodology
VIII - Acknowledgements

I - Survey Data

To produce this report, in addition to extensive interviews and a literature review, we also conducted a survey intended to provide several insights. We were interested in understanding:

- the relative demand for finance amongst the Scottish business community;
- what type of capital was required;
- general awareness of crowdfunding and the perception of it;
- the willingness of those in search of capital to consider using crowdfunding;
- what might build confidence in crowdfunding as a source of finance.

The survey received 170 responses, 143 of which were from Scottish based respondents that conformed to the requirements of being a "business" and not a public sector body. All figures shown here represent those of the filtered group of respondents. In some high level categories, percentages are rounded. Where figures are presented, percentages and totals are included in the format of percentages defined by the % sign and the related totals in parentheses. e.g. 52% (20).

The survey was anonymous and few questions were mandatory. Consequently some respondents chose not to answer certain questions, which accounts for any apparent numerical discrepancies in the figures shown. Percentages are expressed as percent of those that answered the question.

Respondent Characteristics

In terms of the makeup of the respondents, the majority were located in the central belt with 59% (84) from Glasgow and 15% (22) from Edinburgh.

By company structure, the makeup of respondents was as follows:

- 60% (86) Limited companies;
- 16% (23) Sole traders;
- 12% (17) Partnership or LLP.

The remaining 12% (17) were a mix of third sector bodies with trading arms, social enterprises and cooperatives.

In terms of company size by headcount, the bulk of the responses were from SMEs, with 53% (76) responses from businesses of between 1 and 9 employees and 14% (20) from businesses of between 10 and 49 employees.

The respondent organisations were largely founded within the last 20 years, with 81 having been founded in the last 10 years, and 27 between 10 and 20 years ago. 28 respondent organisations had been in operation for more than 20 years.

Awareness of Crowdfunding

For the high level awareness questions, we asked simply if the respondents had heard of crowdfunding: 76% (105) had heard of crowdfunding whereas 24% (33) had not.

For those that had heard of crowdfunding, we sought further details to establish which of the four main types they recognised.

- 88% (88) had heard of Reward based crowdfunding;
- 73% (75) had heard of Equity based crowdfunding;
- 59% (60) had heard of P2P crowdfunding;
- 80% (80) had heard of Donation based crowdfunding.

This led to a more detailed question regarding any active participation in crowdfunding the respondent may have had. The results indicated a low level of participation.

Have you ever participated in any form of crowdfunding?

	Sought Funding from	Provided Funding to	Never used
Reward Based	9.8% (10)	13.7% (14)	**79.4% (81)**
Equity Based	4.0% (4)	0.0% (0)	**96% (95)**
Peer to Peer (P2P) Lending	6.1% (6)	3.0% (3)	**90.9% (99)**
Donation Based	8.9% (9)	10.9% (11)	**80.2% (81)**

We presented a list of 14 of the more well-known crowdfunding platforms and asked if the names were recognised and whether the platform had been visited. The most well known platform by response was Kickstarter, with 47 of 78 respondents saying they had heard of it and 28 saying they had visited the site - which is also the highest visitor score of the platforms.

Indiegogo and BloomVC were also recognised by 28 and 30 respondents respectively. BloomVC received more acknowledged visits from the survey respondents than Indiegogo, with 24 and 18 visits respectively, perhaps an acknowledgement of BloomVC's Scottish presence.

The two main equity platforms, Crowdcube and Seedrs, were both recognised by 14 respondents and visited by 7 and 10 respondents respectively.

Of the P2P platforms, Funding Circle was the most recognised with 22 acknowledgments of recognition and with 10 visits.

The question also asked about the respondents' use of the platforms and whether they had participated as someone either seeking funds or providing funds through them. It is worth noting that a significantly higher number acknowledged providing funds to a project than those that acknowledged seeking funding. Across all platforms, there were 12 records of respondents in total that had sought funding from a platform, and 31 records of respondents having made investments or contributions. In terms of which platforms had been used, only 5 of the 14 platforms offered had been used to seek funding but 11 of the platforms had been used to provide funding to others, so where there is participation it is typically as providers of funding.

Funding needs

It was important for us to understand these responses on crowdfunding in the context of funding need. When asked if they were currently in need of funding, 56% (73) respondents said they were currently seeking some form of funding, which is higher than official statistics but not markedly out of line and gave us a benchmark for considering their further responses.

We tried to establish the type and scale of funding sought.

Most commonly sought type of funding

Startup (Seed Capital)	21.6%	16
Working capital	20.3%	15
Expansion	39.2%	29
Research & Development	23%	17
Innovation or a new product	43.2%	32
Company survival/maintenance	16.2%	12
Other	12.2%	9

How much funding are you seeking?

	Response Percent	Response Count
0-£999	0.0%	0
£1,000-£4,999	8.3%	6
£5,000 -£19,999	19.4%	14
£20,000- £49,999	19.4%	14
£50,000 - £99,999	13.9%	10
£100,000 - £249,999	16.7%	12
£250,000 - £499,999	5.6%	4
£500,000 - £999,999	8.3%	6
£1 million and above	2.8%	2
Prefer not to say	5.6%	4

Raising Funds

We tried to establish if those saying they were in need of funding had already begun the process of attracting it.

Have you already tried to raise this finance?

Yes	44.4%	32
No	55.6%	40

For those that are actively seeking funding, we were interested in the methods employed.

What Routes to Finance have you tried?

	Response Percent	Response Count
Grant	81.3%	26
Bank	43.8%	14
Venture Capital	18.8%	6
Angel	25%	8
Other	40.6%	13

In the comments left for those selecting "Other", 3 mentioned crowdfunding

For those that will be trying to fund, we asked how they might go about it.

What routes do you intend to try?

	Response Percent	Response Count
Grant	64.2%	43
Bank	26.9%	18
Venture Capital	31.3%	21
Angel	40.3%	27
Other	29.9%	20

In the comments left for those selecting "Other", 8 mentioned crowdfunding which might indicate a growing interest in crowdfunding as a possible source of funding.

When the wider group was asked directly whether they would consider using crowdfunding, 54% (70) said they would consider it, 24% (31) said they would not and 22% (28) said they had never heard of it. For the section that had never heard of crowdfunding, it is reasonable to assume that, if made aware of it, they might be inclined to use it and so push up the number inclined to consider this form of funding to well over the 50% mark.

We also tried to understand a little further the considerations and views of those that expressly said they would not use crowdfunding and what particular issue lay behind that view. Of the 23 offering a response, the overriding constraint was that it was “not appropriate”. Within that a variety of more specific issues were mentioned, including concerns over money laundering, IP protection, a suggestion that “it doesn't work outside US art scene”, loss of company control, “storing up problems”, insufficient knowledge and that it was “too complicated”.

More on Crowdfunding

For those that would consider crowdfunding, we asked for preferences amongst the main crowdfunding formats.

Which type of crowdfunding would you use?

	Will not use	Unlikely to use	Likely to use	Will use	Already used
Reward Based	7	15	**31**	11	5
Equity Based	15	20	**28**	6	0
P2P Lending	10	**28**	27	4	0
Donation based	9	20	**25**	10	5

Within this and in the context of the emerging nature of crowdfunding, we wanted to understand if there were factors that might make crowdfunding a more suitable or desirable option.

What factors might make you feel more confident to consider crowdfunding as a method of raising funds?

	More Info	Support & Advice	Training	More Regulation	I would never use this
Reward based	37	**38**	19	8	21
Equity based	**38**	35	18	9	22
P2P Lending	**45**	31	18	11	22
Donation based	**33**	29	16	6	27

The overarching impression is that information support and advice are key confidence building factors. This would be in keeping with the general findings we have made in the process of compiling this report that, whilst generic awareness of crowdfunding is growing, it is not yet at a sufficient level of detail to provide the assurance required to confidently choose this as a preferred funding mechanism.

II - The Regulatory Environment

Of the four types of crowdfunding that we have described in this document, it is the equity and P2P based models that are the most heavily regulated.

This is largely due to the fact that it is in these two models that the potential and promise of a financial return for lenders and investors exists and where, by extension, the perceived risk is highest. The law is intended to protect investors in this context.

In the case of reward and donation based models, the relationship between the crowdfunders and those seeking funds is essentially a single and limited transaction with clear and defined outcomes, and with little persistent financial relationship.

It is in the equity based model where this new approach to funding encounters extensive and rigorous legal scrutiny, based on a range of well established laws and regulations designed to protect investors in the traditional capital markets.

The law is complex and failure to comply with it can result in criminal prosecution and significant penalties.

In essence companies seeking to raise funding through the sale of shares must comply with a range of legal requirements mainly set out in the following legislation:

- UK Financial Services and Markets Act 2000
- EU Prospective Directives 2010/73EU and 2003/71/EC.
- Companies Act 2006

Typically, an offer must be made in the form of a “prospectus” that is approved by a suitably authorised person or that the communications associated with that offer are made via a suitably authorised person or organisation (who would require high levels of rigour be applied to those communications), or that they offer the shares only to “exempted” people.

EU legislation allows for certain exemptions to the requirements of a prospectus on sales below €5 million, however the promotion itself must still be handled through a suitably authorised group.

Exempted people might include people of high net worth or sophisticated investors, but the purpose of the legislation is intended to prevent direct sales of equity to the general public.

Two UK crowdfunding platforms are directly authorised by the Financial Conduct Authority (FCA), the regulatory body in the UK (formerly the FSA), and they see this as a significant confidence building mechanism in their platforms. Others seek to use a variety of methods that they believe satisfy the requirements on this highly complex area of the law. So far these models have not been tested in a legal case, but the FCA would emphasise that they are keeping an eye on all activity in this area and do not relax the requirements in any way for crowdfunding platforms.

Currently Peer 2 Peer platforms are regulated by the Office of Fair Trading (OFT), the body responsible for regulating consumer credit. The platforms have lobbied for additional regulations believing this will build confidence and have formed an association to introduce their own self regulation and standards. The UK Government has responded and confirmed that, as of April 2014, the P2P sector will fall under the regulatory remit of the FCA, a change being enabled by the Financial Services Bill.

The FCA has published a consultation document, CP13/07, which within its 201 pages, includes basic proposals for regulating the P2P sector, suggesting that specific regulations aimed solely at the P2P sector will be developed. The key proposals relate to:

- requiring platforms to provide borrowers with adequate explanations of the key features of the credit agreement (including identifying the key risks) before the agreement is made;
- a requirement for the platform to assess the credit worthiness of borrowers before the credit agreement is made;
- rules relating to 'financial promotions';
- a requirement to include in the standard credit agreement a right for the borrower to withdraw from the agreement, without giving any reason.

These are not extensive and the document is a consultative document. However, there is a generally held view that whatever regulation should come into play, the industry, whilst welcoming it, should also ensure that the burden does not become onerous and add significant cost to the lending and borrowing process.

Disclaimer: This is for general information purposes and does not represent legal advice. We would recommend that anyone considering using equity based crowdfunding to raise funds to take legal advice.

III - Advice and Guidance

Crowdfunding is not easy. Although the demands and expectations of a crowdfunder will vary depending on the type of crowdfunding chosen, the overriding message from those who have completed a crowdfunding project is that, whilst the outcomes can be excellent, the effort required can be considerable.

In order to help you to enhance the potential success of your crowdfunding effort, we have compiled a list of some of the most commonly offered advice from successful projects. As the approach will vary depending on the model of crowdfunding chosen, the advice has been split into three groups: Reward and Donation platforms, Equity platforms and P2P Lending platforms.

Reward and Donation

- **Platforms** - Choose your platform carefully - they are not all the same and have specific requirements, restrictions, costs and operating models. Do the research and choose the right one for your campaign.
- **Message** - Be clear, concise and passionate about what it is you are funding and why others should care.
- **Video** - Do make one. Videos provide an opportunity to give a compelling message and an information rich version of your project's story. They can be eye catching and very personal which are good ways of engaging your investors.
- **Rewards** - Have a variety that will appeal to a range of investors, both in terms of price and style. Be prepared to amend and add to them as your campaign develops and in response to feedback. Try to make them exclusive and unique. Evaluate your rewards carefully for the cost and effort needed to produce them and make sure that you can meet those costs and commitments should they be widely purchased - not forgetting postage and packaging!
- **Social Capital** - If you haven't got any, then try to get some before you start. Build relationships with your target investors. Don't forget, its not just twitter and Facebook - your email lists and offline contacts are all very important. The more you are looking for, the more you need to have a network.
- **Scheduling** - Most seem to think a shorter campaign is better than a long one.
- **Momentum** - Get off to a good start. It's not cheating to line up some trusted parties to invest when the project goes live.
- **Respond** - Keep the updates going. It's important to keep people engaged and interested in the progress of the story.

Equity

- **Platform** - As with all forms of crowdfunding, there are a number to choose from and they are not the same. Review the process, costs and credentials for each.

- **Research** - Know your market and your idea. There is no hiding place and you need to show investors you understand your business and marketplace.
- **SEIS and EIS eligibility** - There is a strong correlation between being eligible for SEIS and EIS and equity crowdfunding success. The tax advantages for investors make the decision to invest less risky and therefore much more compelling.
- **Accounts** - There are mixed views on this, but it seems that established businesses and those that are looking for larger sums benefit from having well-prepared and well-understood financial statements. Investors will often want quite detailed information before committing to invest, so you need to be in a position to provide this to them.
- **Pitch and Video** - Your pitch should be clear and compelling and not filled with buzz words and jargon. A more professional video can be a good investment.
- **Momentum** - As with most crowdfunding campaigns, getting off to a good start is helpful as it builds confidence, so try to prepare a few early investors to step in and make an investment from the start.
- **Respond** - You will get asked questions, so be responsive and open to these.
- **Team** - Investors are often as interested in the team involved with the business as much as the idea itself. Having good people around you and making that team's skills and experience visible to the investors can be helpful.

Peer 2 Peer

- **Platforms** - Platforms vary and new ones are emerging regularly. Select one that works best for your need and pay particular attention to the process, costs and credentials.
- **Credit history** - Your personal or organisation's credit history will play a significant role in determining how costly a loan will be. Pay attention to it and understand what influences it. If you can improve your credit history, then do so.
- **Accounts and Documentation** - You will be required to provide specific documentation and financial records as you apply to be registered as a borrower on most of the platforms. Ensure that you have them and that they are in good order. Well-prepared financials will be useful in getting onto a platform but are also important in the loan auction processes, as you will almost certainly be asked to explain aspects of your books to potential lenders.
- **Respond** - If you are asked a question by a potential lender you must respond. Do not be evasive.

IV - Case Studies

Crowdfunding is neither easy nor foolproof. It is difficult, demanding and requires significant assessment, consideration and planning before it is undertaken. Many companies are not permitted onto their chosen crowdfunding platform as the platform itself considers that they are not suitable. Of those that are permitted to run a campaign, many fail. It is worth noting that the majority of reward based campaigns fail.

We have spoken to many organisations and individuals who have launched crowdfunding campaigns, and found that they were ill-prepared and their campaign subsequently failed. Whilst there are some that suggest a failed campaign can have an upside in terms of delivering insight, it can also be disheartening and brand damaging.

In many cases the failure can be attributed to unrealistic expectations and poor preparation.

However in the interests of demonstrating that it can be done and to capture some insight from some of those successes, we offer a series of case studies that capture the experience of a few successful projects from a variety of platforms and models.

Union of Genius
http://www.unionofgenius.com/
Crowdfunding type - Reward
Platform - Kickstarter
Location - Edinburgh
Target - £10,000
Achieved - £20,000

It's been such a positive experience
Elaine Mason opened Edinburgh based soup cafe Union of Genius in October 2011. The success of the cafe led to the establishment of a wholesale business in May 2012, but they quickly found that the demand from their wholesale clients meant that they outgrew the capacity of the kitchens at the cafe. To fund the refit of an expanded commercial kitchen, Elaine and partner Bruce were attracted to the idea of crowdfunding the £10,000 investment they were looking for.

"We considered other approaches but liked the social aspect of crowdfunding, but our accountant initially really struggled with the concept," Elaine laughingly told us when we talked about their successful campaign, which met its target of £10,000 and ultimately netted a £20,000 investment. "Crowdfunding is not just about financial returns. Our business is nothing without the community it works with and serves, and being on Kickstarter simply strengthened that and made it wider." The number of rewards on offer grew to 19 over the campaign, in response to what people asked for and to offer something suitable to those who were purchasing from afar as well as those who were more local. "Some rewards were being purchased from the States, people who are unlikely ever to visit us and you can't post soup," says Bruce. They chose the "All or Nothing model" of Kickstarter as they felt it added a "tension and narrative" to the project.

Their advice to budding crowdfunders? Run a short campaign. Be focused as it is demanding. Update the community and keep it fresh. Make sure the idea of the project is clear and easily understood. Be sure to fully cost your rewards and be aware of what the implications are if your project exceeds its targets. At the end of the day, it's all about people and you need to be willing to engage with them.

Veeqo
http://www.veeqo.com/
Crowdfunding Type - Equity
Platform - Seedrs
Location - Swansea
Sought £30,000 in return for 10% equity
SEIS registered

I would do it again; I do believe that it's the future
Matt Warren is an experienced ecommerce entrepreneur, having raised £850,000 to start an online luxury watch retailing site which opened in 2007. His experience of the frustration and complexity of the logistics of managing orders, inventory and despatch services when selling through multiple retail channels online led to the invention of Veeqo.

Veeqo is a middleware platform that integrates websites, retailers, couriers and other fulfilment services into a single manageable interface. Matt needed £30,000 to develop the new product and turned to Seedrs to help with that. "I could have gone back to my original investors, but I was fascinated by crowdfunding," Matt told us.

The project on Seedrs offered up 10% of the equity of the firm in return for the £30,000 and attracted 68 investors. Matt identified immediate benefits through the connections, interests and skills found within the group of investors, including potential customers for the product. He was impressed by the track record of some of the investors and felt that their credentials gave confidence to other investors. Seedrs uses a nominee model for holding the equity and this was an attractive approach for Matt as he feels it makes it easier and more straightforward to manage the relationship with investors through this model and, for him, the Seedrs interface is a good mechanism to manage the communication with his group of investors.

We asked Matt about keys to success in a crowdfunding campaign and his main advice was to create momentum. "Get off to a good start by getting some people ready to back you straight away when you start the campaign. Spend time and effort on creating a good video, it creates a good impression. Get a good team behind you as well. It helps to have a team with skills and experience - the idea is fine but what you need is a team to execute, and investors tend to look at that".

Since completing this round Matt has secured further investment for Veeqo, which he hopes will see an even quicker development schedule and an earlier launch.

"I would do it again; I do believe that it's the future. It gives your business a much bigger audience and you are much more likely to find that investor that really gets what it is that you are trying to do."

RunRev
http://www.runrev.com/
Crowdfunding Type - Reward
Platform - Kickstarter
Location - Edinburgh
Sought £350,000
Achieved - £493,000

"It's a fantastic alternative in funding!"
RunRev was founded by Kevin Miller in Edinburgh in 1997 with the goal of empowering rapid creation of applications for enterprise, commercial, creative and academic environments. In 2003, it acquired the rights to an existing programming language platform which has, since then, seen extensive development into a popular and simple to use desktop programming language which can be used, amongst other things, to create mobile apps.

The company decided they wanted to refresh and modularise the code base, make it open source, and raise the profile of the firm - all in one go! They needed to fund that process and chose crowdfunding as a mechanism to do it and settled on a reward based model, based on their belief in its cost effectiveness and a desire not to dilute the equity of the firm. The baseline target for the project was £350,000 and, with such a big target, they felt the name and scale of Kickstarter was the platform of choice. Kevin told us that the firm had a good deal of social capital to draw on, although not so much in its social media presence. Their capital was founded more in an established user group and customer base. It is Kevin's view that it was the effort of that community that helped spread the campaign awareness widely, raising its momentum considerably towards the end of the project. "Success generated success," says Kevin, "and we found the press outlets like Wired and Huffington Post began to run stories on us as the main threshold target was breached."

The curve of the campaign was a mixed one. Within 24 hours of launching they had reached 10% of their target, but it took a further 10 days to get to 20% and by halfway through their project they had only reached 25% of their target. But it was in the last week that the momentum really picked up. Ultimately the campaign raised £493,000 from 3342 backers.

Kevin makes the point that it is necessary to be realistic about the campaign and recognise that it will take dedication and effort. Planning on how to manage the campaign and to deliver on the promises and rewards you offer must be factored in. So even after doing the research and consideration to get to a decision to proceed with the campaign there was a further one month's solid work planning and preparing before the launch. The final list of 20 rewards on offer was tremendously mixed and was adjusted through the campaign to meet the needs of an extremely diverse group of investors.

Kevin's advice for anyone considering crowdfunding includes planning very carefully and having a good idea of who you are targeting. The more you are trying to raise, the bigger the community you need. Be prepared to work round the clock on it as it will take all of your time. Be willing to rework messaging, rewards and all aspects based on feedback through the campaign. Cost all of your rewards and plan for the demands of fulfilling them.

"The benefits come in on several levels. It's not just the money; that community is a tremendous asset," said Kevin.

OVIVO
http://ovivomobile.com/
Crowdfunding type - Equity
Platform - Crowdcube
Location - London
Sought £150,000 in return for 12.5% equity
SEIS eligible

OVIVO is what is known as a Mobile Virtual Network Operator (an MVNO). It is a SIM only, Pay as You Go provider founded by Dariush Zand, an experienced telecoms executive. Ambitious plans like those of OVIVO require serious funding and Dariush set a series of targets to meet the demands of taking the company from launch to profitability. Describing each step as "an external proof point" for the business, Dariush felt that there was insufficient venture in venture capital and when he needed to move to Phase 2 of his funding plan, he turned to an equity based crowdfunding campaign to raise £150,000 for 12.5% of the firm. The result was a quickly completed and over-subscribed successful crowdfund that has placed OVIVO in a position to undertake a second fundraising round on Crowdcube to hit a further "proof point".

"I am a huge convert to crowdfunding, having had little previous awareness of it," Dariush told us. "We were referred to Crowdcube by a couple of funding groups who clearly believe in it. It gives traction, exposure and reach into a community we otherwise wouldn't reach."

The process on Crowdcube required considerable due diligence for OVIVO, a process they both welcomed and understood. Dariush is dismissive of those who suggest that the equity crowdfunding model with its many small investors can create complex and unsustainable company articles and legal complexity. "If you find lawyers that have done this, as those at Crowdcube have, they can provide appropriate and flexible options to cope with the growth plans of a firm." OVIVO reached their target with 68 investors, with a typical investment being in the range of £1,000 to £2,000.

"Some of our investors have deep experience in the mobile industry and I want them to get involved because they are going to help me grow this business."

Seeing this as a growing and exciting way to finance high-growth tech start-ups, Dariush believes that there is a growing group of younger investors who are open to the emerging field of crowdfunding. "They are tech savvy and aware how this is a good source of innovative start-up investment opportunities. The market moves very quickly, you need to be highly responsive. Angels and VC will need to change with that to find their opportunities."

Clearly enthused about the process, what advice would he offer to other firms considering crowdfunding? "If you are a serious business then, of all the models available, equity based crowdfunding is, in my view, the best way to go. You really need to present well and definitely need a good team around you. It's like playing poker but everyone you are playing with can see your cards, which sounds crazy but in fact you are playing from strength because, if your cards are good, and ours are, you don't need to worry."

Sir F's
http://www.sirfs.co.uk/
Crowdfunding type - Equity
Platform - Seedrs
Location - Plymouth
Sought £9,500 in return for 15% of equity
SEIS eligible

Crowdfunding works out better for small businesses than dealing with Angels.
Sir F's is a community focused specialist patisserie retailer in Plymouth. Founded by Simon Back, it needed a £9,500 investment to get up and running. Simon did not have an extensive entrepreneurial background and found that attracting backing was tough. There was little interest from banks, and Angels were not attracted to retail and were looking typically to make larger investment. So they kept returning to crowdfunding as a viable option.

To Simon, it seemed to offer a greater diversity of participants and the equity model felt right. They felt it was the proper reward for investors who show faith and confidence in the business. Seedrs seemed to provide the most simple, straightforward and transparent process and, as something of an investment novice, Simon was encouraged by the support and assistance the platform offered.

Despite launching their campaign at a quiet time at Christmas, once the investment started to come in, it developed into a steady stream of investors through to their meeting their target. 22 investors contributed to the fund. Simon told us, "I think that being a retail project made us a little unusual and that helped us stand out amongst the other projects."

Asked for his advice for anyone else considering a similar campaign, Simon said, "Be honest. The investors are putting their money and faith in you, so be honest. If you don't you will get found out and then they won't fund you again. Also, be sure to do your research on your market thoroughly and know it so that you can answer the questions coming from the investors. They will ask and you need to show you know it."

GigDropper
http://www.gigdropper.com/
Crowdfunding type - Equity
Platform - Seedrs
Location - Liverpool
Sought £30,000 in return for 35% equity
SEIS Eligible

GigDropper is an App that will allow bands and performers to “leave” songs at specific locations, with these performances subsequently becoming available to be discovered and enjoyed by anyone using the GigDropper app on their phone at that location. Ross Evans came up with this innovative idea and, in the spirit of entrepreneurship, began the process of making it a reality. To do that, he needed funding but his experience of trying to secure it was frustrating. Too often, he came up against what he felt were too costly or excessively complex processes often backed by people who were not, in Ross’s view, particularly tech savvy.

“People didn't feel the idea was enough. Often they didn't get it or before they would even speak to me, they wanted to see the development already done and detailed extended and complicated business plans which, at the end of the day, would simply have been guesswork,” Ross told us.

Browsing Techcrunch, Ross came across an article mentioning Seedrs. This turned out to be the lead he needed to get on course for funding. Reassured by the FCA stamp of approval, he liked the way that the unfussy style of Seedrs allowed him to pitch his idea.

Reflecting on his successful funding round where he raised £30,000 for 35% of the equity in the firm, Ross mused on the motivation of his investors. “I suppose people invest for a range of reasons. First thing to remember is that it is a low barrier to get involved - you don't have to invest a fortune. Some are interested in novelty, some people are just taking a punt, some are very focused on a return, some just like to own a bit of a company they believe in.”

In pitching his project, Ross did have to offer the model of monetisation but, for him, long term cash flow forecasts were not key to the success. Despite not having any extensive social capital to draw on, the campaign was a success, although Ross concedes that having more of that social resource in his locker might have made the process easier and quicker.

That said, the process of completing the funding on Seedrs certainly raised his profile and Ross is in no doubt that he would do it again, and probably will as the company develops. “I see no reason to go anywhere else,” he says, “and second time we will have concrete figures to work with!”

GigDropper is currently being developed in Glasgow by icmobilelab.

The best advice from Ross to others would be, “Don't fill your pitch with jargon, write it to speak to the widest possible audience.”

Debasers Filums
http://www.debasers.co.uk/
Crowdfunding Type - Reward
Platform - Kickstarter and Sponsume
Location - Edinburgh
Target - $4,000 and £3,000

We struck lucky first time, but we have had three successes now!
Felipe Bustos Sierra is a Chilean filmmaker based in Edinburgh who has run three successful crowdfunding campaigns to fund the costs of his highly regarded films.

Felipe's first short film *Tixeon* won the Ovidiu Bose Pastina Award at the Anonimul Independent International Film Festival. When asked whilst accepting the prize what he would do with the money that came with the award, his immediate response was "Make another film!" Returning to Scotland on a high, he found out that the British Film Council had just closed, leaving him with few options to fill a funding gap for his planned next production *Three-Legged Horses*.

But the win at the festival had resulted in a surge in the social media connections for the filmmaker and it dawned on him that crowdfunding might be the solution. Thinking that most of the backers would come from the USA, he selected Kickstarter for the campaign. Seeking $4000 he soon discovered that the majority of his investors were coming from the UK and so, in an effort to reduce the costs associated with running a campaign on the then US based platform, he launched a second campaign on Sponsume.

Amongst the rewards he offered was a striking film poster which attracted many investors and ultimately both campaigns proved successful.

Felipe had used Facebook for some time prior to the campaign so had a good capital to draw on, but by using the crew and others associated with film he feels they reached out much further. "Typically we offer three kinds of rewards in film crowdfunding: firstly, a credit as a producer or some association with the film. These are good because in many respects they cost nothing to provide but they are sought after. Getting a credit on IMDB is hard to get now, you need to be associated with a proper film, but people love to feel part of something bigger than themselves. Secondly a DVD of the film and thirdly a poster or postcard."

There were other benefits to the process according to Felipe "We found many collaborators through using crowdfunding. The illustrator for *5,6,7,8* (his third successful crowdfunding campaign, this time on Sponsume) came to us through the campaign and we had festivals approach us about the film who had heard of us as a result of the crowdfunding."

The success of the *Three-Legged Horses* campaign was a relatively early success in the history of UK and Scottish crowdfunding and Felipe feels that this was a lucky situation for him: now that more projects are using crowdfunding, there are greater challenges to film crowdfunders. He offered this advice: "Now crowdfunding is more established, you need to be much more prepared and accept that it is immensely demanding. Grow your own social network before you start and the more you ask for, the bigger your network needs to be. You need strangers on board, so get a good video and make sure you don't come across as a chancer. Don't just say “it’s gonna be great”. You need to say HOW or WHY it’s gonna be great. For a filmmaker, if you are going to do this, you should consider this as an integral part of the filmmaking process, not just a means to an end. And make sure your rewards are affordable - quality DVDs are expensive to produce!”

Shona Maguire - Plum
http://www.plumtunes.com/
Crowdfunding type - Reward
Platform - Sponsume
Location - Edinburgh
Target - £5,000

It was better than a loan!
Shona Maguire is an award winning Scottish musician who writes and performs as Plum. Having already released an album and two EPs, Shona began to plan the recording and release of a new album called *The Seed*.

Finding the financial resource needed was challenging and the sources Shona tried proved to be both slow and unsuccessful. When an application to the Performing Right Society (PRS) ran into the sand, crowdfunding seemed the best remaining option.

Checking and approaching a number of platforms, Shona decided the “jeopardy” model of an “All or Nothing” platform was her preferred approach and decided that Sponsume was the right platform for her project.

7 reward categories were on offer and whilst Shona did not feel she had significant social capital to draw on, she found that using a combination of email, twitter, Facebook and instagram she built a successful campaign. As the rewards sold, Shona found individual mention of the supporters brought in new followers and reward buyers.

By the end of the campaign, 139 backers had pushed her total beyond the £5,000 target and the social capital of Plum had grown considerably.

The album is complete and released and Shona, or to be correct Plum, has won the Best Scottish Electronic Act at the Scottish Alternative Music Awards 2013.

Asked if she would crowdfund again, Shona told us, “Definitely. It was better than a loan, and it does generate followers.”

In terms of advice for fellow crowdfunders, her emphasis was to make it easy. Shona reflected that her rewards were very complicated and so difficult to deliver and produce. “Cost it out fully in terms of reward cost and factor in postage and packing, and platform costs,” she told us, “and be sure to have a team of people to help - it is very demanding running the campaign and following up with the all the commitments.”

V- Crowdfunding Sites

This listing is not by any means an exhaustive list of sites, but offers a collection of some of the more popular sites for reference. Whilst some might regard some of these platforms as having greater focus on certain sectors and an emphasis on social causes, each does offer services applicable and of value to businesses.

BankToTheFuture.com
https://banktothefuture.com/
An interesting hybrid model founded by Simon Dixon
Type: Hybrid Model including Reward, Lending & Equity
Model: All or Nothing
Charges and Costs: 5% of money raised (reward or equity) and £1750 legal fees+VAT (equity only) if successful. 3-5% of amount borrowed for loans
Location: UK

BloomVC
http://www.bloomvc.com/
Currently Scotland's only operating crowdfunding platform, BloomVC is also one of the most recognised crowdfunding platforms in Scotland according to our survey findings.
Type: Reward
Model: All or Nothing
Charges and Costs: 5% fee from project funding total + Paypal fee on successful projects
Location: Scotland

BuzzBnk
https://www.buzzbnk.org/
Type: Hybrid Model including Reward & Lending
Charges and Costs: £25 registration fee, 5% of total raised on successful projects
Location: UK

CrowdBnk
https://www.crowdbnk.com/
Type: Hybrid Model including Donation, Reward & Equity
Model: All or Nothing
Charges and Costs: 5% fee + 3% transaction costs if successful. £1,000 legal fees for equity campaigns
Location: UK

Crowdcube
http://www.crowdcube.com/
Now authorised by the FCA, Crowdcube was the first operating equity based platform in the UK and is taking its approach into other countries around the world.
Type: Equity
Model: All or Nothing
Charges and Costs: £250 listing fee. 5% of money raised + Legal Fees of £1750 if successful
Location: UK

Crowdfunder
http://www.crowdfunder.co.uk/
Associated with Peoplefund.it, it is part of an emerging group of platforms in the UK that collaborate closely.
Type: Reward
Model: All or Nothing
Charges and Costs: 5% of amount raised if successful + Paypal or direct debit fees
Location: UK

Fundedbyme
http://www.fundedbyme.com/
Swedish based reward and equity based platform.
Type: Reward, Equity
Charges and Costs: 6% of amount raised if successful
Location: Sweden

Funding Circle
https://www.fundingcircle.com/
One of the largest and most well established P2P platforms that does undertake peer to business lending.
Type: P2P
Model: All or Nothing
Charges and Costs: 2-5% if target reached
Location: UK

IndieGogo
http://www.indiegogo.com/
One of the largest international reward based platforms.
Type: Donation, Reward
Model: Keep It All
Charges and Costs: 4% of amount raised if successful. 9% of amount raised if you chose a flexible project and don't reach your target.
Location: US

Kickstarter
http://www.kickstarter.com/
Probably the world's most widely recognised platform, Kickstarter has generated considerable publicity from some sizeable campaigns and holds the record for the world's most valuable campaigns.
Type: Reward
Model: All or Nothing
Charges and Costs: If successful, 5% of the amount raised + 3% payment processing + VAT applied to those fees
Location: US/UK

PeopleFundIt
http://www.peoplefund.it/
With its close association with the River Cottage group, the platform has had a number of notable successes and is developing some interesting regional development initiatives.
Type: Reward
Model: All or Nothing
Charges and Costs: 5% of each contribution made by a supporter + 3% for Gocardless on contributions to successful projects
Location: UK

Pleasefund.Us
http://www.pleasefund.us/
A platform that emphasises the creative aspect of many of its projects and describes itself as the world's local fundraising platform.
Type: Reward
Model: All or Nothing
Charges and Costs: 5% fee and 1-4% payment processing fees on successful projects
Location: UK

Ratesetter
http://www.ratesetter.com/
Type: P2P
Charges and Costs: Loan fee and Credit charge fee varied on size of loan
Location: UK

Rebuilding Society
https://www.rebuildingsociety.com/
A rapidly emerging platform in the peer to business market, offering incentives to those who introduce participants to the platform and strong returns.
Type: P2P
Model: All or Nothing
Location: UK

Seedrs
http://www.seedrs.com/
FSA/FCA regulated from the start, this platform specialises in start-ups and has a novel nominee model for holding the issued shares.
Type: Equity
Model: All or Nothing
Charges and Costs: 7.5% of amount raised if successful (incl. legal fees)
Location: UK

ShareIn
http://www.sharein.com/
A soon to launch Scottish based equity platform.
Type: Equity
Model: All or Nothing
Charges and Costs: Not yet publicly available
Location: Scotland

Spacehive
http://spacehive.com/
A specialist platform, Spacehive has played a leading role in developing crowdfunding for urban development and civic projects.
Type: Donation, Reward
Model: All or Nothing
Charges and Costs: 5% of amount raised if successful
Location: UK

Sponsume
http://www.sponsume.com/
A mature and well known platform, Sponsume has an international perspective and is distinctive for its support for transactions and projects in multiple currencies
Type: Reward
Model: Keep It All
Charges and Costs: 4% fee of amount raised if successful. 9% on projects that don't successfully meet their target.
Location: UK

Squareknot
http://www.squareknot.co.uk/
A soon to launch Scottish based equity hybrid platform.
Type: Hybrid Loan and Equity
Model: All or Nothing
Charges and Costs: Not yet publicly available
Location: Scotland

Zopa
http://uk.zopa.com/
A leading and well established participant in the consumer lending marketplace which has received Government funding for sole trader lending.
Type: P2P
Charges and Costs: 0.5% of all interest and a 1% annual charge to lenders
Location: UK

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VII - Methodology

This report was produced by twintangibles between February and May 2013.

A mixed methodology was employed incorporating three main activities:

- Desk based literature search and review
- Interviews - More than 50 interviews were conducted with an extensive range of correspondents including platforms, funders and investors, crowdfunding project owners, regulators and policy makers and subjects from allied and associated groups including banks and finance communities.
- Survey - An online survey was conducted with more than 170 completed responses. The survey was promoted and publicised through numerous channels and usually presented as an access to finance questionnaire and not specifically as a crowdfunding survey. Responses were filtered to include only Scottish based firms.

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Stewart Whyte - McClure Naismith
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West of Scotland Loan Fund

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