Cambridge Centre for Alternative Finance

UNIVERSITY OF CAMBRIDGE Judge Business School

Nesta

PUSHING BOUNDARIES

THE 2015 UK ALTERNATIVE FINANCE INDUSTRY REPORT

February 2016

Bryan Zhang, Peter Baeck, Tania Ziegler, Jonathan Bone and Kieran Garvey

In partnership with

KPMG

with the support of

CME GROUP FOUNDATION

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ROBERT WARDROP

Executive Director

Cambridge
Centre
for Alternative
Finance

UNIVERSITY OF CAMBRIDGE
Judge Business School

This year's online alternative finance industry report follows its predecessors with a title reflecting the evolutionary state of an industry having a growing impact on the UK economy and the society in which we live. The Rise of Future Finance in 2013 described the size and scale of a new channel of finance emerging from outside of the traditional banking system. In 2014, Understanding Alternative Finance, analysed the surging participation of individuals and businesses both funding and fundraising. This year's report, Pushing Boundaries, reflects an industry that is coming of age, increasing its engagement with traditional institutions while speeding up its own pace of innovation.

Pushing boundaries is associated with positive change and innovation. Pushing some boundaries, however, puts trust at risk. The growth of the industry to date attests to the trust placed in platforms by many funders, fundraisers, policy makers and the general public. Many tests of this trust are to come, and the outcomes will shape the industry's growth trajectory and institutional relevance within the financial system. Tellingly, the platforms themselves recognise that the greatest risks to the continued growth and development of the industry are not increased regulation or changes to tax incentives, but events related to their own conduct: malpractice or a cyber security breach.

Each year's industry research seeks to provide insights into questions raised in our previous reports. Last year, for example, we noted the arrival of institutional investors, and this year's study analyses the scale and growth of their activity. Our aim is to continue this cycle of insightful analysis, as we believe that this year's report invites as many questions as it answers, providing the grist needed to benchmark and analyse the evolution of this fascinating industry.

STIAN WESTLAKE

Executive Director of Policy and Research

Nesta

2015 has seen another year of remarkable growth for Alternative Finance in the UK.

When Nesta began working with the sector in 2010, it consisted of a few plucky startups. The industry such as it was could be gathered around a largish table. Discussions with policymakers and regulators had to begin with careful explanations of what crowdfunding and peer-to-peer finance actually meant.

How things have changed. The UK Alternative Finance sector now does £3.2 billion of business a year, up 84% on last year. It has its first unicorn, with Funding Circle's latest round of financing valuing at over a billion dollars. And other countries look at the UK's policy set-up with interest and sometimes envy.

As the sector grows, it is sure to face challenges. In the coming year, as equity crowdfunded businesses mature, investors will be on the lookout for evidence of actual rates of return. If the economy turns sour, backers will learn more about the quality of peer-to-peer loans. Bad news on either of these fronts will be a challenge for the industry. We are also likely to see incumbents playing an increasing role: both mainstream financial institutions, who are seeking to learn from their new competitors, and institutional funders, who are providing significant amounts of the funds available on a growing number of platforms.

If the industry can rise to these challenges, its growth seems set to continue. So far, the ability of alternative finance providers to harness the power of the crowd to connect savers, borrowers and businesses has been powerful. We look forward to seeing how the sector advances in the year to come.

WARREN MEAD

Partner, Global Co-Lead of Fintech

SARAH WALKER

Director, UK Lead of Alternative Finance

KPMG

If 2015 was the year of pushing boundaries, then 2016 will be the year that so called 'alternative finance' becomes mainstream. The industry is growing up. It is bigger than ever and it is more sophisticated than ever, building out an infrastructure including risk, compliance and legal teams to support that growth.

This evolution brings both the opportunity of legitimacy and the challenge of growing pains. The industry has been legitimised through its recognition by regulators. It has been legitimised by government through the tax and ISA reforms. Even the establishment is on board, with two of the industry's pioneers appearing in the Queen's New Year's Honours list. This, together with a sharp focus on customer needs and social purpose, provides a great platform for future growth.

But for 2016 we have three critical questions.

1. Will the growth in institutional funding dilute the social purpose of alternative finance – is it no longer finance 'for the people by the people'? The majority of the market will conceivably be institutionally funded in a few years, in order to diversify funding and manage conduct risk. In that sort of world a key differentiator could be lost.
2. How will the platforms compete for assets when the incumbents are catching up with their own digital investment and customer service innovations? Are todays platforms 'alternative' enough?
3. How will the industry cope with the inevitable platform failures – there are simply too many to be economic. When they start to fail, will the legitimacy that has been so hard to win, start to crumble.

We are optimistic that the industry can respond to these challenges and thrive. 2016 looks to be another interesting year.

RUMI MORALES

Executive Director, CME Ventures

CME GROUP FOUNDATION

Type ' bank' or 'finance' into any search engine and you'll find countless images of Greco Roman buildings, calculators, stack of gold coins, and the occasional pen resting on a chart. But the world of banking and financial services is changing swiftly and dramatically, with alternatives to traditional products and services being introduced daily, significantly impacting the way people and institutions use money.

Previously, financial technology could be regarded as applications of traditional financial services upon existing technologies, but today, we are witnessing truly novel inventions with participation from previously untapped markets. Crowdfunding, invoice trading, and peer-to-peer lending are just a few examples where new participants are accessing technological innovations to create new marketplaces.

To this end, this report could not be more important or timely. The size and growth of the online alternative finance market, new entrants and partnerships, and the impacts on regulation and tax incentives, have the potential to transform the global economy. But this transformation can be best achieved only with thoughtful analysis and a thorough understanding of the alternative finance landscape.

CME Group, as the world's leading and most diverse derivatives marketplace, is proud to support the publication of this report through its Foundation. Since established nearly 170 years ago, CME Group has helped to push boundaries in the financial system to explore new frontiers in finance. We believe that it is with informed view of the possible future, we can work to achieve new opportunities and economic prosperity through financial innovation.

We would like to acknowledge the generous support received from the UK Crowdfunding Association, the Peer-to-Peer Finance Association and Innovate Finance.

We would like thank the following platforms for completing the tracking survey.


investden

investUP

JustGiving Crowdfunding

Just
Cashflow

KARADOO

LANDBAY

LandlordInvest

LENDING
WORKS

LendingCrowd

lendinvest

lendwithcare.org
Microloans from CARE International

MADISTON
Lend£oanInve$t

marketinvoice

Mayfair&Morgan

Money
&Co.

MONEYTHING.COM

neyber

Platform
Black

PrimaryBid

Property Moose

Property
Partner

Proplend


QuidCycle

You could be a Rate%Setter

REAL FUNDS

rebuildingsociety.com

sancus

Saving Stream

SEEDRS

SHARE IN

SIMPLE
BACKING

SME CAPITAL

Spacehive

StudentFunder

SYNDICATE
ROOM

TechBnk

the
house
crowd

the route
City wealth club | Finance

ThinCats.com

Trade
River

Trillion Fund

ukbondnetwork
The standard for investing and financing

VENTURE
FOUNDERS

WALACEA
back science you believe in

Wellesley & Co.

wiseAlpha

YesGrowth
Funding for business

zopa

EIGHT FACTS ON ALTERNATIVE FINANCE

IN 2015 THE MARKET GREW TO £3.2 BILLION

INVOLVING MORE PEOPLE, PROJECTS AND BUSINESSES IN FUNDING AND FUNDRAISING

NUMBER OF

FUNDERS:

1.09 million people invested, donated or lent via online alternative finance platforms in the UK

NUMBER OF

FUNDRAISERS:

254,721 individuals, projects, not-for-profits and businesses raised finance via online alternative finance models

INCREASED MARKET SHARE FOR SMALL BUSINESS LENDING AND START-UP INVESTMENT

BUSINESS LENDING:

12% of the market for lending to small businesses in the UK.

START-UP INVESTMENT:

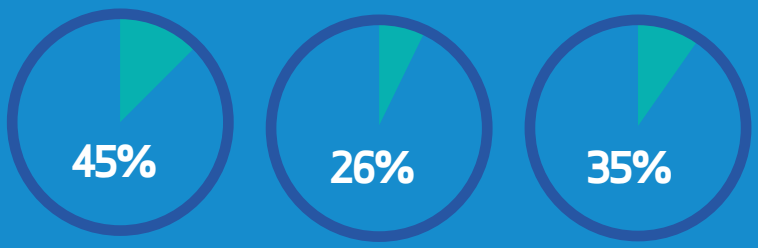
Equity-based crowdfunding is **15.6%** of total UK seed and venture-stage equity investment

REAL ESTATE IS TAKING OFF

The combined debt and equity-based funding for real estate amounted to almost ***£700 million in 2015***

THE 2015 UK ALTERNATIVE FINANCE INDUSTRY REPORT #ALTFIN16

GROWING INSTITUTIONALISATION OF THE MARKET



45% of all platforms reported some institutional involvement

26% of all P2P business loans in 2015 were funded by institutions

35% of all P2P consumer loans in 2015 were funded by institutions

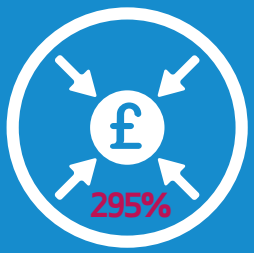
FAST GROWING MODELS:

DONATION-BASED CROWDFUNDING

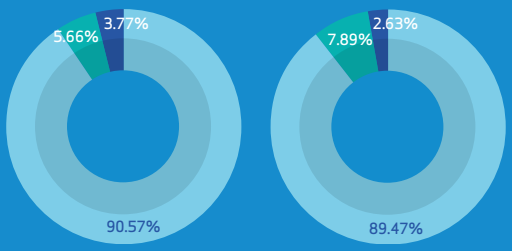
grew by 507% from £2m in 2014 to £12m in 2015

EQUITY-BASED CROWDFUNDING

is the second fastest growing sector - up by 295% from £84 million raised in 2014 to £332 million (including real estate crowdfunding) in 2015



PLATFORMS ARE HAPPY WITH EXISTING REGULATION



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

RISKS TO GROWTH

FRAUD OR MALPRACTICE

57% of platforms saw a collapse of one or more of the well-known platforms due to malpractice as a high risk to growth.

CYBER SECURITY

51% of the surveyed platforms regarded cyber security as a factor that could have a very detrimental effect on the sector.

1

INTRODUCTION

Rarely a day goes by without a story about the growth of the online alternative finance market in the UK. In 2015, many peer-to-peer lenders reported continued growth and record-breaking financing rounds. At the same time, the equity-based crowdfunding market saw its first exits, while donation, reward and community based platforms funded more good causes than ever before.

Looking beyond the headlines, what is the real state of the market in the UK?

In this study by the University of Cambridge and Nesta, in partnership with KPMG in the UK and supported by the CME Group Foundation, we show how in 2015, the combined market activity of the UK online alternative finance industry grew to £3.2 billion - an 84% increase compared to the £1.74 billion of 2014. Although the absolute year-on-year growth rate is slowing down (the growth rate between 2013-2014 was 161%),[1] the alternative finance industry still recorded substantive expansion across almost all models. Looking beyond the total market size, stand-out findings from this study include:

- **Increased share of the market for business finance:** In 2015, approximately 20,000 SMEs raised alternative finance through online channels, receiving £2.2 billion in business funding. Total alternative business lending reached £1.82 billion - 3.43% of gross national banks' lending to SMEs, based on Bank of England's 2014 baseline figure (i.e. £53 billion). Alternative business lending in our data included peer-to-peer business lending, invoice trading and debt-based securities. Looking specifically at the small business sector, we estimate peer-to-peer business lending (excluding real estate lending) supplied the equivalent of 13.9% of new bank loans to small businesses in the UK in 2015 (based on BBA's 2014 baseline figure of £6.34 billion).

- **Institutionalisation is taking off:** 2015 saw increased involvement from institutional investors in the online alternative finance market. This is particularly significant within peer-to-peer lending where we estimate that 32% of loans in peer-to-peer consumer lending, and 26% of peer-to-peer business loans, were funded by institutional investors.

- **Donation-based crowdfunding is the fastest growing model:** Although it started from a relatively small base (£2 million in 2014), donation-based crowdfunding is the fastest growing model in our 2015 study - up by around 500% to £12 million.

- **Real estate is the single most popular sector:** It is clear that real estate is the most popular sector for online alternative finance investments and loans, with the combined debt and equity based funding for real estate amounting to almost £700 million in 2015.

- **Equity-based crowdfunding is growing fast, and secured its first exits:** The second fastest growing sector in 2015 was equity-based crowdfunding, which was up by 295% from £84 million raised in 2014 to £332 million in 2015. Excluding real estate crowdfunding (£87 million), equity-based crowdfunding contributed £245 million worth of venture financing in 2015, which we estimate is equivalent to 15.6% of total UK seed and venture-stage equity investment, based on Beauhurst's data during the same period (i.e. £1.57 billion in 2015). In addition to this, 2015 saw the equity-based crowdfunding market report its first two exits, although this figure should be understood in the context of over 1,200 successfully funded deals between 2012 and 2015.

- **The industry is satisfied with current regulation:** When asked what they thought of the existing regulation of peer-to-peer lending and equity-based crowdfunding, more than 90% of platforms, for which this was relevant, stated that they thought current regulation was adequate and appropriate.

- **The biggest risk is platform fraud or malpractice:** The study asked platforms what they saw as the biggest risks to the future growth of the market. Ranking highest was the potential of a collapse of one or more of the well-known platforms due to malpractice, which was seen as a high risk to growth by 57% of surveyed platforms.

Looking at the market trends in this year's study, it is clear that the online alternative finance industry is pushing boundaries of market growth, business models, public awareness, corporate partnerships, institutional funding, product innovation, international expansion as well as further regulatory support and policy acceptance. The UK online alternative finance market is growing increasingly complex, fluid and dynamic. We hope this study will shed some light on this fast evolving alternative finance landscape.

ABOUT THIS STUDY

Since 2013, the University of Cambridge and Nesta have collaborated to systematically benchmark and continuously track the growth and development of the UK online alternative finance market.[2,3] As in our previous studies, this industry report is aimed at tracking the growth and development of the market. More importantly, we also look beyond the sheer numbers to identify the emerging industry trends and analyse the market dynamics of specific alternative finance models.

In contrast to our previous studies, the Cambridge-Nesta research team administered the 2015 UK Alternative Finance Industry Tracking Survey at the beginning of January 2016. This was carried out to collect actual transactional numbers from all four quarters of 2015, directly from alternative finance platforms, rather than projected Q4 figures as in previous studies. With the support from the online alternative finance industry, and generous help of our partners, which included the Peer-to-Peer Finance Association (P2PFA),[4] the UK Crowdfunding Association (UKCFA)[5] and Innovate Finance,[6] the research team was able to successfully survey 94 leading alternative finance platforms in the UK, over the course of two weeks, capturing over 95% of the visible UK online alternative finance market.

All survey data has been cleaned, anonymised and aggregated to analyse industry growth and market trends. Two additional platform datasets were generated using web scraping methods and added to the total survey database, which increased the overall research sample size to 96 platforms. As described in this study, the alternative finance industry is growing in complexity, with an increasing number of platforms operating hybrid models, offering a range of products across the alternative finance spectrum. For alternative finance platforms that offered 'mixed' or 'other' financing models/products, their 2015 quarterly transaction volume was then further broken down and added to its associated model based upon the information provided by that platform.

For all average data points (e.g. platform acceptance rates, funding success rates or most funded sectors), weightings (by transaction volume) were applied in order to produce the most accurate estimates based on the available data.

THE SIZE AND GROWTH OF THE UK ONLINE ALTERNATIVE FINANCE MARKET

General Trends and Dynamics within the Online Alternative Finance Market

In 2015, the UK online alternative finance market facilitated loans, investments and donations totalling £3.2 billion. Compared to the industry total of £1.74 billion in 2014, this represents a year-on-year growth rate of 83.91%. This is almost half of the 2013-2014 growth rate of 161%. Nevertheless, the rapid expansion in the size of the market in 2015 is still impressive, especially when compared to the mere £267 million raised in 2012.[7]

Looking at the 2015 quarterly data, the industry has been growing at a healthy, yet decelerating pace from 20.1% between Q1-Q2, to 14.9% between Q2-Q3 and 12.22% between Q3-Q4. Overall, the UK online alternative finance industry has certainly been testing the limits of expansion and pushing boundaries of growth. Assuming a reduced industry growth rate of between 55-60% this year, the market is still on course to surpass the £5 billion mark in 2016.

Total UK Online Alternative Finance Raised Between 2013 and 2015

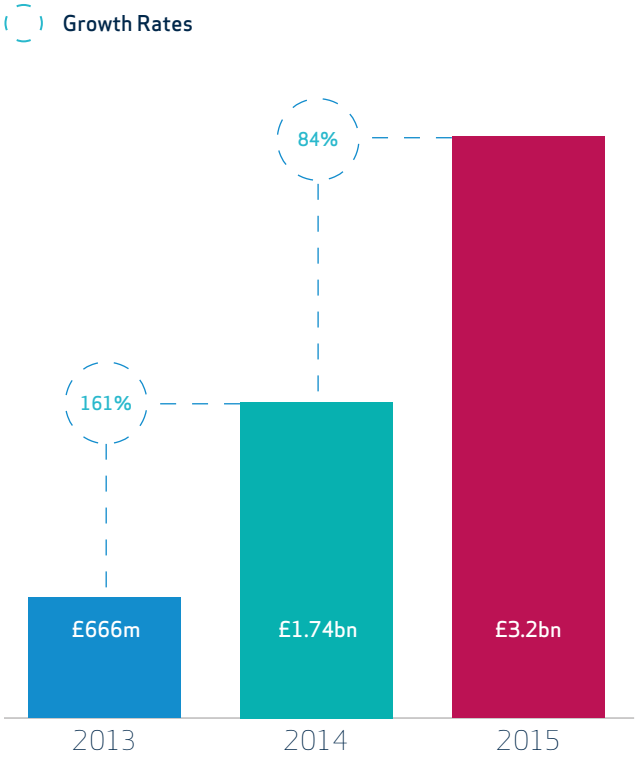


Figure 1

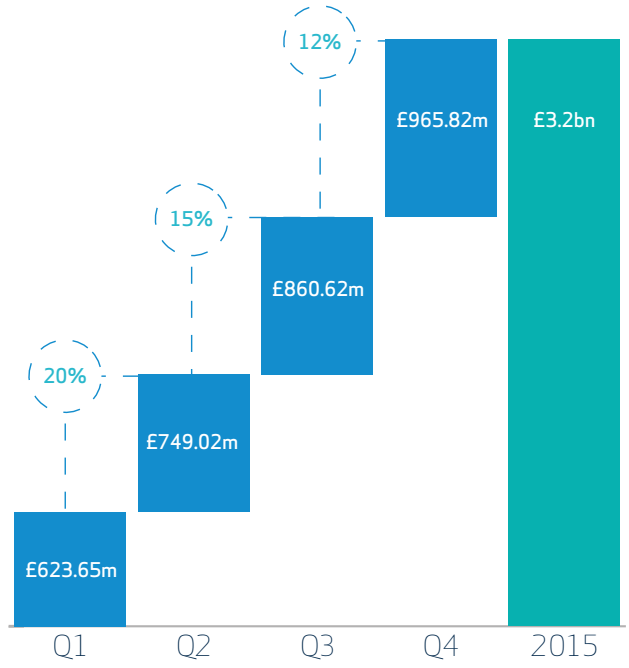


Figure 2

MARKET SIZE AND GROWTH BY ALTERNATIVE FINANCING MODELS

An Increasingly Complex Market

As the alternative finance market grows in size, it also grows in complexity challenging how we understand growth and dynamics within the different models. The first UK market study, The Rise of Future Finance (2013), developed a working taxonomy of the online alternative finance market. Since then, the industry has evolved rapidly; with innovative business practices and, consequently, blurred boundaries emerging amongst the various alternative finance models. This is evident in 2015, with 28% of platforms taking part in this study reporting that they were operating either a 'mixed' or 'other' business model, which doesn't easily fit into the existing taxonomy.

A number of peer-to-peer consumer platforms are now offering substantial volumes of business lending to both sole traders and SMEs. At the same time, peer-to-peer business lenders are facilitating increasing volumes of real estate finance - particularly to real estate developers. The breakthrough of 'online alternative real estate financing' is also evident within equity-based crowdfunding, with a significant number of platforms now offering retail investors the opportunity to buy shares/securities in a property. A number of equity-based crowdfunding platforms are also offering debt-based investment instruments, from 'mini-bonds' to 'convertible notes.' Adding further complexity, alternative finance platforms continue to develop new and innovative products such as venture/managed funds and real estate investment trusts.

The influx of institutional funding from traditional financial institutions (funds, family offices, governmental and non-governmental organisations), coupled with the increasing involvement of high net worth investors, is also blurring and pushing the boundaries of 'orthodox' peer-to-peer/crowdfunding models. Outside of the UK, this market trend has permeated the alternative finance marketplaces of the Americas, Continental Europe and Asia-Pacific countries. These different iterations of the peer-to-peer lending model have spurred debate centering on how the model should be described; either as 'peer-to-peer', 'marketplace', 'hybrid' or even 'balance-sheet' lending.

Therefore, the Cambridge-Nesta research team has refreshed, and in some cases re-defined our working taxonomy for the UK online alternative finance industry.

As illustrated in the taxonomy table, for many alternative finance models, funders can be both individuals and institutions. Alternative real estate financing, due to its significant transactional volumes in 2015, from both debt-based and equity-based models, warrants individual categories to reflect this important industry development.

Growth Across Most of the Market, but Peer-to-Peer Business and Consumer Lending Remains the Largest Models by Volume

Peer-to-peer business lending remains the largest model by volume of the UK online alternative finance market. In total, nearly £1.49 billion was lent to SMEs in the UK. This represents a 99% year-on-year growth rate and 194% average growth rate between 2013-2015.

However, it is worth noting that at least £609 million of the total peer-to-peer business lending came from the real estate sector, providing capital for mostly small to mid-sized property development companies, financing both residential and commercial developments. Many of the funders for peer-to-peer real estate lending, which we will look at as a separate peer-to-peer model in this year's market study, are institutional investors.

Nonetheless, even after excluding real estate lending, peer-to-peer business lending still recorded a sizable £881 million for the year 2015. Putting this into context, this was the equivalent of 3.9% of new loans lent to SMEs based on the BBA's 2014 baseline figure.[8] Looking specifically at new bank loans to small businesses in the UK, which is the market served by most peer-to-peer business lenders, the market share is a more sizeable 13.9% if compared with BBA lending figures from 2014.[9]

Peer-to-peer consumer lending reached £909 million in 2015, compared with £547 million in 2014. With a 66% year-on-year growth rate and a 78% average growth rate for the period 2013-2015, the peer-to-peer consumer lending sector is growing fast and continues to provide efficient consumer credit to UK borrowers. It is worth noting that a number of consumer lending platforms are expanding their borrower base by forging corporate partnerships, sometimes with disruptors and challengers

Table 1

Working Taxonomy for UK Online Alternative Finance with 2015 Total Volumes

Model name	Definition	Volume in 2015
Peer-to-Peer Business Lending	Secured and unsecured debt-based transactions between individuals/institutions and businesses with trading history; most of which are SMEs.	**£1,490m** (£881m excluding real estate lending)
Peer-to-Peer Business Lending (Real Estate)	Property-based debt transactions between individuals/institutions to businesses; most of which are property developers.	**£609m**
Peer-to-Peer Consumer Lending	Debt-based transactions between individuals/institutions to an individual; most are unsecured personal loans.	**£909m**
Invoice Trading	Businesses sell their invoices or receivables to a pool of primarily high net worth individuals or institutional investors.	**£325m**
Equity-based Crowdfunding	Sale of registered securities, by mostly early stage firms, to both retail, sophisticated and institutional investors.	**£332m** (£245m excluding real estate crowdfunding)
Equity-based Crowdfunding (Real Estate)	Direct investment into a property by individuals, usually through the sale of a registered security in a special purpose vehicle (SPV).	**£87m**
Community Shares	Withdrawable share capital which can only be issued by co-operative societies, community benefit societies and community-based charitable organisations.	**£61m**
Reward-based Crowdfunding	Donors have an expectation that fund recipients will provide a tangible but non-financial reward or product in exchange for their contributions.	**£42m**
Pension-led Funding	Mainly allows SME owners/directors to use their accumulated pension funds in order to re-invest in their own businesses. Intellectual properties are often used as collateral.	**£23m**
Donation-based Crowdfunding	Non-investment model in which no legally binding financial obligation is incurred by fund recipients to donors; no financial or material returns are expected by the donor.	**£12m**
Debt-based securities	Individuals purchase debt-based securities (typically a bond or debenture) at a fixed interest rate. Lenders receive full repayment plus interest paid at full maturity.	**£6.2m**

in other industries.. Several peer-to-peer consumer lending platforms are also expanding into business lending, driven by the influx of institutional and government funding.[10] As a result, business lending figures were deducted from the overall peer-to-peer consumer lending figures and added to the peer-to-peer business lending volume.

Invoice trading, an online alternative financial channel that facilitates the trading of discounted receivables between SMEs and individual or institutional investors, increased by 20% from £270 million in 2014 to £325 million in 2015. While the 2014 – 2015 growth is slowing down compared to previous years, the 99% three-year average growth rate is still substantial.

Equity-based crowdfunding is one of this year's fastest growing models, up by 295%, to £332 million raised in 2015, compared to £84 million in 2014. A sizable part, £87 million of the total equity-based crowdfunding volume, is from real estate crowdfunding, wherein a syndicate of individuals receive a legal share of a property, typically through equity into a registered security in a special purpose vehicle (SPV) that is operated by the online platform. In addition to property ownership, investors receive any profits/interests derived from the property, in proportion to their legal share. Excluding real estate crowdfunding, equity-based crowdfunding still raised a sizable £245 million in 2015. Comparably speaking, according to 2014 data (2015 figures have not yet been released) from the British Venture Capital

Association (BVCA)[11], 'total venture capital' funding (including seed, start-up, early stage and later stage) from its members in the UK, amounted to only £293 million, whilst Beauhurst's Seed and Venture stage finance totalled £874 million in 2014 and £1574 million in 2015, respectively.[12,13]

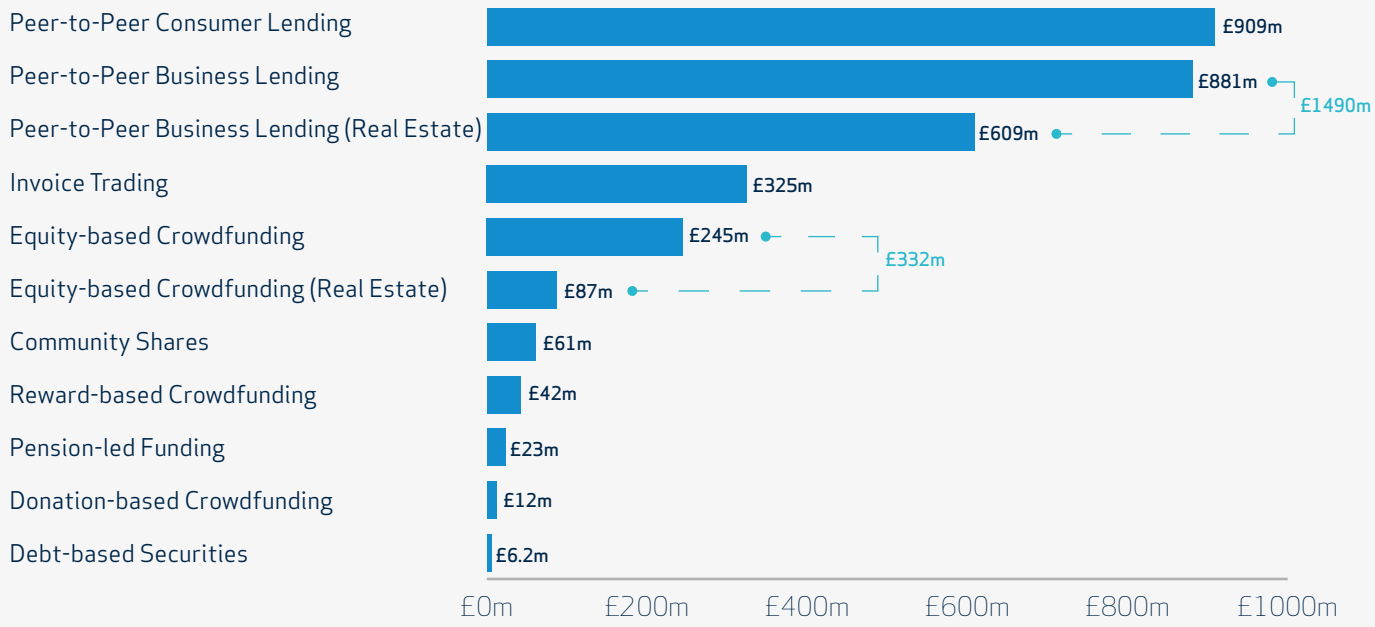
Reward-based crowdfunding, is taking hold in the UK with both national and overseas-based platforms growing fast in transaction volume and popularity. In 2015, £42 million was facilitated through reward-based crowdfunding platforms, with a 62% year-on-year growth rate.

Donation-based crowdfunding grew the fastest amongst all alternative finance models in 2015, with a 507% year-on-year growth rate and £12 million distributed. Although it was growing from a relatively low base (i.e. just £2 million in 2014), its development over the last twelve months is still noteworthy. The rapid growth of this market could have significant implications for community and voluntary sector organisations.

In 2015, community shares reached £61 million with a 79% year-on-year growth rate, while pension-led funding was almost flat with £23 million for the year. Debt-based securities, which allow investors to invest in both short-term and long-term renewable energy initiatives, achieved a very respectable £6.2 million with a 52% three-year average growth rate.

2015 Market Volume by Alternative Finance Model

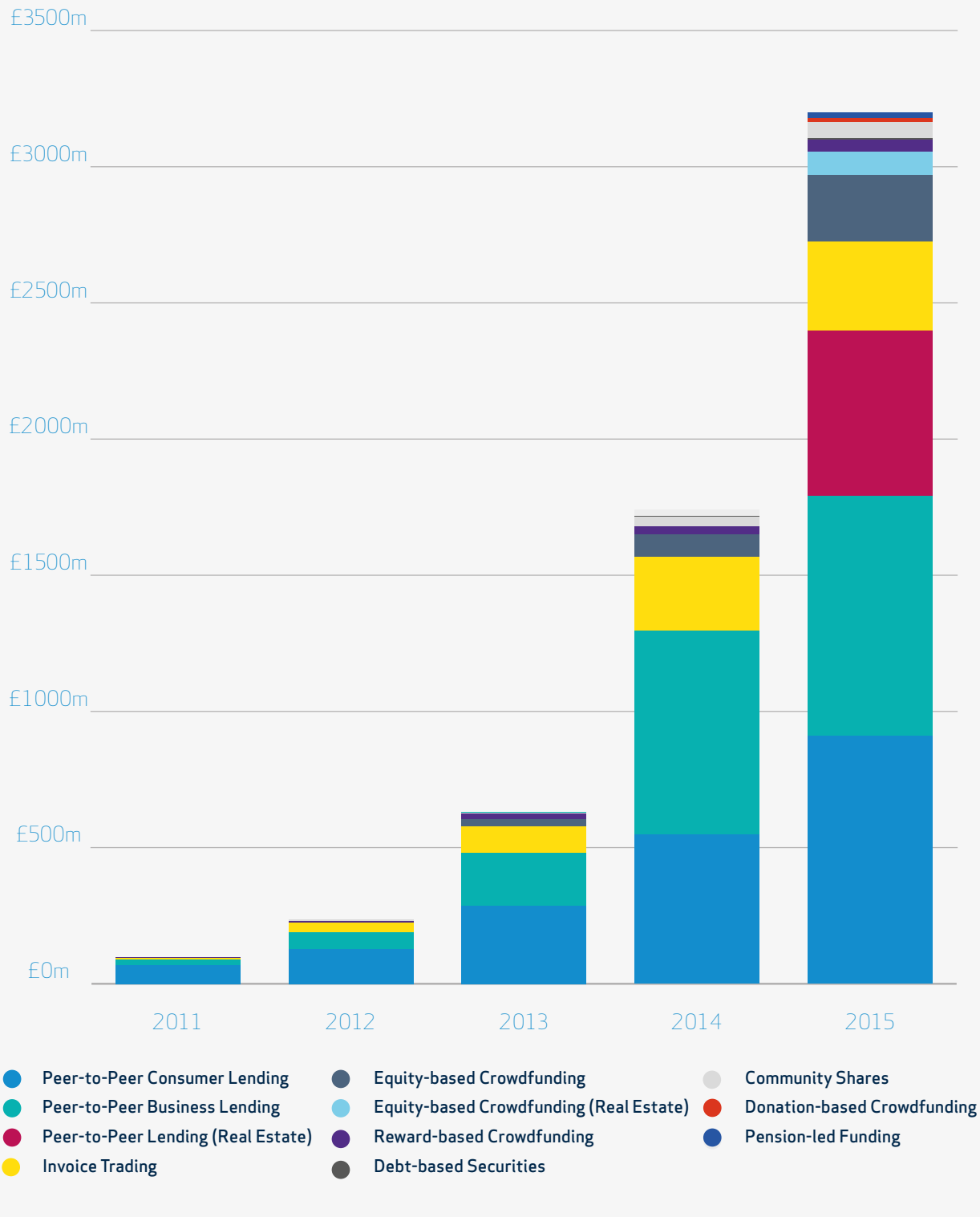
Figure 3



As illustrated below, over the course of five years, the UK online alternative finance industry has increased both in market size and in diversity. From 2011 to 2015, we have witnessed the rapid development of alternative financing models such as peer-to-peer consumer lending and equity-based crowdfunding as well as the breakthroughs of relatively new and innovative models such as peer-to-peer lending for real estate and donation-based civic and community crowdfunding.

The Development of Online Alternative Finance Models between 2011 and 2015

Figure 4

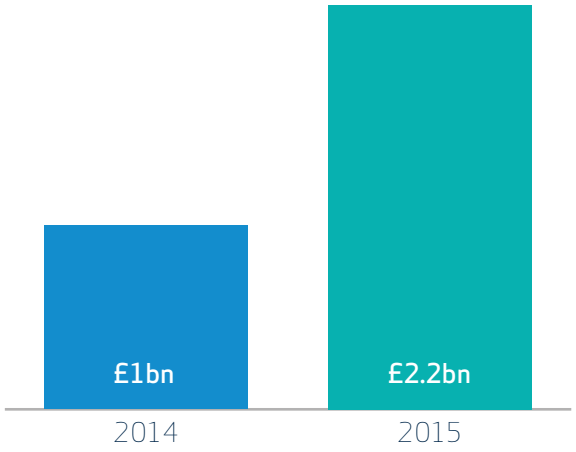


INCREASING SHARE OF THE MARKET FOR BUSINESS FUNDING

Online alternative business finance has become an increasingly important channel of financing for entrepreneurs, start-ups and SMEs in the UK, promoting economic growth, creating jobs and fostering innovation.[14] In 2015, we estimate that £2.2 billion of business finance[15] was raised through online alternative finance platforms, providing venture, working, growth and expansion capital for around 20,000 SMEs in the United Kingdom. Year-on-year, the total online alternative business funding rose by 120% from 2014 and the total number of SMEs served increased by 185.71%.[16]

Total Alternative Business Funding in 2015

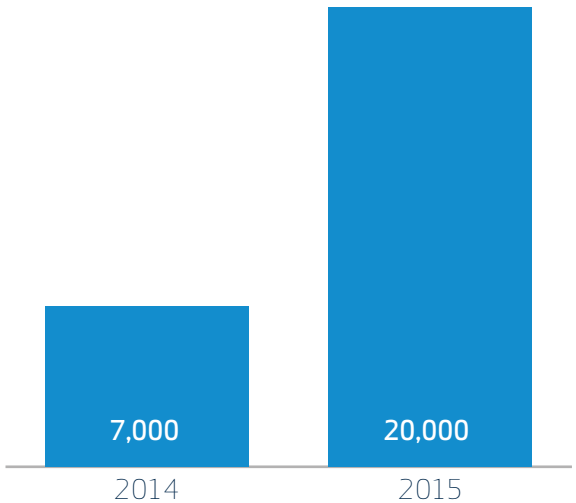
Figure 5



Comparing this to the £53 billion the Bank of England estimates was lent by national banks to SMEs in 2014,[17] we estimate that the total online alternative business lending in 2015 was 3.34% of gross national lending to SMEs. Alternative business lending in our data included peer-to-peer business lending, invoice trading and debt-based securities. If we compare the peer-to-peer business lending volume (including real estate lending) with the British Bank's Association's (BBA) annual data in new loans lent to SMEs[18], the percentage of alternative business lending has increased steadily from just 0.3% in 2012, to 0.9% in 2013 and 3.3% in 2014.

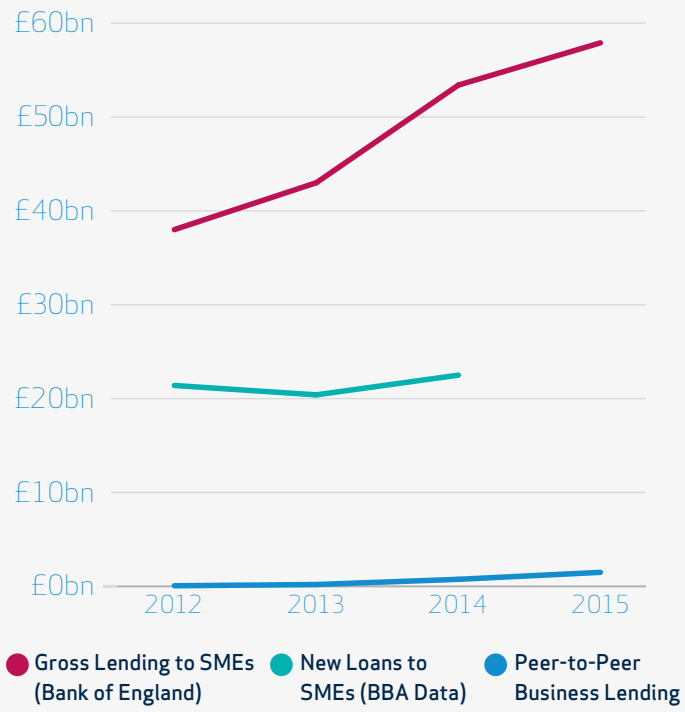
Total Number of SMEs Funded through Alternative Finance Channels in the UK

Figure 6



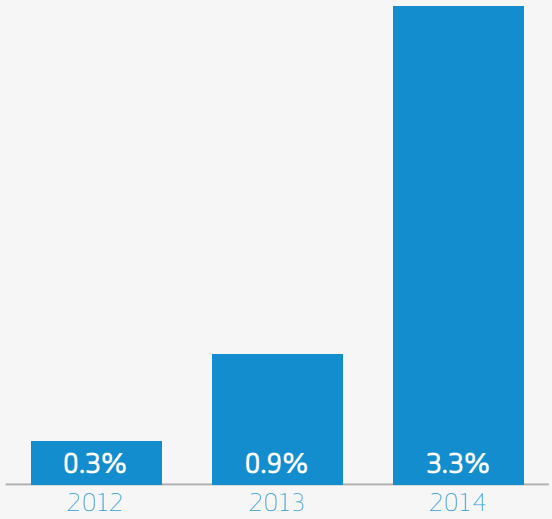
Peer-to-Peer Business Lending in the Context of Bank Lending to SMEs (2012-2015)

Figure 7



Peer-to-Peer Business Lending as a Percentage of New Loans to SMEs (Based on BBA Data 2012-2014)

Figure 8

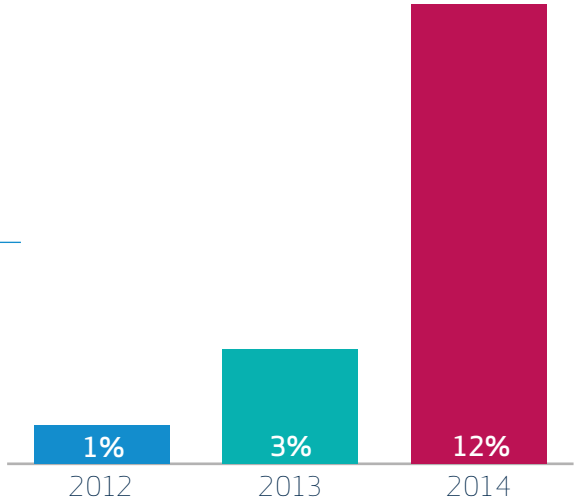


Furthermore, peer-to-peer business lending (excluding real estate lending) is predominantly catering to small business borrowers, given the average business loan size stands at just £76,280 according to our data. Therefore, as the figure below demonstrates, if we are looking at peer-to-peer lending to small businesses specifically (excluding real estate lending), then its percentage of new bank loans to small businesses (according to the BBA data)[19] has been increasing steadily from a mere 1% in 2012, to 3% in 2013, 12% in 2014[20] and an estimated 13.9% in 2015 in the UK.

From 2011 to 2015, equity-based crowdfunding has gradually established itself as a valuable provider of investment to seed, start-up, early stage and fast growing companies. This is evident when compared with both the British Venture Capital Association's (BVCA) aforementioned annual figures for 'total venture capital' in the UK and Beauhurst's figures for seed-stage and venture stage equity investment funding in the UK.[21]

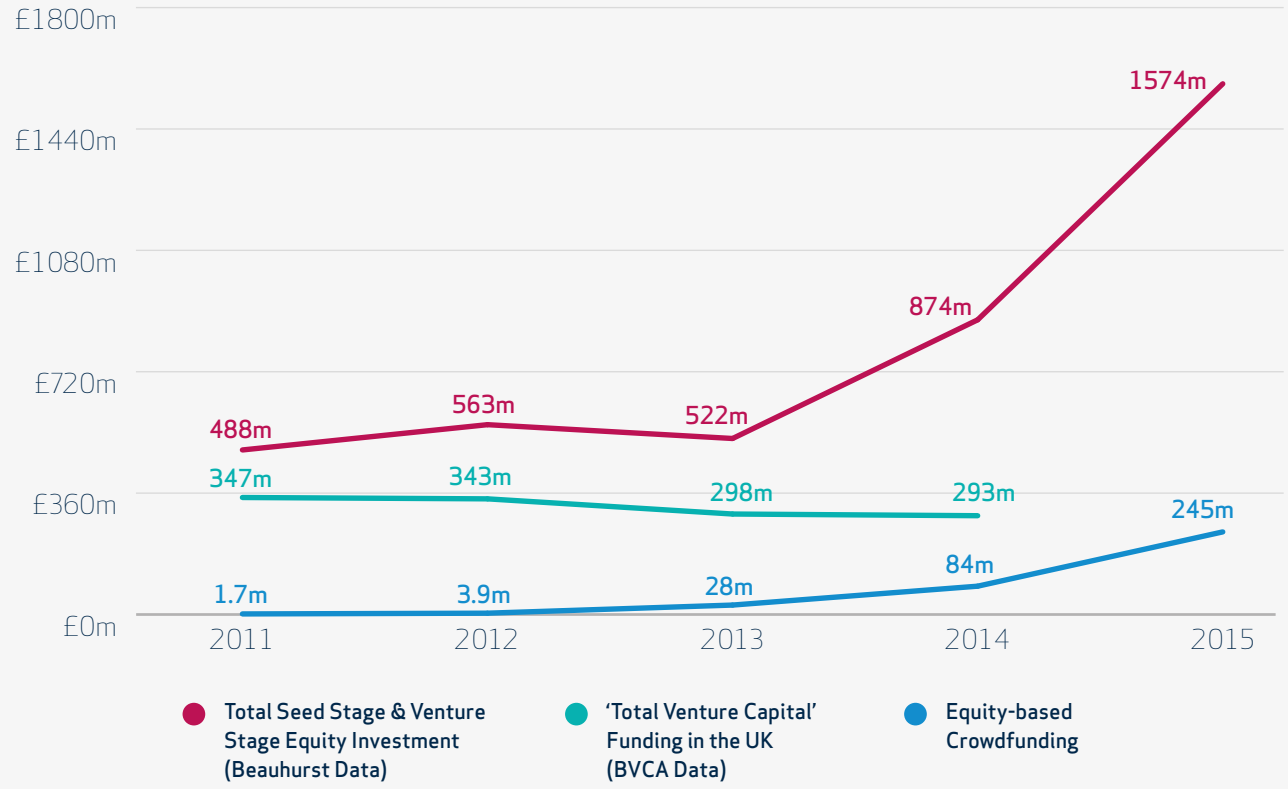
Peer-to-Peer Business Lending as a Percentage of New Loans to Small Businesses in the UK (Based on BBA Data 2012-2014)

Figure 9



Equity-based Crowdfunding in the Context of VC/ Equity Investment in the UK (2011-2015)

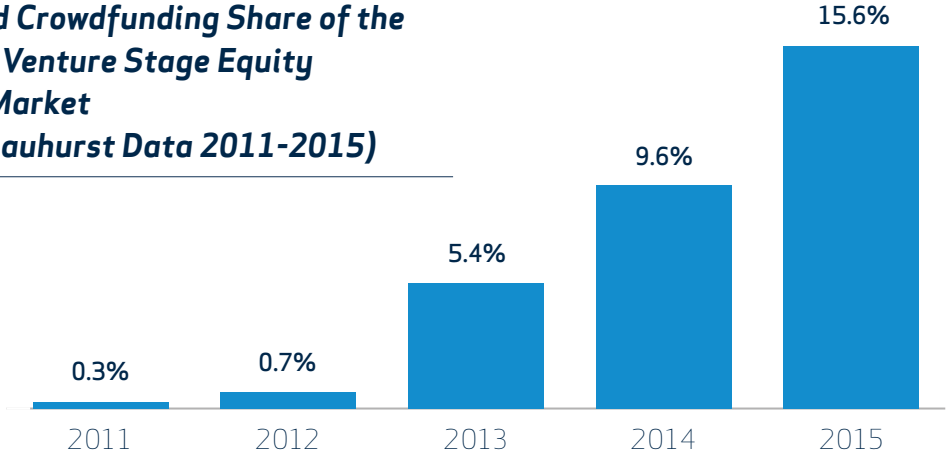
Figure 10



As the figure below illustrates, the upward trajectory of equity-based crowdfunding in the UK is evident in the wider context of Beauhurst's equity investment data (seed and venture stage financing).[22] From 2011 to 2015, the percentage of equity-based crowdfunding as a proportion of the total UK seed and venture stage equity investment has been growing rapidly from just 0.3% in 2011 to 9.6% in 2014 and 15.6% in 2015. The total number of equity-based crowdfunding deals has also increased from 175 in 2013, to 323 in 2014 and 720 in 2015 according to our alternative finance industry tracking data.

Equity-based Crowdfunding Share of the UK Seed and Venture Stage Equity Investment Market (Based on Beauhurst Data 2011-2015)

Figure 11



"Looking specifically at the small business sector, we estimate peer-to-peer business lending (excluding real estate lending) supplied the equivalent of 13.9% of new bank loans to small businesses in the UK in 2015"

2

MARKET TRENDS IN ALTERNATIVE FINANCE

EXPANDING BASE OF FUNDERS AND FUNDRAISERS

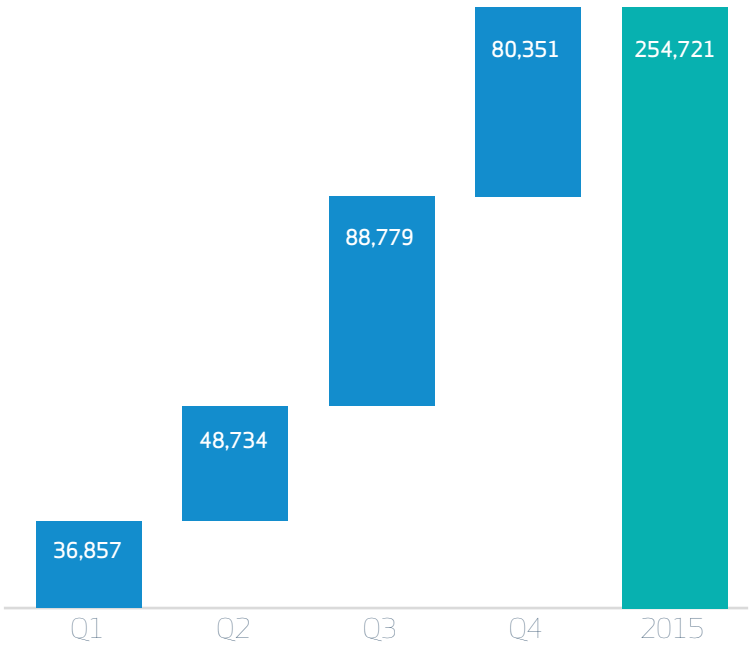
Expanding Base of Funders and Fundraisers

As the market grows, the number of fundraisers and funders is naturally increasing as well. On the funder side, platform data shows that around 1.09 million people invested, donated or lent via online alternative finance platforms in the UK. This figure likely includes a high-level of double counting; nevertheless, it demonstrates that there is a wide base of funders participating in the market.

In 2015, it is estimated that 254,721 fundraisers raised finance through online alternative finance channels in the UK. Although the number of active fundraisers was relatively low at around 36,000 in Q1 and 48,734 for Q2, the numbers picked up considerably in Q3 and Q4, registering 88,779 and 80,351 respectively. While this gives some indication of the general levels of participation within the market, it is important to note that a proportion of these will be repeat fundraisers who have raised finance for more than one business or project in 2015.

Number of Fundraisers in 2015

Figure 12



Differing Levels of Female Participation

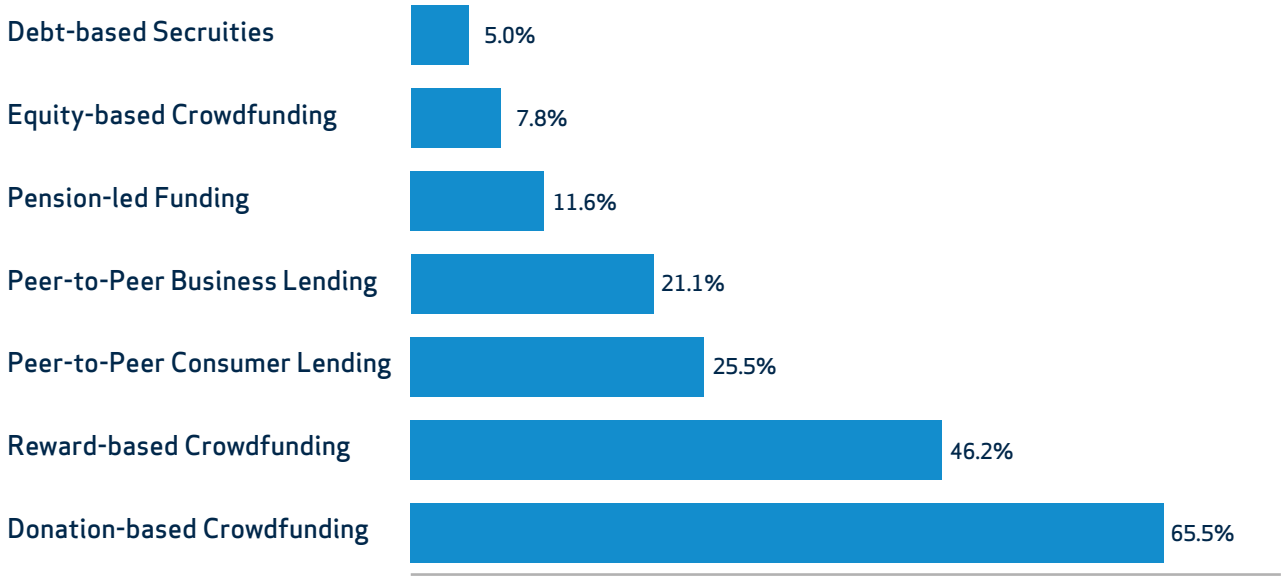
Whilst the online alternative finance industry has pushed through many boundaries in 2015, the gender gap still persists in the online marketplace, particularly within equity-based crowdfunding.

We estimate that approximately 8% of fundraisers/entrepreneurs that raised capital through equity-based crowdfunding platforms, were women. This figure is perhaps higher than that of offline venture capital and angel investing. However, the gender gap could definitely be further bridged; especially when considering female participation rates are so much higher in other online alternative finance models. For instance, while 21.1% of SME borrowers on peer-to-peer lending platforms are female, the percentage of female fundraisers is 46.2% on reward-based crowdfunding and 65.5% on donation-based crowdfunding platforms.

Female participation in the online alternative finance market is markedly higher on the funder side. 23.2% of investors using equity-based crowdfunding platforms were women, in comparison to 29.5% in peer-to-peer consumer lending, 34% in peer-to-peer business lending and 55% in donation-based crowdfunding. The percentage of female funders was also considerably higher in debt-based securities (45.5%) in contrast to fundraisers (only 5%), although this finding should be taken with some caution as it was based on a relatively small sample of data. For reward-based crowdfunding, the percentage of female participation on the funding side is almost identical to the fundraising side at around 46%.

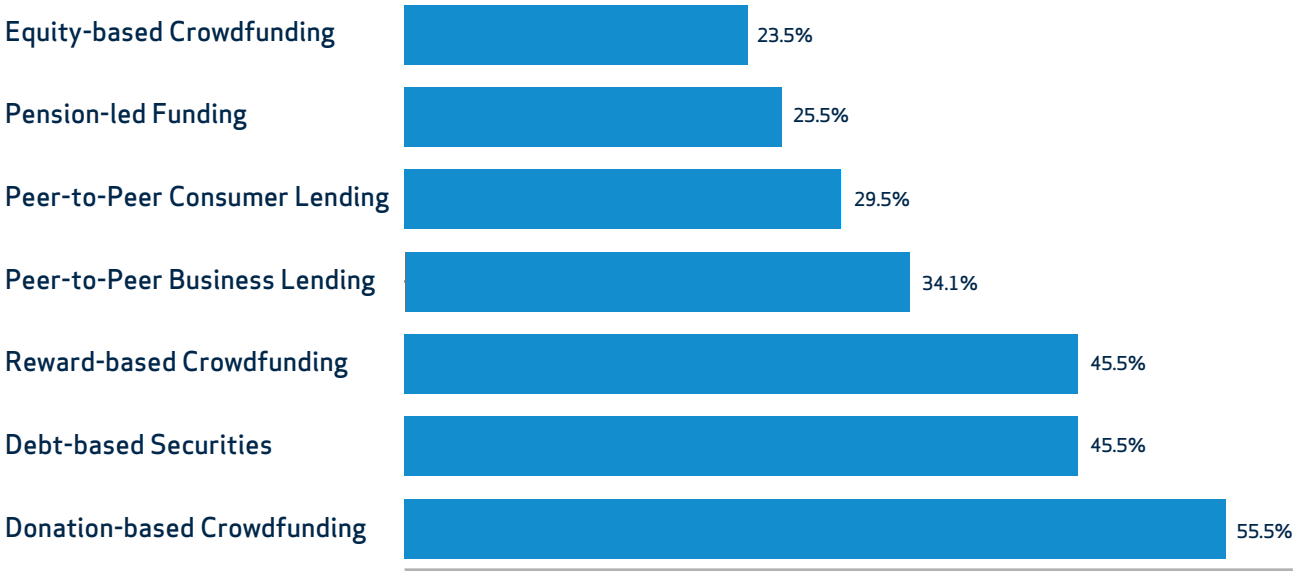
Percentage of Female Fundraisers Across Platforms (Weighted 2013-2015)

Figure 13



Percentage of Female Funders Across Platforms (Weighted 2013-2015)

Figure 14



MARKET ENTRANTS AND PARTNERSHIP STRATEGIES

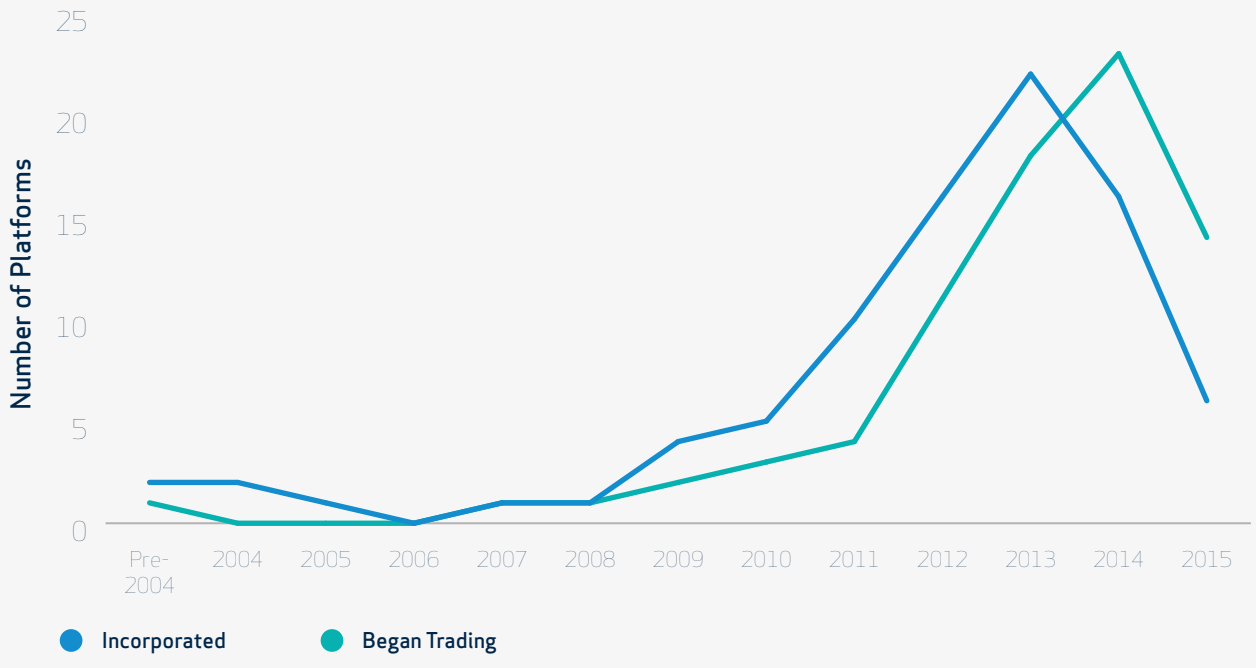
New Entrants to the Alternative Finance Market

This year's study suggests that the alternative finance market is beginning to consolidate. Since previous years' studies, a number of alternative finance platforms have either 'gone quiet' or disappeared altogether. In addition, while 24 new platforms started trading in 2014, 2015 saw only 14 new platforms start trading. This indicates that the number of new platforms entering the market may be beginning to plateau. Looking at the platforms facilitating online alternative finance, it is clear that growth is driven by both existing platforms increasing their total volumes, as well as new platforms that are still entering the market.

As illustrated below, large numbers of alternative finance platforms have been incorporated and started trading in the last three years, although this number appears to be starting to stall between 2013 and 2015. The average number of years between incorporation and actually starting to trade for a peer-to-peer business lending platform is 1.16 years and 1.27 years for an equity-based crowdfunding platform. Although the time gap between incorporation and trading cannot be entirely attributed to the FCA authorisation process, these data points could serve as a useful proxy for authorisation time.

Alternative Finance Platform Incorporation and Trading (Pre-2004 to 2015)

Figure 15



SEEKING GROWTH THROUGH AWARENESS, INCREASED MARKETING AND FORGING PARTNERSHIPS

As competition in the market grows, other than creating innovative models, platforms are utilising new methods to attract funders and fundraisers. A wide range of major online alternative finance platforms were leveraging mainstream and online advertising and marketing channels, including television.[23] Particularly in London, peer-to-peer lenders, rewards and equity-based crowdfunding platforms alike have used advertisements on billboards, buses, taxis or trains to reach new customers.[24]

In addition, alternative finance platforms have started marketing specifically to independent financial advisors (IFAs), business associations (e.g. The Federation of Small Businesses) and other financial intermediaries (e.g. commercial brokers) in an effort to further raise SMEs' awareness and use of their services.[25,26]

Besides raising general awareness, alternative finance platforms are also utilising private and public sector partnerships to source both high-quality borrowers/ fundraisers and institutional funding. For instance, it is estimated that at least 39 British universities are using online alternative finance models [27] to engage their alumni communities in starting and funding various projects. A large number of regional or local authorities, including Plymouth,[28] Angus,[29] Lancashire[30] and Manchester,[31,32] have either partnered with online alternative finance platforms to fund local SMEs or have raised alternative finance to fund community projects.[33,34,35,36] Innovative corporate partnerships are being forged between alternative finance platforms with the likes of Virgin,[37] Amazon,[38] Uber,[39] Sage[40] and KPMG.[41] This has certainly pushed boundaries - fusing the traditional corporate world with the disruptive models of alternative finance.

Moreover, while the Government's SME referral scheme is still in development, a number of alternative finance platforms have formed bilateral referral partnerships with banks such as Santander,[42] RBS[43] and Metro Bank[44] to source high quality borrowers and fund more SMEs. As the alternative finance ecosystem continues to develop, a number of online aggregators (e.g. ABF, FinPoint, Funding Options and Informed Funding to name but a few) have emerged to provide additional channels and services to connect fundraisers, predominantly businesses, to alternative finance platforms.[45]

"Besides raising general awareness, alternative finance platforms are also utilising private and public sector partnerships to source both high-quality borrowers/ fundraisers and institutional funding"

INSTITUTIONALISATION OF THE MARKET

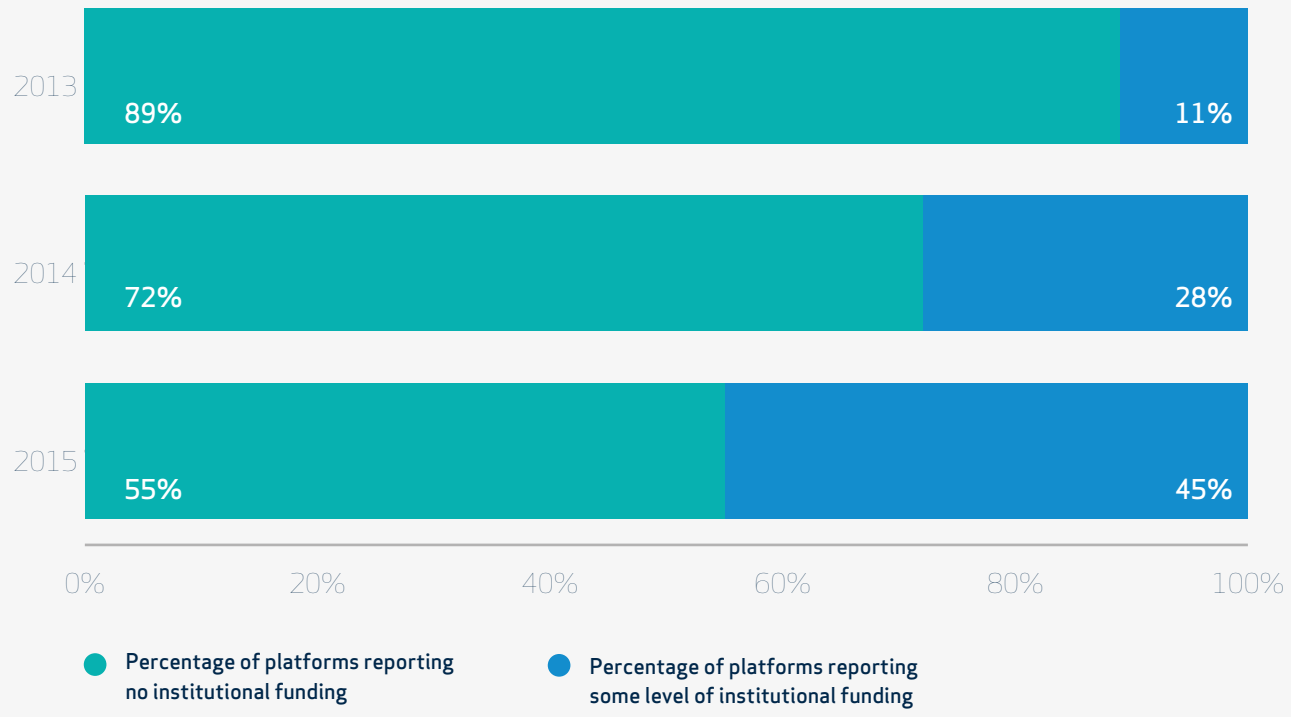
Increasingly Entrenched Institutionalisation

To reflect the growing interest and involvement from institutional investors, such as banks and investment funds in the online alternative finance market, this year's study has sought to quantify the level and volume of participation by these relatively new funders within the market.

Based on platform reporting, it is estimated that 1,031 institutional funders were actively involved in financing or co-financing loans or equity deals on alternative finance platforms in the UK in 2015. Looking at participation over time, it is clear that this is a trend that really began to take off in 2015, with 45% of platforms reporting institutional involvement, compared to 28% in 2014 and just 11% in 2013.

Growing Involvement of Institutional Funding in the UK Alternative Finance Market (2013-2015)

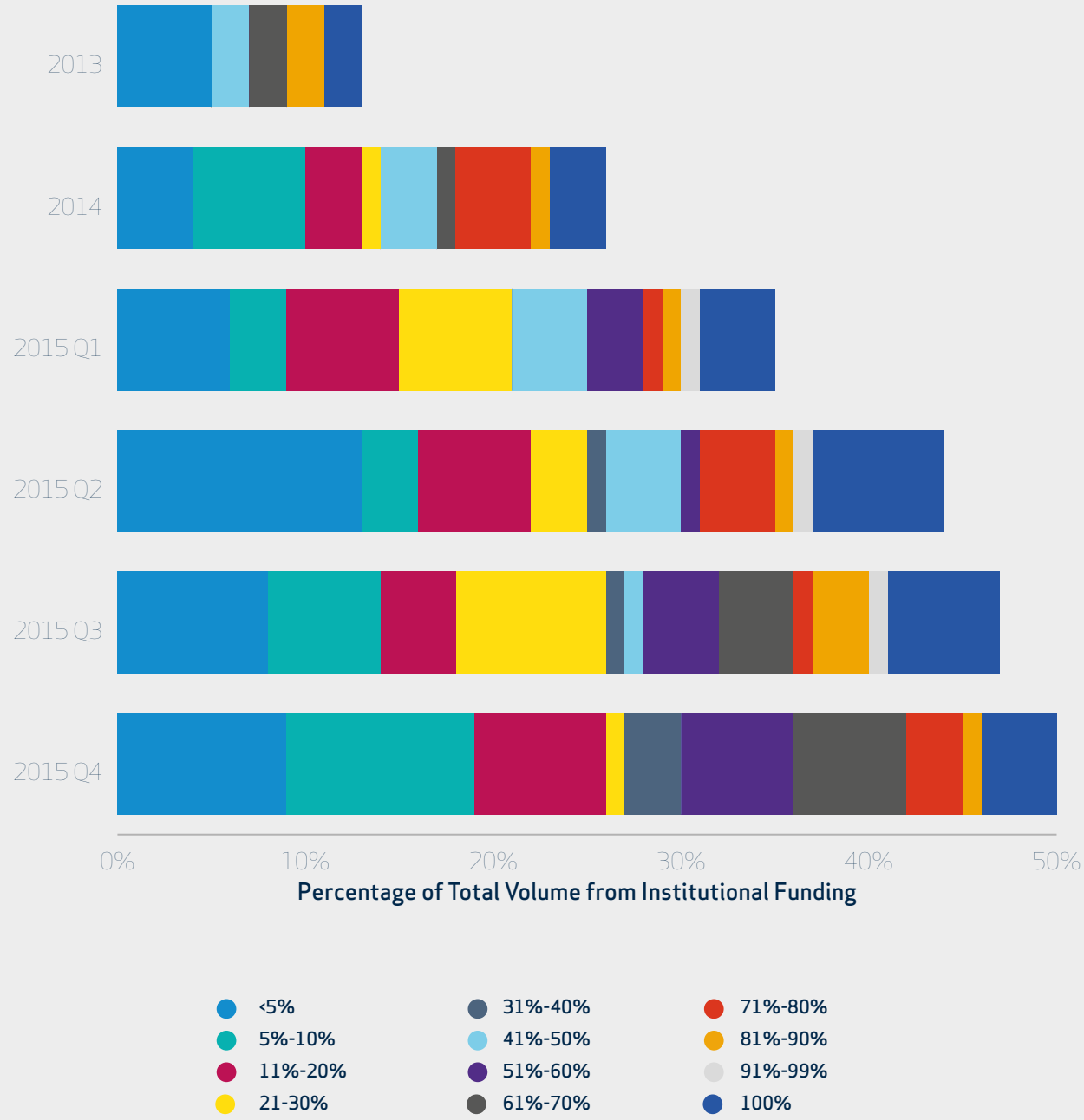
Figure 16



A quarterly breakdown for institutional involvement in 2015 provides further indications that this is a growing trend, with more than 50% of platforms reporting institutional involvement in Q4 compared to 35% in Q1. Notably, over 10% of surveyed alternative finance platforms reported channeling over 80% of institutional funding (as a proportion of their total funding) in Q2 and Q3 in 2015.

Institutional Funding as a Percentage of Total Volume as Reported by Platforms (2013-2015)

Figure 17

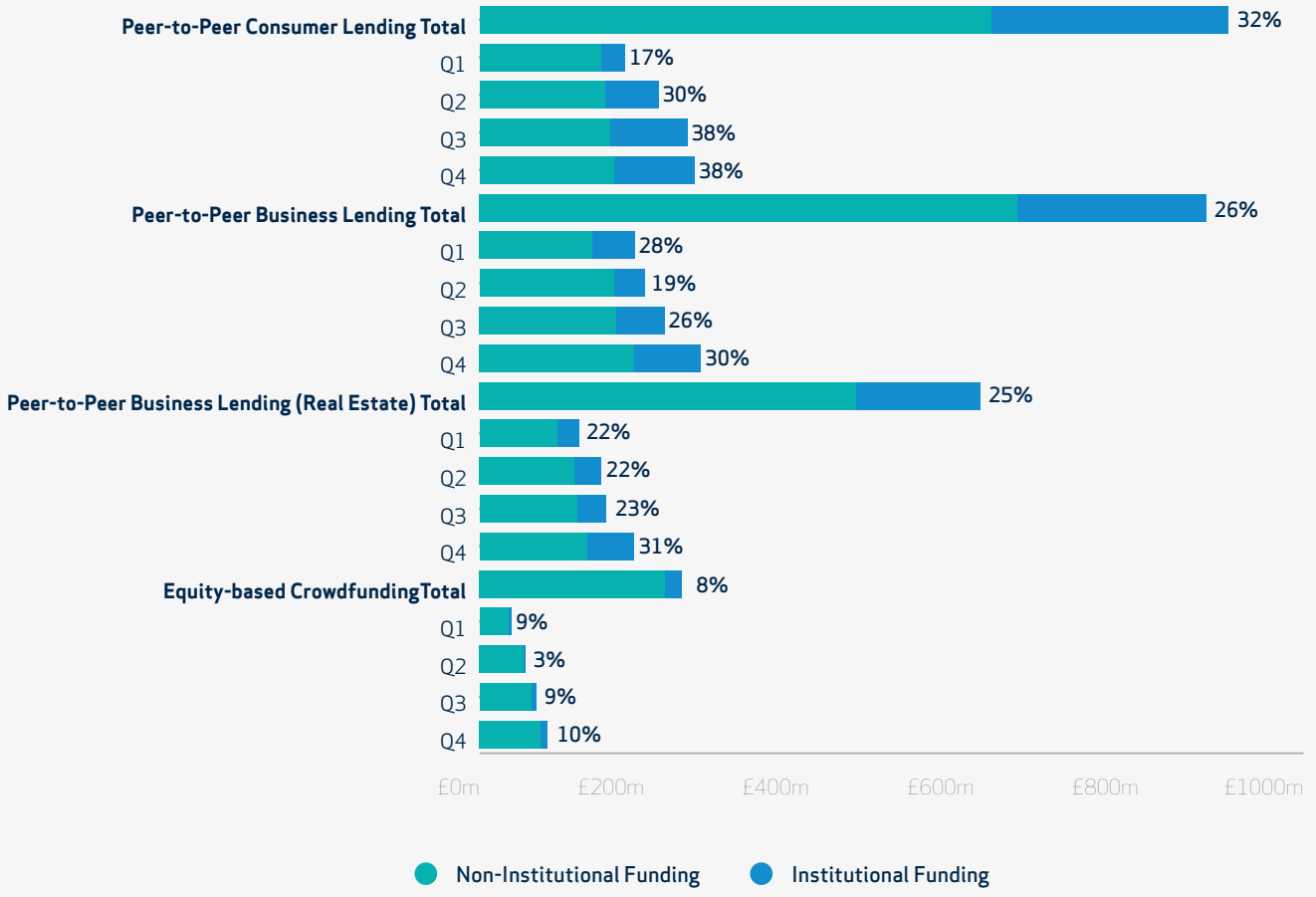


In terms of actual institutional funding volume, as the figure illustrates below, in 2015 32% of the total peer-to-peer consumer lending was derived from institutions. The level of institutional funding for peer-to-peer consumer lenders was relatively low, at 17% in Q1, and then increased to a sizeable 30% in Q2 and remained at 38% throughout both Q3 and Q4, showing clear signs that institutionalisation is a growing trend which is expected to continue in 2016.

For peer-to-peer business lending, 26% of total funding in 2015 could be attributed to institutional funding. In contrast, peer-to-peer real estate lending recorded 25% of institutional funding with quarterly percentages increasing from 22% in Q1 and Q2 to 23% in Q3 to 31% in Q4. By way of comparison, the level of institutional funding in equity-based crowdfunding is still relatively low at only 8% for 2015 overall.

The Percentage of Actual Institutional Funding Across Models in 2015 (Weighted)

Figure 18



The sources of institutional funding vary significantly from model to model. For peer-to-peer lenders, traditional banks, mutual funds, pension funds,[46] hedge funds and asset management companies[47] are increasingly important. Public and governmental funders, such as local authorities[48] and the British Business Bank,[49] are also actively lending to SMEs through alternative finance channels.

Despite developing at a relatively slower rate, and at a smaller scale than the Pee-to-Peer lending market, institutional funding and match funding are becoming increasingly commonplace within the equity, reward and donation-based crowdfunding models. The involvement of entities such as the London Co-Investment Fund (LCIF),[50] the Department of International Development (DFID)[51] and Ben & Jerry's,[52] are raising awareness of alternative finance platforms by attracting both fundraisers and funding to these models. This year also saw the emergence of platform-owned and self-managed listed investment trusts, funds and vehicles,[53] a sign that platforms are beginning to challenge the fund management space.[54]

CROSS-BORDER TRANSACTIONS AND INTERNATIONALISATION

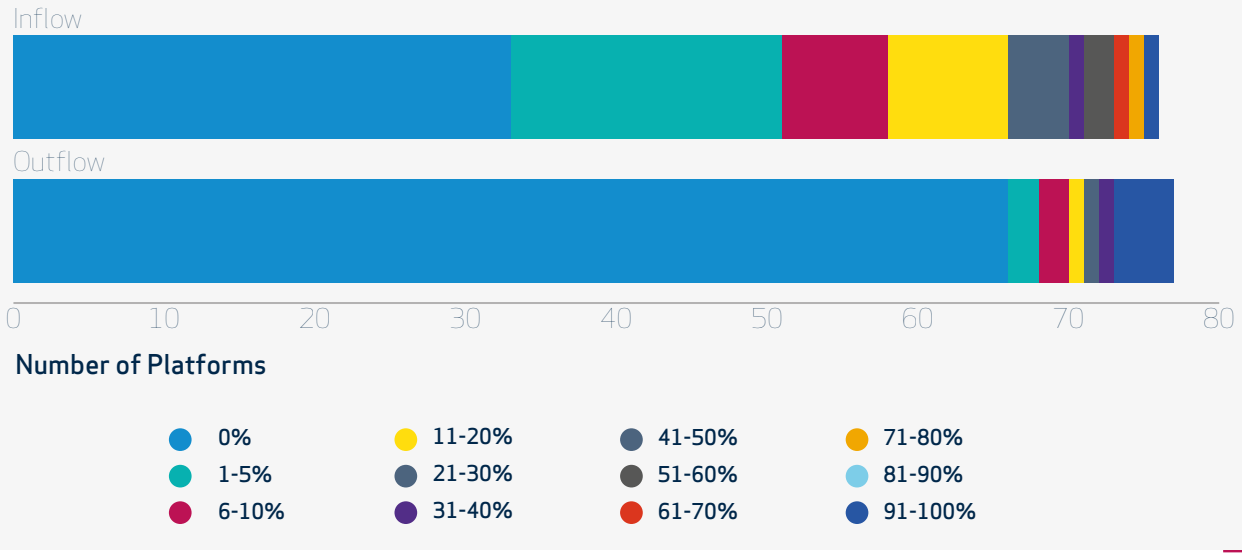
One of the hallmark market developments for alternative finance in the UK has been the increasing international expansion in the last few years. Since 2014, we started witnessing some of the leading peer-to-peer lending and equity-based crowdfunding platforms pushing geographical boundaries and expanding operations throughout Europe[55] and as far as the USA[56] and Australia.[57] Whether through organic expansion or by merger & acquisition, there are clear signs that alternative finance platforms are increasingly looking beyond the UK to grow their business.

For alternative finance platforms headquartered in the UK, cross-border activities have picked up with increasing transnational interactions and engagements. We asked platforms to give estimates of their overseas funding inflow (i.e. what percentage of funding raised through the platform for UK-based fundraisers, came from funders outside of the UK) and funding outflow (i.e. what percentage of funding raised through the platform went to fundraisers not based in the UK). For the vast majority of UK alternative finance platforms, there is little to no funding outflow activity. However, more than half of the surveyed platforms reported a certain degree of funding inflow from overseas, with around 17% registering medium (approximately 25%) to high levels (55%) of funding (as % of total funding volume) from foreign countries.

Nevertheless, the amount of funding inflow and outflow varies greatly between models. For peer-to-peer business lending platforms, there has been little or no cross-border activity reported. Whereas, for equity-based crowdfunding, the weighted funding inflow and outflow was reported at 11.55% and 4.86%, respectively. The high levels of funding outflow from reward-based crowdfunding could be a reflection of the great success of a number of US-based platforms in the UK.

Cross-Border Transaction Percentages for the UK Alternative Finance Market

Figure 19



THE GEOGRAPHY AND INDUSTRIES & SECTORS OF ALTERNATIVE FINANCE

London and the South Still Dominate the Alternative Finance Landscape

While the industry is growing across the UK, there is a distinct level of variation in where funding and fundraising takes place. We asked the platforms to identify and rank the top 5 most active regions in which they operate, both in terms of funding received and funding provided.[58] London remains the most active UK region by total transactional volume, in both fundraising (funding received) and funding (funding provided). The South East, South West and West Midlands followed thereafter, with Scotland ranking as the 5th most active region for receiving funding and the East of England being the 5th most active region for providing funding.

Ranking	Funding Received	Funding Provided
1	London	London
2	South East	South East
3	South West	South West
4	West Midlands	West Midlands
5	Scotland	East of England
6	East Midlands	East Midlands
7	North East of England	Scotland
8	East of England	North East of England
9	Yorkshire and The Humber	Yorkshire and The Humber
10	Northern Ireland	Northern Ireland
11	Wales	Wales
12	North West	North West

Table 2

Real Estate, Technology and Manufacturing & Engineering are the Most Popular Sectors

Similar to regional activity within the UK, we also asked platforms to rank the 3 most popular industry sectors funded on their platforms. Looking across the range of the most funded industry sectors, it is no surprise that 'Real Estate and Housing' constituted the single most popular sector given the combined debt and equity-based funding for real estate amounting to almost £700 million in 2015. Nevertheless, the top ten most funded sectors outlined below demonstrate the diversity of the UK online alternative finance industry, from funding for technology, manufacturing & engineering to food & drink and social enterprises.

	Sector Ranking
1	Real Estate & Housing
2	Technology
3	Manufacturing & Engineering
4	Food & Drink
5	Retail & Wholesale
6	Leisure & Hospitality
7	Community & Social Enterprise
8	Finance
9	Construction
10	Education & Research

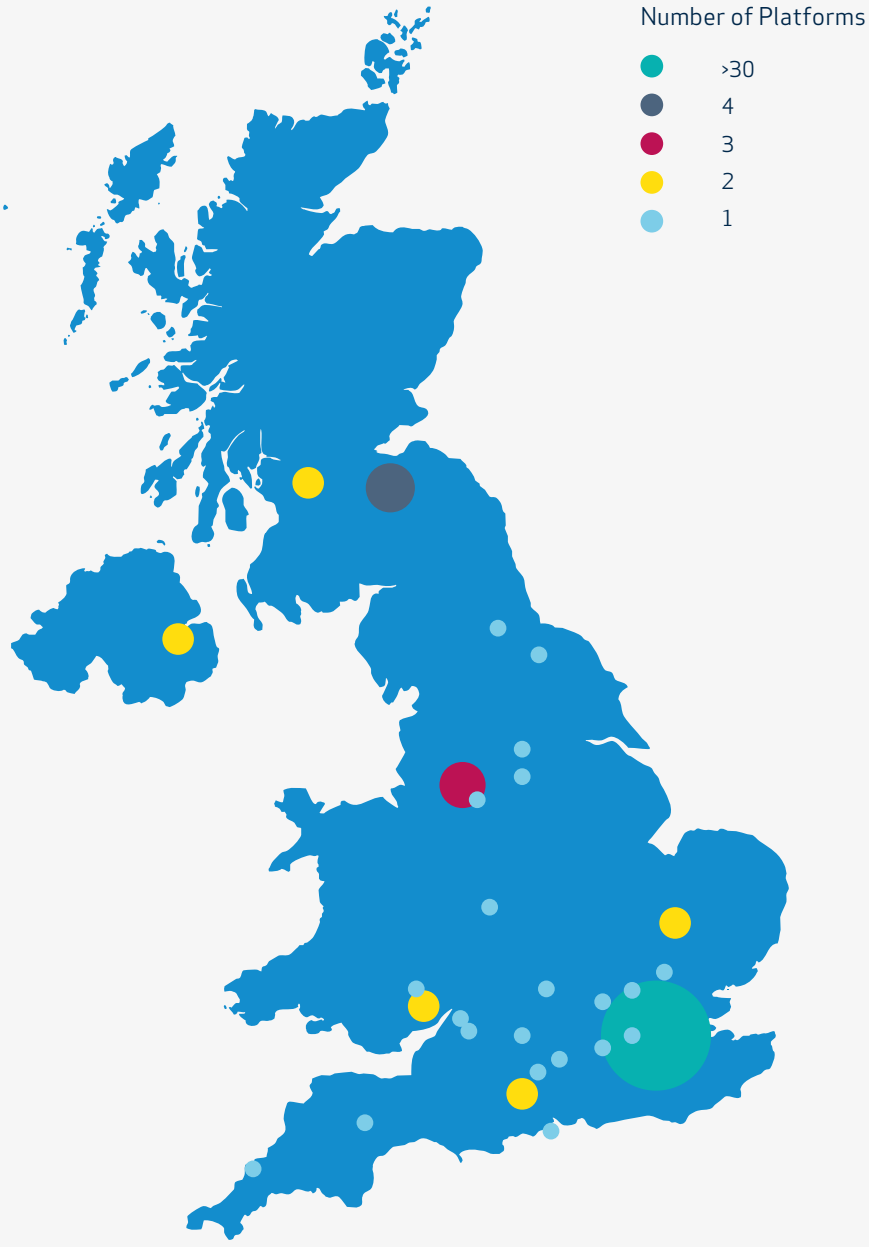
Table 3

Geographic Distribution of Platforms in the UK

As illustrated by the figure below, the South dominates the map with respect to the location of platform headquarters. 58 platforms (which is equivalent to 62% of the platforms who participated in the study) are headquartered in London, followed by Edinburgh, Manchester and Cardiff.

The Distribution of Surveyed Online Alternative Finance Platforms in the United Kingdom

Figure 20



INDUSTRY PERSPECTIVES ON REGULATION AND TAX INCENTIVES

Alternative Finance Platforms are Broadly Satisfied with Existing Regulations

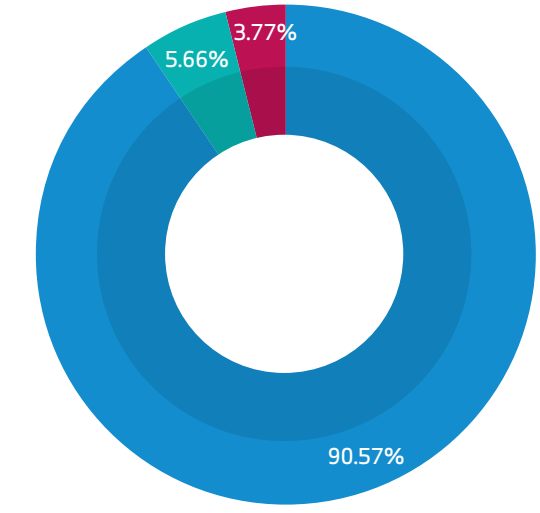
In 2014, the Financial Conduct Authority (FCA) introduced regulation of peer-to-peer lending and equity-based crowdfunding, which after a period of transition, will come into full effect in 2017.[59] Having now been in place for more than a year, we were interested in better understanding the platforms' perspectives of the FCA's regulatory approach.

It is evident that the vast majority of alternative finance platforms are satisfied with existing regulation. For instance, 91% of surveyed peer-to-peer lending platforms stated that they regard the current regulation as 'adequate and appropriate', with only 5.66% suggesting that tighter and stricter regulation should be introduced. Just 3.77% stated that regulation is 'excessive and too strict'. A very similar picture can be seen within equity-based crowdfunding, where 89% of platforms reported that existing regulation for investment-based crowdfunding is 'adequate and appropriate'. As with peer-to-peer lending, where a few (7.89%) surveyed platforms advocated for a tighter and stricter regulatory approach, only 3% of the surveyed equity-based crowdfunding platforms thought the current FCA regulation is too 'excessive and strict'.

One particular aspect of FCA regulation that has drawn some attention is the approach to online and social media promotion. We were therefore interested in better understanding the industry's perspective of this specific part of the regulatory framework. According to our survey data, while the majority of the platforms (77%) still think regulation in this area is adequate and appropriate, 21% of surveyed platforms think that the FCA's approach to online and social media promotion is 'excessive and too strict' for their platforms' activities.

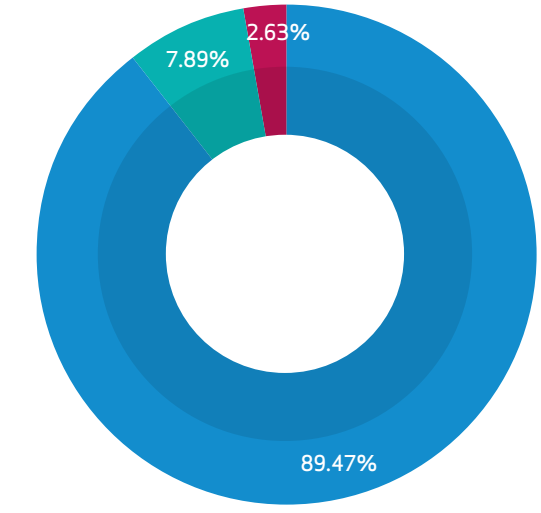
Industry Perceptions of FCA Regulatory Approach to Peer-to-Peer Lending (2015)

Figure 21



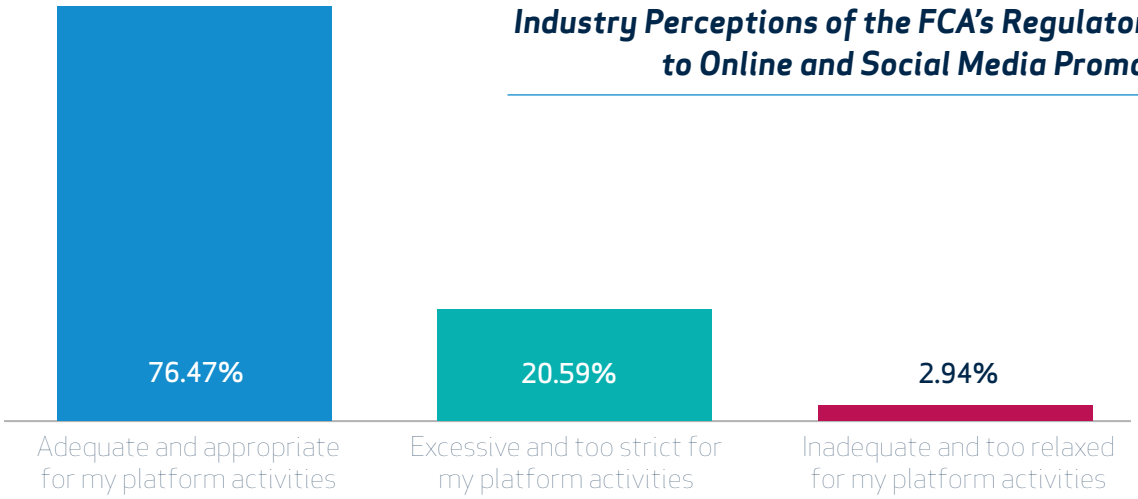
Industry Perceptions of FCA Regulatory Approach to Investment-based Crowdfunding (2015)

Figure 22



Industry Perceptions of the FCA's Regulatory Approach to Online and Social Media Promotion (2015)

Figure 23



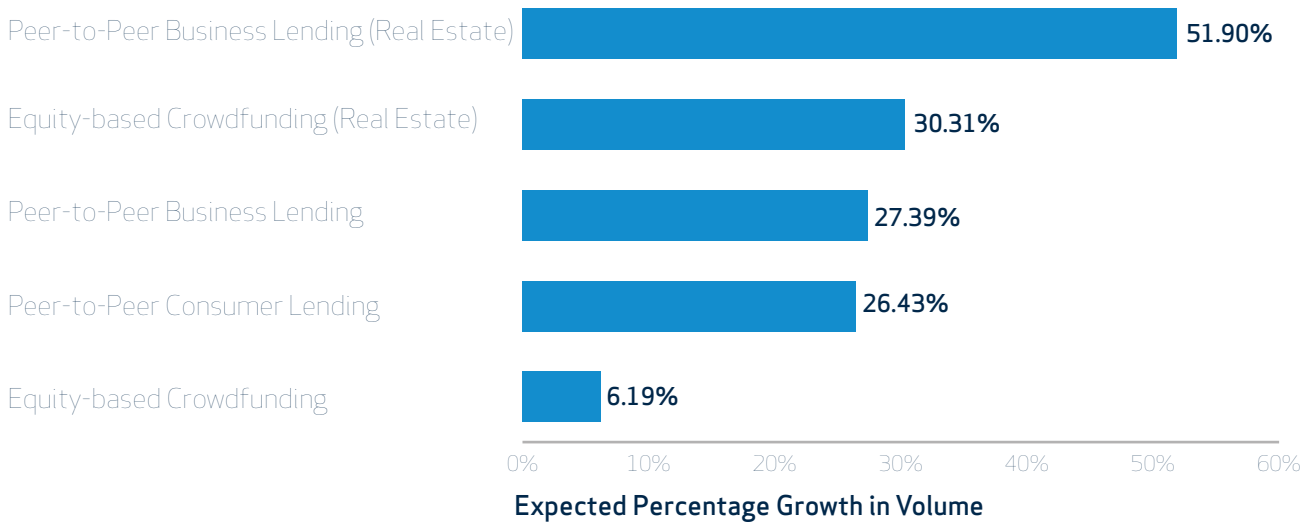
Tax Wrappers and the Innovative Finance ISA

In comparison to many markets around the world, the UK's government is known for its support of the online alternative finance market. The government has supported the growth of this market through direct investments (such as the more than £60m lent to SMEs by the British Business Bank via peer-to-peer lending platforms) to the application of tax incentives, such as the EIS and SEIS[60] which have been used by a large proportion of investors using alternative finance platforms particularly within equity-based crowdfunding.

In 2016 the government will introduce the Innovative Finance Individual Savings Account (IFISA).[61] This will allow for peer-to-peer loan agreements to be included within the tax-free ISA tax wrapper. Our study asked alternative finance platforms to estimate the percentage of additional growth in transaction volume they would expect from the introduction of the IFISA in 2016. The surveyed alternative finance platforms anticipate the IFISA to have a significant impact. Peer-to-peer consumer lending platforms expect the IFISA to add 26.43% to their annual volume and peer-to-peer business lenders expect a 27% increase. Moreover, Peer-to-peer business lending for real estate platforms are expecting a very substantial 51.9% growth in transaction volume.

Expected Growth in Volume Following the Introduction of the IFISA in 2016 by Models

Figure 24



Perceived Risks to the Continued Growth of the Alternative Finance Sector

As discussed throughout this chapter, there are many indications that the online alternative finance market will continue to experience significant growth in the years to come. In light of this, we were interested in understanding what platforms perceived as the biggest risks to the future growth of their market.

The potential 'collapse of one or more of the well-known platforms due to malpractice' was seen as the highest risk to future growth, with 57% of surveyed platforms considering this factor as a high or very high risk. While the UK industry to date has seen very few incidents of systematic fraud or malpractice at the platform level, the growth of the industry will inevitably bring with it examples of platforms not playing by the rules. In Europe, we saw the first significant example of this when a Swedish platform suspended its business due to suspicion of misconduct, including misuse of client money.[62] Very recently, there have also been high-profile collapses of well-known Internet finance platforms reported in other much less regulated markets.[63] Looking ahead, it will be interesting to see what impact that a collapsed platform(s) might have on the future development of the industry, in terms of investor confidence, public sentiment and regulatory implications.

For an industry based almost entirely around online intermediaries, funding channels and payment systems, unsurprisingly a 'cyber security breach' was also viewed by 51% of the surveyed platforms as a factor that could have a very detrimental effect on the sector.

A 'notable increase in default rate/business failure rate' was also ranked as a high risk, which is connected to the broader issues around platforms' credit scoring, underwriting and due diligence (particularly for crowdfunding models) capabilities that likely will determine the long-term sustainability of these business models. A robust risk management infrastructure and business practice will also help prevent, or at least, limit the cases of fraudulent fundraising activities on platforms, which is also ranked highly as a potential risk factor. Of course, one also cannot equate failure with fraud. Businesses do fail, particularly if they are early-stage companies; and inevitably some proportion of peer-to-peer loans will default on platforms. The key issues are whether platforms are doing their utmost to lower the chances of malpractice/fraud by borrowers and fundraisers, and whether investors, backers, donors and funders clearly understand the risks associated with their investment and funding activities.

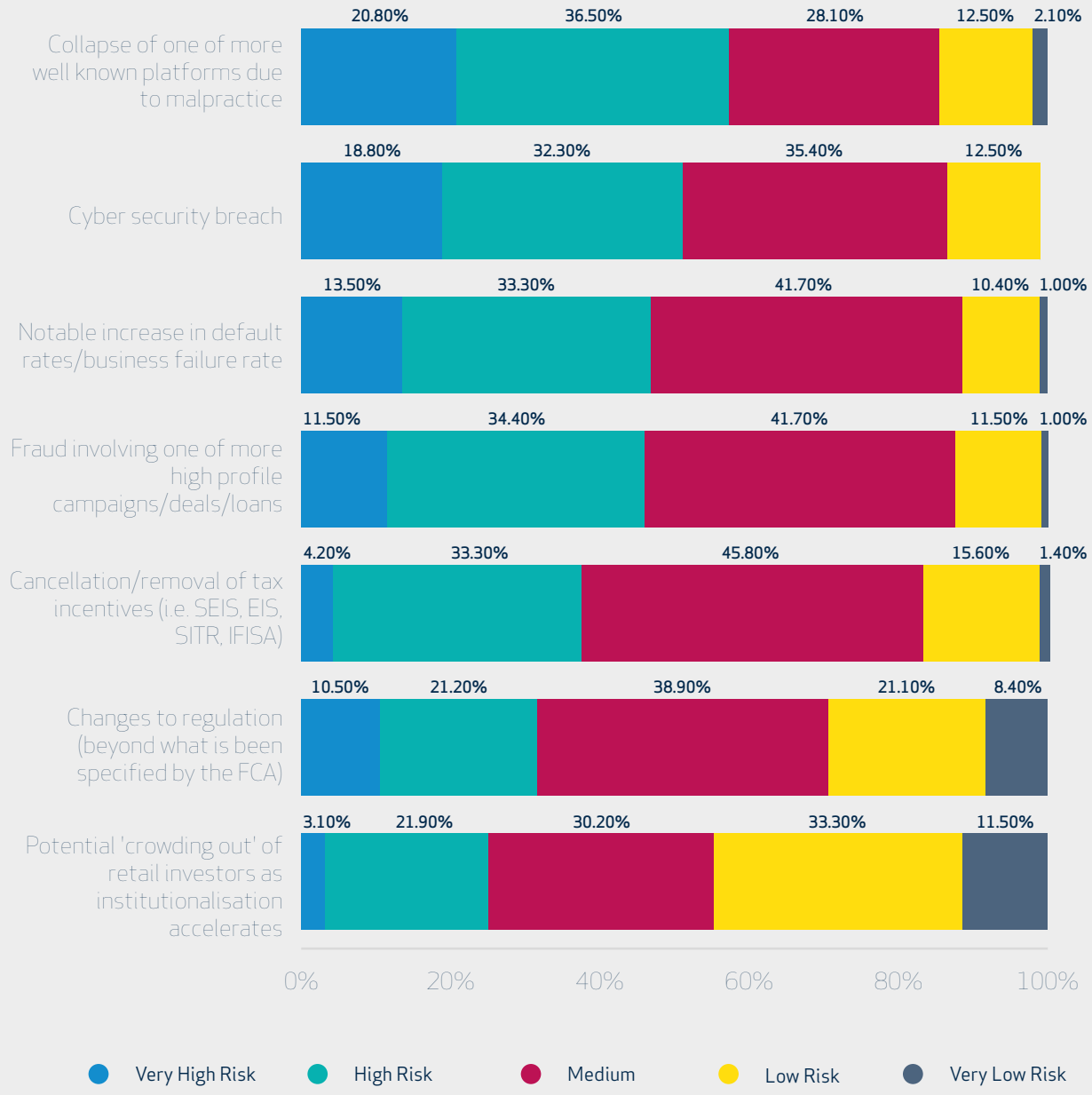
For instance, one of the big challenges for many projects funded through reward-based crowdfunding is project delivery, with one study estimating that 75% of reward-based projects are delayed (with overfunded campaigns being particularly prone to delay). [64] As the volume of reward-based projects go up, so do stories about campaigns struggling to deliver on their promises, with one of the most severe incidents in the past year linked to the collapse of the company after successfully raising £2.3 million for a mini drone.[65] An education piece is clearly missing, to ensure that consumers understand the inherent risk of backing often yet to be realised ideas or projects. Furthermore, it is necessary to educate fundraisers about the common challenges of reward fulfilment and how to manage expectations and to be realistic in their business plan and capabilities.

> ***"The potential 'collapse of one or more of the well-known platforms due to malpractice' was seen as the highest risk to future growth, with 57% of surveyed platforms considering this factor as a high or very high risk"***

As mentioned previously, the past year saw the equity-based crowdfunding market deliver its first two exits, indicating the potential of this online model to deliver a financial return to investors. However, it is important to put these two successes into greater context, as these are only two exits against the backdrop of more than 1,200 successfully funded equity-based crowdfunding campaigns, in the UK over the last three years - amongst several significant failures.[66] The equity-based crowdfunding model is certainly showing promises, but is still unproven. The long-term viability of this model can only be tested with longitudinal data and to see whether equity crowdfunding deals can deliver consistent returns over a longer horizon.

Industry Perceived Risks to Future Growth of the Alternative Finance Sector

Figure 25



A further risk to the alternative finance market may come from policy changes in regard to tax incentives for investors (rated high or very high risk by 37% of the platforms), such as SEIS, EIS, SITR and IFISA. The market has already seen how changes to tax-incentives can negatively affect a platform's business model. In response to government cuts to renewables subsidies, one crowdfunding platform has pivoted away from their model focusing solely on renewable energy. [67]

As described earlier in this chapter, the market is also experiencing increased involvement from institutional investors, such as banks and investment funds. Despite this trend, few platforms saw 'crowding-out' of retail investors by institutions as a high risk to the growth of the market.

"The key issues are whether platforms are doing their utmost to lower the chances of malpractice/ fraud by borrowers and fundraisers, and whether investors, backers, donors and funders clearly understand the risks associated with their investment and funding activities"

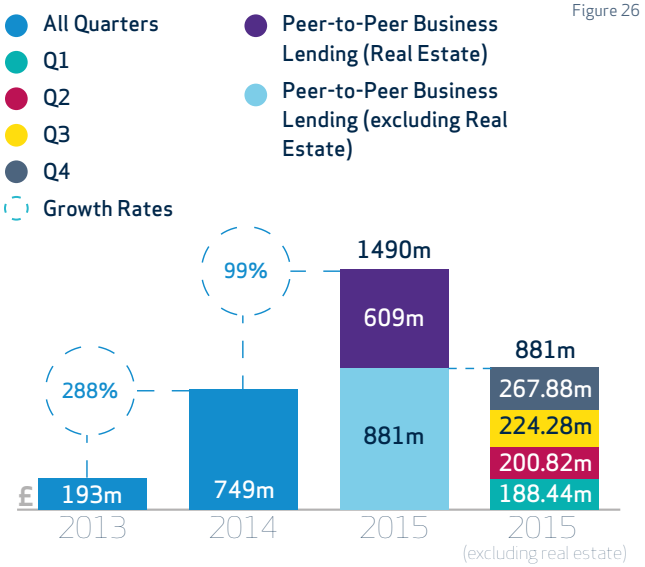
3

SIZE AND GROWTH OF THE DIFFERENT ONLINE ALTERNATIVE FINANCE MODELS

PEER-TO-PEER BUSINESS LENDING

Peer-to-Peer Business Lending Market Volume by Year and by Quarter (2013-2015)

Figure 26



The peer-to-peer business lending sector has grown considerably over the last year, nearly doubling from £749 million in 2014 to £1.49 billion in 2015. Whilst the year-on-year growth rate of 99% is slower than the 288% jump between 2013 to 2014, this is expected as the market levels and fewer new entrants join the market. For instance, six new peer-to-peer business lending platforms began trading in 2014, compared to just one in 2015.

The largest segment of the peer-to-peer business lending market is for real estate mortgages and property development, which accounted for £609 million in 2015, around 41% of the total volume of peer-to-peer business loans. Given the large volume and that this is quite a distinctive type of lending product compared to the rest of business lending, peer-to-peer real estate lending was analysed separately from other business lending.

Excluding real estate lending, in 2015 peer-to-peer business lenders facilitated loans to around 10,000 SMEs in the UK totalling £881 million. Data on transaction volumes between 2013-2015 show that peer-to-peer business lending platforms accepted, on average, 22.7% of loan applications. The average size of a peer-to-peer business loan was £76,280 and was funded by an average of 347 lenders.

On average, our survey data indicates that 42.3% of lenders on peer-to-peer business lending platforms have used auto-bidding/auto selection[68] functionalities, whereas lenders need only to specify the lending amount, duration and risk appetite but do not choose individual loans to invest in. This figure is likely to rise in the future, as many peer-to-peer lending platforms have moved away from the reverse-auction model to, in some cases, exclusive use of automatic-bidding. Automatic bidding can enhance market efficiency, as both the lenders and SME borrowers know the applicable interest rate with a greater certainty. Nevertheless, auto-bidding challenges peer-to-peer business lending platforms to constantly improve their own underwriting and credit risk management capabilities, as the platform must now make loan selections on behalf of the lender.[69]

In 2015, we also saw an increase in secured-lending across the peer-to-peer business lending model, particularly against fixed assets such as machinery and property. Secured lending has translated into larger, more complex loans. This, coupled with auto-bid lending, has driven platforms to either update or create their own in-house underwriting facilities or seek external underwriting partners to deal with the influx of secured lending.[70] Additionally, with the increase in institutional funding within peer-to-peer business lending (around 26%), the scrutiny and demand for more robust due-diligence processes and credit risk management capabilities will only increase going forward.

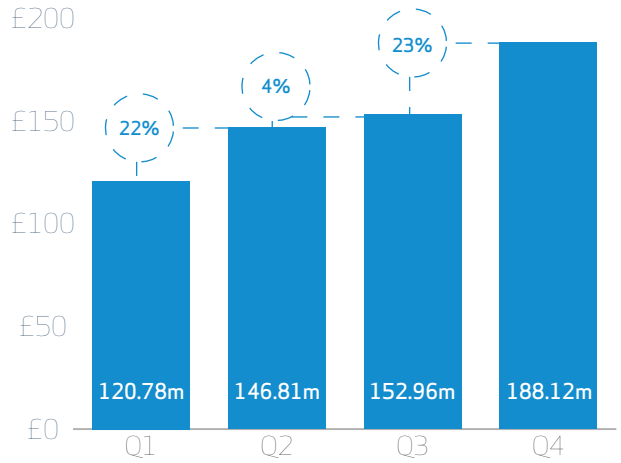
In terms of the most popular sectors funded on peer-to-peer business lending platforms, besides real estate and housing, the second highest funded industry sector was manufacturing & engineering, followed by transport & utilities and then finance and retail.

On the SME borrower side, the most active regions receiving funds were the East Midlands, London and the South East. Although it may seem surprising that the East Midlands received more investment from peer-to-peer business lending platforms from amongst all the regions, this may be explained by the fact that manufacturing makes up a larger part of the East Midlands economy than any other region in the UK.[71] The most active regions for providing peer-to-peer business lending were London, the South East and the South West.

PEER-TO-PEER BUSINESS LENDING (REAL ESTATE)

Peer-to-Peer Business Lending (Real Estate) Market Volume by Quarter (2015)

Figure 27



In 2015, peer-to-peer business lending for real estate grew to £609 million, which amounts to 41% of the total volume of peer-to-peer business loans. For this reason, this and future studies will look at peer-to-peer real estate business lending as a separate alternative finance model.

On a quarterly basis, this market segment increased from £120.78 million in Q1, to £146.81 million in Q2, £152.96 million in Q3 to £188.12 million in Q4. Overall, peer-to-peer real estate lending financed over 600 commercial and residential developments in the UK in 2015, mostly by small to medium sized property developers.[72]

Peer-to-peer business for real estate lending is comprised of a variety of financing models and products: ranging from short-term (typically 12-18 months) bridging finance, to longer term (e.g. 3-5 years) commercial & residential mortgages and construction & development debt finance. With an average level of 25%, the level of institutional funding participation in this model is high; and for some platforms, this can be as high as 75%.

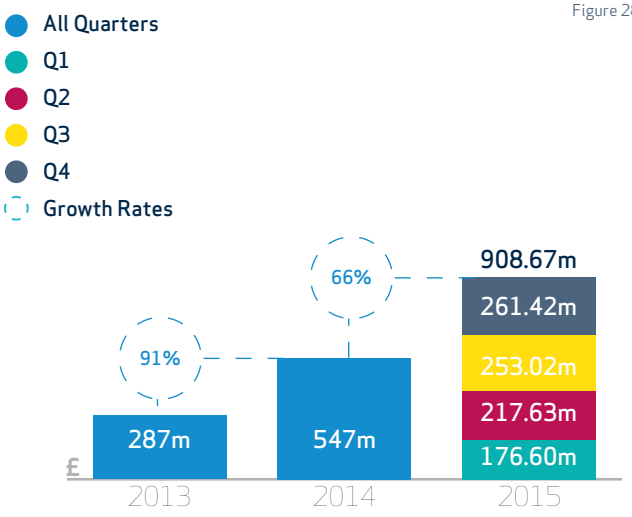
With the prospect of the introduction of the Innovative Finance ISA, some of the peer-to-peer real estate lending platforms are lowering their minimum investment thresholds in anticipation of the influx of retail investors.[73] Indeed, a recently published study stated that, "44% of UK retail investors would like to increase their exposure to the property market, not only through owning their home, but also in other ways, such as investing through peer-to-peer lenders".[74] Peer-to-peer lending platforms that specialise in real estate finance were particularly optimistic about the introduction of the Innovative Finance ISA, reporting that they expected the IFISA to result in a 51% increase in market volume in 2016.

According to our survey data, peer-to-peer business lending for real estate accepted an average of 27.5% of loan applications. The average size of peer-to-peer loans for real estate was £522,333 in 2015, slightly less than the £662,425 reported in 2014. The average loan size in 2015 was closer to the average house price in the UK compared to the previous year,[75] perhaps reflecting a growing use of peer-to-peer lending to fund residential or commercial mortgages rather than larger developments. It should be noted that, at present, peer-to-peer real estate lending cannot be utilized for an individual's own residential mortgage (i.e. a mortgage based upon the primary residence of the borrower) due to regulatory constraints.[76] On average, it takes 490 lenders to fund a typical loan for this model.

PEER-TO-PEER CONSUMER LENDING

Peer-to-Peer Consumer Lending Market Volume by Year and by Quarter (2013 to 2015)

Figure 28



In a similar fashion to peer-to-peer business lending, the peer-to-peer consumer lending market continues to grow, albeit at a slightly slower year-on-year growth rate of 66%. In total, £909 million worth of loans were facilitated through peer-to-peer consumer lending platforms in 2015, providing consumer credit to more than 213,000 individual borrowers. The weighted average size of a peer-to-peer consumer loans was £6,583. As with most of the peer-to-peer consumer lenders, it is common practice to offer almost exclusive auto-bid/auto-selection features for lenders in order to improve market efficiencies and reduce credit risk through diversification. Ninety-eight per cent of lenders used the auto-bidding/auto-selection functions. The weighted average acceptance rate for peer-to-peer consumer lending platforms is 15.84%.

Institutional lenders continue to increase their activity within this market segment. The surveyed peer-to-peer consumer lending platforms reported that institutional funders lent out £288 million in total via their platforms, accounting for 32% of the total market volume in 2015. The institutionalisation of consumer lending began relatively slowly in 2015 with only £29 million being lent in Q1, but then rapidly increased to £98 million by the end of the year in Q4. Nevertheless, unlike their counterparts in the USA,[77] the UK peer-to-peer consumer lending market is still largely dominated by retail investors.

The introduction of the Innovative Finance ISA could have substantial impact on the market, with peer-to-peer consumer lenders expecting around a 26% increase in total volume. Regarding loan origination, a number of peer-to-peer consumer lending platforms have struck high-profile partnership deals with a number of corporates. These partnerships help to increase public awareness of the sector and could have considerable implications for deal origination; attracting high quality borrowers, with potential to gather additional borrower data to enhance credit scoring and risk management.

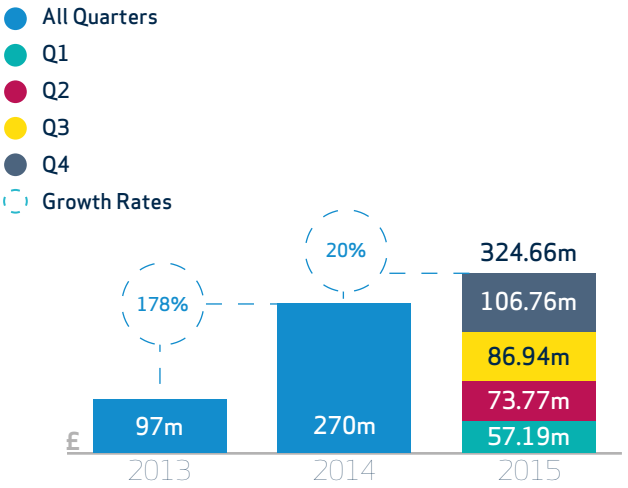
Looking at activity by regions, London, the South East and the East Midlands had the most peer-to-peer consumer lending borrowing activity. On the lender side, the three most active regions in the UK were London, the South East and the South West.

> ***"Institutional lenders continue to increase their activity within peer-to-peer consumer lending"***

INVOICE TRADING

Invoice Trading Market Volume By Year and Quarter (2013-2015)

Figure 29



Invoice trading continues to be a popular financing tool for small and medium sized enterprises wanting to trade their invoices or receivables at a discount, in exchange for the speedy procurement of working capital. However, while the £270 million market size in 2014 grew by 178% compared to 2013, growth from 2014 - 2015 was more modest, with a 20% growth rate to £325 million. However, there are signs that the momentum for growth could be increasing, with £107 million traded in Q4 compared to £57 million in Q1.

Invoice trading platforms, on average, accepted 84.7% of all businesses who approach them to trade their invoices, with the average invoice traded amounting to £57,094 and an average of just 12 investors involved in each transaction. A total of 5,015 businesses utilised invoice trading to raise finance in 2015. Businesses that used invoice trading mainly came from the construction, technology and manufacturing & engineering sectors. Reflecting the broader trend of corporate partnership integration observed across the industry, invoice trading platforms have joined forces with large accounting firms, such as KPMG in the UK's Small Business Accounting services, to enhance their deal origination.[78]

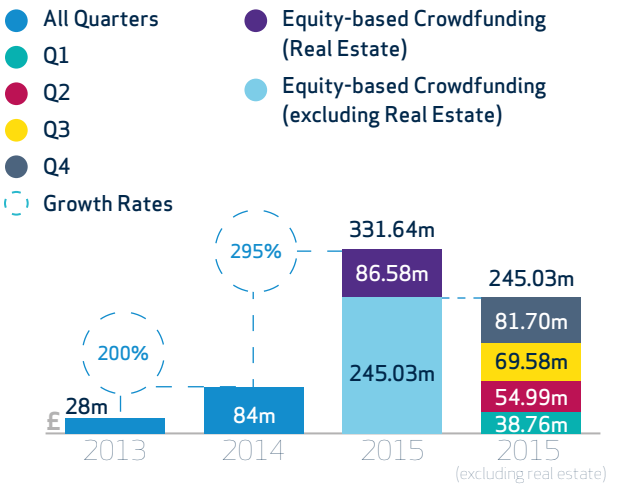
Invoice trading platforms have also integrated accounting add-ons into their service packages with providers such as Sage,[79] XERO and KashFlow, in addition to the aforementioned partners.[80] This allows invoice trading platforms to have greater insight into the business trading history of their SME clients by better integrating their accounting systems to ensure they are more aligned to the borrowing process.

> ***"There are signs that the momentum for growth in invoice trading could be increasing, with £107 million traded in Q4 compared to £57 million in Q1"***

EQUITY-BASED CROWDFUNDING

Equity-based Crowdfunding Market Volume by Year and by Quarter (2013 to 2015)

Figure 30



2015 was another year of significant growth for the equity-based crowdfunding market with the total value of all investments up by 295%, from £84 million in 2014 to £332 million. A substantial proportion of the market volume for equity-based crowdfunding came from real estate investments, contributing £87 million in 2015. The volume and characteristics of equity-based real estate crowdfunding will be discussed in a separate section below.

Excluding real estate projects, equity-based crowdfunding for seed, start-up and early-stage financing reached £245 million in 2015. High growth rates were maintained throughout all four quarters of 2015, with the amount invested more than doubling from Q1 (£38.76 million) to Q4 (£81.7 million). The average deal size stood at £523,978, a considerable increase from the 2014 average of £199,095. This perhaps demonstrates the maturing of the equity-based crowdfunding model, by which bigger, later stage and co-financing venture investment deals are increasing on the platforms. A typical equity-based crowdfunding campaign included investment from 77 investors on average. Each investor had an average portfolio size of four to five (4.73) investments across the platform.

London, the South East and the South West remain the most active regions, both in terms of fundraisers receiving and funders providing investment. In total, 720 businesses successfully raised investment through equity-based crowdfunding platforms in 2015. The average acceptance rate across platforms was 20.59%, with 40.24% of platform-listed campaigns successfully securing investment. The most popular industry sectors funded on equity-based crowdfunding platforms in 2015 were technology, food & drink, Internet & e-commerce, real estate & housing as well as media & publishing.

2015 was a particularly important year for equity-based crowdfunding as it began to demonstrate its potential for delivering financial returns to investors. The industry recorded its first two exits in the UK crowdfunding market.[81] At the same time, there were inevitably business failures within this relatively high-risk asset class, some of which were high profile cases reported widely by the media.[82] According to our survey, equity-based crowdfunding platforms reported a weighted average business failure rate of 5.5% in 2015. However, that figure should be taken with some caution as the majority of equity-based crowdfunding investments have taken place within the last 2 -3 years.

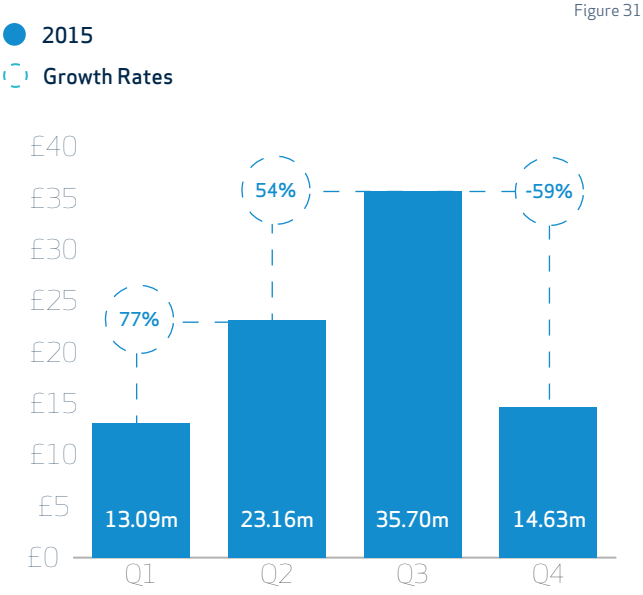
On the investor side, 68,306 investors used equity-based crowdfunding platforms in 2015, with 27% (14,446) of those being sophisticated or high-net-worth individuals. An increasingly interesting development within equity-based crowdfunding that mirrors industry-wide trends is the increasing involvement of more traditional investors. A growing number of venture capital and angel investors are co-investing alongside or in parallel with 'crowd investors'. In certain cases, venture capital firms are investing directly through equity-based crowdfunding platforms, but more commonly in partnership with them.[83] This enables venture capital firms to increase the total capital raised for each company, in addition to demonstrating market validation and benefitting from increased brand awareness of their investee companies. All in all, this is helping businesses to raise larger rounds as evidenced by the 15 largest deals of 2015, raising a total of £37,775,031.[84]

An important development within equity-based crowdfunding is continued product innovation driven by the platforms' efforts to further differentiate and grow. New financial products, such as mini-bonds, convertible notes, real estate investment trust (REIT), accelerator funds are examples of the kinds of product innovations initiated and further developed by crowdfunding platforms over the course of 2015. This year looks set for the continued development of these financial products and indeed more.

EQUITY-BASED CROWDFUNDING (REAL ESTATE):

Equity-based Crowdfunding (Real Estate) Market Volume by Quarter (2015)

Figure 31



To reflect the relatively large proportion of the equity based crowdfunding market that is focused on real estate, this year's study will look at this new subset of equity-based crowdfunding independently. Equity-based crowdfunding for real estate enables investors to acquire ownership of a property-asset via the purchasing of shares of a single property or a number of properties. In 2015, equity-based crowdfunding for real estate raised £87 million in total for 174 fundraisers/development projects. Growth rates increased rapidly over the first three quarters of the year registering £13.09 million, £23.16 million and £35.7 million in Q1, Q2 and Q3 respectively. This indicates that equity-based crowdfunding for real estate has the potential to become a substantial segment within the UK alternative finance industry, as it has become in other markets such as the United States.[85,86] Other notable hallmarks from 2015 include setting the record for fastest funding, with a £843,100 raise filled in 10 minutes, 43 seconds from 319 investors.[87]

Though growth rates increased throughout the first three quarters of the year, the weighted average platform acceptance rate was relatively low, with only 2.9% of deals making it onto the platform. However, once accepted on a platform, deal success rate was 87% and average deal size was £820,042 with an average of 150 investors participating per equity deal.

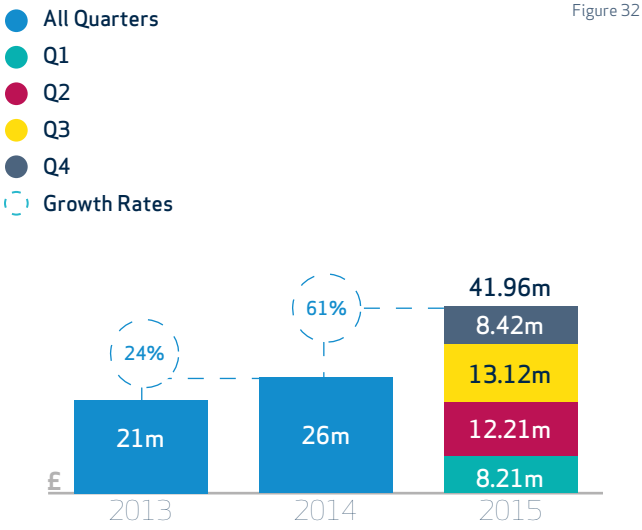
The most active regions receiving funds were London, the North West and the North East, respectively. One trend noted in 2015 was the emphasis on real estate crowdfunding within areas for regeneration. Regeneration areas are potential investment opportunities that will cost investors less than prime locations, and are likely to experience the highest levels of growth in coming years. It is therefore not surprising that leading regions include the North East and North West, as these regions' economies have been transformed in recent years with a number of regeneration projects and development funding from the public and private sectors.[88,89] The most active regions providing funds came from London, the South East and the North West.

Throughout this report, we have discussed the prevalence of institutional funding in 2015. However, unlike other models where there has been substantial institutional involvement, this model has been, by and large, contingent on retail, sophisticated and high-net-worth individuals. Of the 10,626 funders participating in real estate crowdfunding, only 3% were categorized as institutional funders by the platforms, while 77% were categorised as either sophisticated or high-net-worth. The emphasis on individual investors is supported further by the recent inclination to lower minimum investment thresholds, which is likely to further entice retail investors.[90]

REWARD-BASED CROWDFUNDING

Reward-based Crowdfunding Market Volume by Year and by Quarter (2013 to 2015)

Figure 32



Reward-based crowdfunding is often perceived as being synonymous with crowdfunding itself, with fundraising campaigns and models dating back to the turn of the Millennium.[91] In spite of being one of the oldest online alternative finance models, reward based crowdfunding continues to grow from £26 million in 2014 to £42 million in 2015. This represents a 61% year-on-year growth rate, a significant increase compared to the 24% growth rate between 2013-2014.

On average, reward-based crowdfunding platforms accepted 32.34% of projects that approached them and 33.7% of these listed campaigns then went on to successfully achieve their fundraising target. In total, 6,633 projects successfully raised finance using reward-based crowdfunding in 2015, with an average campaign size of around £1,379. We estimate that 858,553 contributors backed reward-based campaigns in the UK, with a typical crowdfunding campaign being backed by an average of 326 contributors.

London received the lion's share of funding, followed by the South East, the West Midlands, the East Midlands and the South West. In terms of the regions from which funding was provided, again London-based backers contributed most to reward-based crowdfunding campaigns, followed by the South East, the East Midlands, the East of England and the West Midlands.

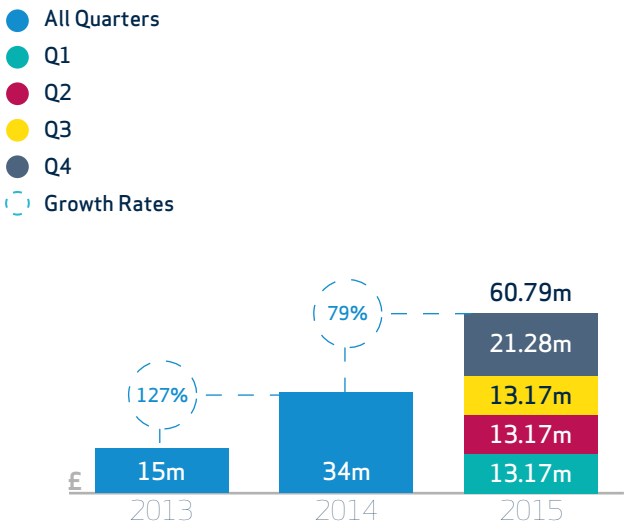
The survey showed that projects within the creative economy tend to be the most popular funded reward-based crowdfunding categories. For instance, film is the most popular category followed by technology, media & publishing and community & social enterprises. Akin to the trends within peer-to-peer lending and equity-based crowdfunding, there are an increasing number of major corporations partnering with reward-based platforms. Examples include 'Ben & Jerry's Join Our Core'[92] program which trained, supported and promoted social enterprise campaigns across Europe and JC Decaux which created an innovative partnership involving reward-based crowdfunding campaigns for advertising and has raised over £1 million to date.[93] Another important development over the course of 2015 within reward-based crowdfunding was the increased prevalence of match funding from various public and private sector organisations. For example, the Department for International Development launched their Crowd Power[94] research initiative to explore the efficacy of crowdfunding models to fund renewable energy projects in the developing world. Likewise, Big Society Capital established the foundations for a £5 million match fund to support UK social enterprises.[95]

In 2015, local authorities, universities and even political parties were also utilising reward-based crowdfunding platforms in order to fund various projects within their respective areas of interest. Plymouth council, for example, has allocated £60,000 in match funding to reward-based crowdfunding projects that benefit the city.[96] One of the other key developments within this sector, which is likely to evolve in 2016, is the evolution of enterprise crowdfunding wherein major corporations use reward-based crowdfunding platforms in order to test, gather feedback and drive interest in products by engaging and involving early adopters.[97]

COMMUNITY SHARES

Community Shares Market Volume by Year and by Quarter (2013 to 2015)

Figure 33



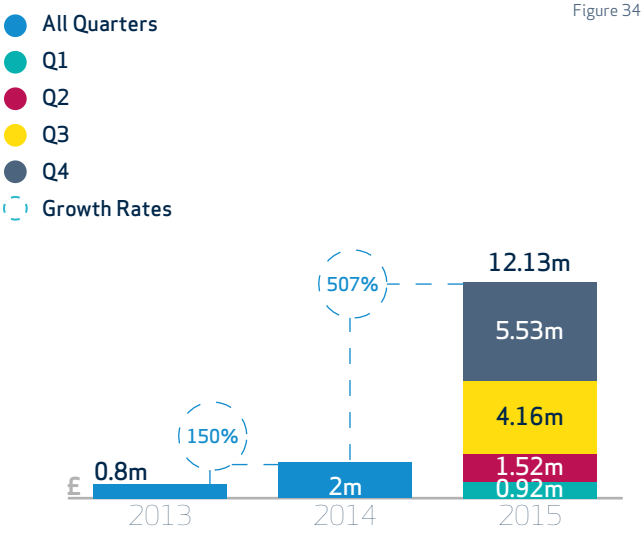
In 2015, £61 million worth of Community Shares, a unique form of share capital regulated by co-operative and community benefit society legislation were issued in the UK. This represents a growth of 79% compared to the £34 million worth of shares that were issued in 2014.

Ninety-seven organisations, including co-operative societies, community benefit societies and charitable community benefit societies successfully raised finance using community shares in 2015. It is interesting to observe that unlike most of the other alternative finance models, the majority of fundraising activity is taking place outside London. The South West is the most active fundraising region, followed by the North West, the South East and Scotland. The average deal size for a successfully funded community shares fundraising campaign is £309,342, and energy is the most popular funded sector, followed by leisure & hospitality, retail & wholesale, sports and food and farming.

DONATION-BASED CROWDFUNDING

Donation-based Crowdfunding Market Volume by Year and by Quarter (2013 to 2015)

Figure 34



While it remains a relatively small market compared to other models, donation-based crowdfunding is the fastest growing area within the UK alternative finance landscape. In total, the market grew by 500%, up from £2 million in 2014, to £12 million in 2015. This suggests that community and voluntary sector organisations, the primary users of this model, have started to adopt crowdfunding as a viable fundraising tool for good causes. The growth in donation-based crowdfunding has primarily been driven by activity in Q3 and Q4, where £4 million and £5.5 million were raised respectively. This is a significant increase on the £920,000 raised in Q1 2015.

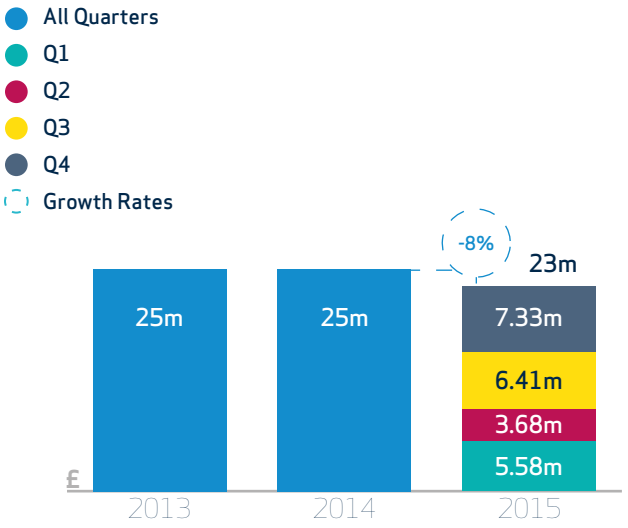
London, the North West, the West Midlands, the South West and Yorkshire were the five most active regions, both in terms of fundraiser and funder activity. Unsurprisingly, the most popular sector funded through donation-based crowdfunding, is charity & philanthropy, followed by health & social work and community & social enterprise.

Donation-based crowdfunding platforms accept, on average, 66% of all campaign projects that approach them. In total, 16,978 projects raised finance through donation-based crowdfunding platforms with an average raise of £7,718. On average, it takes 41 donors to fund a given campaign. Donation-based crowdfunding has a fundraiser repeat rate of just 2.5%.

PENSION-LED FUNDING

Pension-led Funding Market Volume by Year and by Quarter (2013 to 2015)

Figure 35

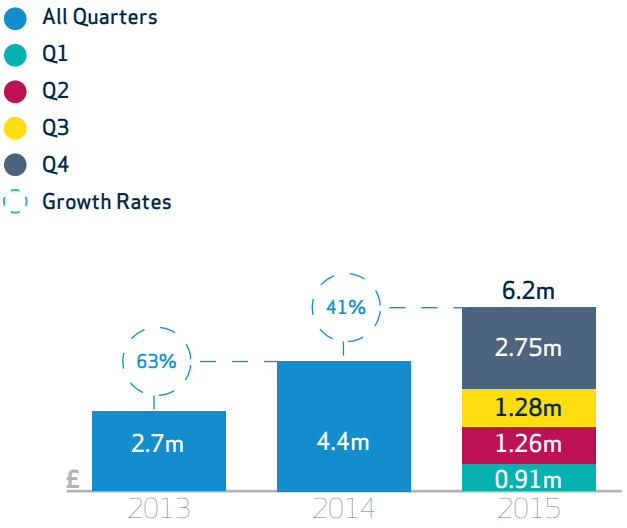


2015 proved to be a stagnating year for pension-led funding when compared to the rest of the alternative finance sector. £23 million was raised in total, a decrease of £2 million or 8% from the £25 million raised in 2014. In Q1, total funds raised amounted to £5.58 million. This subsequently fell to £3.68 million in Q2 before rising steadily to £6.41 million and £7.33 million in Q3 and 4 respectively. 32.3% of businesses were accepted onto pension-led funding platforms with an average deal size of £82,131. 12.3% of total fundraisers were repeat customers, who are mostly SME directors or owners investing their pension fund into their own businesses through SIPP or SAPP mechanisms.

DEBT-BASED SECURITIES

Debt-based Securities Market Volume by Year and by Quarter (2013 to 2015)

Figure 36



Debt-based securities, such as bonds and debentures, are regulated investment products. They are issued by companies with a fixed maturity and interest rate, akin to the so-called 'bullet payment' at maturity, when the original capital invested is repaid in full alongside interest. Most debt-based securities issued, are fully tradable and transferable.

Platforms which offer debt-based securities are regulated under the FCA rules governing investment-based crowdfunding. They carry out due diligence and verification of any offer made through their platform and usually manage the repayment of cash to investors and registration of the debt-based security, (when a DBS is sold, the platform will manage the transfer of ownership and facilitate any payments).

In 2015, a total of £6.2 million was raised via debt-based securities equating to a growth rate of 47.6% on the £4.4 million raised in 2014. Across all quarters in 2015, there was a steady increase from quarter to quarter with £910,000 raised in Q1, £1.26 million in Q2, £1.28 million in Q3 and £2.75 million in Q4. The average deal size stood at £880,000, with an average number of investors of 496 per deal.

4

CONCLUSION

For the UK online alternative finance industry, 2015 was a year of pushing boundaries. As we show throughout this study, the market is not only growing in size, but also in complexity and diversity. Platforms are continuing to diversify into new sectors, with real estate now making up a substantial part of the lending and equity marketplace. Institutional investors, such as banks and investment funds, are increasingly getting involved in lending and investing through online alternative finance channels.

For the UK online alternative finance industry, 2015 was a year of continued growth and rapid market development. From our findings, it is evident that the industry is going through a transformation. Existing taxonomy and business models were challenged and expanded. New market segments such as the peer-to-peer real estate lending and equity-based real estate crowdfunding are making their marks. The influx of institutional funding is likely to be further entrenched and augmented across models, from both private and public sector sources. A wide range of marketing, deal flow and investment partnerships were forged and arrays of innovative products are now on offer for lenders, borrowers, investors and fundraisers. With increasing public and business awareness and the introduction of the Innovative Finance ISA, opportunities are abundant for the alternative finance industry in 2016 as well as challenges. From the peer-to-peer lending side, the challenges for 2016 are likely to be deal origination, credit risk modelling and underwriting. For equity-based crowdfunding, the challenges are not too dissimilar. The focus is likely to be on deal flow, due diligence and dealing with business failures as much as successes.

While this report has hopefully helped shed some light on the development of the UK alternative finance industry, inevitably our research has led to more questions which merit further exploration.

For instance, how will the industry manage the relationship between institutional and retail funders? Will incumbent institutions (e.g. banks) behave and operate increasingly like alternative finance platforms and vice versa? How will the equity crowdfunding market handle exits and failures; can reward-based crowdfunding sustain growth and overcome the inevitable 'backer apathy'? How will fraud, or a platform collapse, affect the trajectory of the entire industry? Can alternative finance facilitate greater equality in terms of gender participation and regional development? Will matched funding from public funders become a catalyst for positive social transformation or an excuse for underinvestment in our communities? Will advanced credit risk modelling and analytics become too intrusive? How would the continued advancement of payment systems, including mobile payments and block chain technology, impact the development of alternative finance? What will a regional and a global online alternative finance market look like with increasing cross-border transactions and internationalisation?

These are indeed big questions and answering them will require the undertaking of a whole host of empirically based studies, both in the short term and over the longer horizon. Indeed, it is only with time that we will be able to see what is really setting the alternative finance industry apart, be it market efficiency, transparency, credit scoring or customer experience. Through continued research, we will be able to determine whether the new paradigm that the industry is trying to fashion, is really that different to the status quo and whether the frontiers can be further expanded upon and boundaries pushed beyond their assumed limits.

"Only with time will we be able to see what really sets the alternative finance industry apart from traditional finance"

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Notes


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