Alternative finance
THE BOOM IN FINANCIAL SERVICES TECHNOLOGY
Alternative finances in figures

Worldwide Funding Volumes
World Regions
Crowdfunding Methods
Wher does the money go
Europe
Spain
Worldwide Funding Volumes (*)

Alternative finance industry has multiplied by **65** the volume of money since 2009.

<table>
<thead>
<tr>
<th>Year</th>
<th>Funding Volume (€ million)</th>
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<tbody>
<tr>
<td>2009</td>
<td>466</td>
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<td>2010</td>
<td>751.5</td>
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<td>2011</td>
<td>1,294</td>
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<tr>
<td>2012</td>
<td>2,469</td>
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<tr>
<td>2013</td>
<td>5,360</td>
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<tr>
<td>2014</td>
<td>14,250</td>
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<tr>
<td>2015</td>
<td>30,270 (ESTIMATE)</td>
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(*) Crowdfunding Industry Report 2014 (Massolution)
World regions

USA, UK and China account for 85% total volume.
Crowdfunding methods

Royalty
240 millions
Up 336% since 2013

Hybrid
429 millions
Up 290% since 2013

Crowdlending
9,750 millions
Up 223% since 2013

Equity
970 millions
Up 182% since 2013
Where does the money go?

- **41.3%** Business and entrepreneurship
- **18.9%** Social causes
- **12.13%** Arts
- **6.25%** Properties
- **4.54%** Music
Europe (*)

2014 (total)

It is expected to reach **7,000 million** by 2015

(*) The European Alternative Finance Benchmarking Report (University of Cambridge)
Spain

Volume

2012: 10 million €
2013: 29 million €
2014: 62 million €

Crowdfunding methods

- **Reward**: 35.1 million € (Up 111% since 2013)
- **Crowdlending**: 13.7 million € (Up 363%)
- **Equity**: 10.5 million € (Up 234%)
- **Royalty**: 0.8 million € (Up 71%)

**Worldwide Funding Volumes**

- **World Regions**
- **Crowdfunding Methods**
- **Where does the money go**
- **Europe**
- **Spain**
A market that doubles every year is a market that offers opportunities, both for those who need to invest and for those who need capital, working capital or to finance their growth. Since 2009, the so-called alternative finance industry, with its own ecosystem in the Internet, has multiplied by 65 the volume of money
While in the US or UK its development is a fact, in the rest of the world it is just starting to take-off. It is estimated that both countries, which represent about 70% of the total volume of alternative finance, are about three years ahead of the rest. It is indeed a market in full swing, and therefore some of its opportunities and risks are yet to discern.

**Technology, low rates and entrepreneurship**

Internet and the development of investment platforms have democratized the possibilities of becoming a shareholder of a company or even a banker. With small investments, from 20 to 50 euros depending on the project and the platform, it can actually be possible.

The access to funding has also expanded. There are thousands of startups, small businesses and individuals who now, with entrepreneurship booming, can apply for money and have more options than just the traditional bank.
If the former -investors- demand profits sometimes around 20% (impossible to achieve in other ways, especially during a period of low rates), the second -entrepreneurs and individuals- want funding that might not be achieved by conventional channels (or not at the price they would like), and in a very simple way: through the internet, with a relatively small number of steps and without needing to commit to other products. These characteristics make investment platforms particularly attractive to smaller businesses (which comprise the immense majority) and even individuals.

But, besides being an opportunity, are alternative finance a safe option?

If we follow exclusively what investment platforms say, we would conclude that the risk is low. The **default rate** of projects is very low, close to 0%. But, as in all, we must not lose sight of one basic rule: profitability and risk often go together, and higher performance offered means also greater uncertainties for the investment. When you invest in a company or make a personal loan to finance the purchase of a vehicle, you know that you can lose up to 100% of your money. It is a risk you take, but if it is handled smartly it can be controlled.
Diversification is key

A look at the different investment platforms allows to discover that they offer dozens of opportunities, with different yields. Therefore, it is better to invest a small amount in several of them than to concentrate all the capital in just one, however interesting it may seem. This **basic investment rule**, recommended by the platforms themselves, also applies in this case.

Therefore, it is important to choose the project carefully, learn about it through all possible channels and keep in mind that, although the projects have passed a preliminary exam (they are solvent and have a credible business plan), there are always unforeseeable factors. Once selected, you invest in them and create a small investment portfolio. Yields will be entered into your account, ready for you to enjoy them or be reinvested.
Choosing the platform

The platform where you invest also plays an important role in the security of the investment. Not all of them choose the same type of projects or have the same support among accredited or institutional investors, or can claim the same experience. Their transparency, the way they speak about themselves and the projects they support, must also be taken into account. In Spain, the sixth country in Europe in volume of money, there are at least 34 different platforms; only the UK has more, which speaks of the growing fragmentation of a developing sector. Many of them are still startups.

There are platforms with international presence (Zencap or Crowdcube), limited to one country, and even to a single project. And there are those who just finance companies, and those who also cater individuals. Unlike what happens in the stock market, where companies are forced to ‘get naked’ in front of the regulator and provide extensive information on their financial statements, alternative finance concentrate on small businesses, so the volume of information shared with shareholders or lenders is lower.
Own research, direct contact

The platform performs a first analysis of the company, which is assigned a credit rating based on various parameters, such as sales, its ability to generate cash or history of defaults. But from there it is the investor who has to take the initiative and apply a second filter, requesting the information he considers necessary and depending on the quantity to be invested, and even establishing direct contact with those who are going to borrow his money.

Knowing the project managers is one of the possibilities offered by collective investment, and it can be extremely useful when making a decision. The investor’s feeling is key, so being transparent and open to be investigated to some extent gives credibility to a business project. Along with this, it is also useful, especially when funding a personal loan or the business project of a single person, to make sure there is an insurance covering illness, accident or even death of the borrower.
Laws tend to walk behind reality; sometimes they merely keep pace, without being able to stay ahead, harmonizing rhythms and generating the best conditions. Something like this has happened with alternative finance, a relatively recent phenomenon, rapidly expanding and much more developed in some places than in others, which has grown without proper laws.
And even though some common objectives have been sought (protection of investors and some control over financial platforms), once national governments have reacted, they have done it in their own way, from different angles and positions.

Thus, the US has its own regulation. UK, with the most developed finance market in the EU, also follows its own path. Though different, the two Anglo-Saxon countries may have the most favorable framework for this industry.

Within the eurozone, national governments haven’t combined positions regarding this global phenomenon, so neither companies have the same financing conditions nor online platforms have a common regulatory framework for providing services that require a clearly defined playing field. In the same way that the crisis has driven a common regulation for conventional banking, the cross-border dimension of the Internet itself calls for more uniform rules to avoid a fragmented market.

There is no specific European directive either, even though the European banking authority understands that both the directive regarding means of payment (2007/64/EC) and the one regulating the activity of electronic money institutions (2009/110/EU) can be applied. Outside Europe, most countries do not have a very clear legal framework.

IN ANY CASE, AVOIDING TO REGULATE THE MARKET DOES NOT SEEM AN OPTION

Informality aggravates the risks of liquidity and solvency faced by investors who become lenders and need reliable information. Some of the regulations designed in recent years in different countries (see below) have gone precisely in this direction.
The world’s largest market for alternative finance has been regulated gradually since the publication in 2012 of the Jumpstart Our Business Startups Act, allowing companies to publicly announce new equity issues through online platforms. Since then, the industry has been developing without very precise rules, as none of the limitations initially raised have been enforced.

Finally, in 2015 the SEC (Securities and Exchange Commission), established that the maximum amount a company can raise through crowdfunding is $50 million, and limited to 10% of the annual income the maximum amount to be allocated by a non-accredited investor (who wins or has less than $200,000). These limits are large enough to offer companies a formidable tool to access capital.
United Kingdom, the most vibrant market

It can be said that the UK has been leading the way for regulators, especially when it comes to transparency. With a market that widely triples the rest of Europe and where there are already rumors about a certain bubble, the regulator (Financial Conduct Authority, FCA) introduced in 2014 a new framework that limits the emissions per project to 5 million euros a year and differentiates between crowdlending and crowdfunding.

More lax in the case of crowdlending, as it considers it less risky, the British legislation tries to protect crowdfunding investors. Thus, it prohibits platforms to make direct sales to customers earning less than 100,000 pounds a year or with an equity, outside their residence, valued at 250,000 pounds minimum.

The FCA is also in the process of admitting the different platforms operating in the UK. According to the consulting firm Bovill, 30 of the 114 who initially applied would have already been rejected due to difficulties they have to be profitable.
Spain, recent legislation

Spain waited until April 2015 to begin regulating alternative finance, with the Law 5/2015 for the Promotion of Business Financing. Unlike what happens in France, UK and Italy, the law does not distinguish between financing based on loans and equity stake. It is therefore a legal framework perhaps not as flexible as in the Anglo-Saxon countries, but somewhat less restrictive than the French or German.

In a still underdeveloped market, the Spanish law seeks to protect investors in various ways. Firstly, distinguishing between accredited investors (professionals) and non-accredited. The former are those individuals who earn more than 50,000 euros or have more than 100,000 euros in financial assets, and those companies that meet at least two of the following conditions: revenues of at least 2 million euros, at least 1 million in assets, and own funds of 300,000 euros. Anyone who meets these terms can invest without limit. On the contrary, non-accredited investors can’t invest more than 3,000 euros per project and up to 10,000 euros a year.

It also limits the amount of money that can be captured per project to 2 million euros, in the case of having non-accredited investors, and to 5 million euros for accredited investors. The legislation puts platforms under the discipline of the CNMV and the Bank of Spain, it requires them to have a capital of at least 60,000 euros or to have a civil liability insurance of up to 400,000 euros, to publish all relevant information, and to evaluate the projects. These conditions may contribute to concentrate a young and extremely fragmented industry in Spain, with at least 34 platforms currently operating.
France, the most restrictive

Since 2014 France has its own legislation, which differentiates between loans and shares. For the former, the law sets limits for both issuers (1 million per project) and investors (1,000 euros, and 4,000 if there is no interest). In the case of equity crowdfunding, platforms can’t collect more than 1 million euros per project in 12 months, although the investor can contribute with as much money as he wants to.
Germany used to apply to crowdlending the same rules that govern investment products, and the maximum amount that a company could raise was 1 million euros. This limit was widely criticized by the industry, as it was believed it limited their growth possibilities. As a result, in the spring of 2015 the limit was raised to 2.5 million euros, with a cap of 1,000 euros a year for small investors (10,000 if they can justify taking the risk.)
Not everyone sees it the same way, but at the presentation of results or at shareholders meetings almost all bankers are warning about the new competitors who, in the not too distant future, will compete with them. It is not just about Apple or Google with their means of payment and almost unlimited liquidity.
Crowdfunding platforms and their many variants have also begun to tread well-known areas by the banking industry, such as lending to SMEs, loans to students and even the real estate business. As a matter of fact, in June 2015 Wang Jianlin, China’s richest man, raised in just three days through crowdfunding 720 million euros to build a new complex of buildings.

The legislation of most countries, which limits the maximum amount of money a project can raise in a year, will not allow to replicate these operations. But the industry already has a regulation that will give some stability, and the volumes it manages, even though still insignificant within the financial system (in total, one cent per each 100 euros borrowed), continue to grow at rates of up to three digits.
Are they a threat to traditional banking? Can their advantages (fast response, lower costs, dilution of risks among the lenders) be enough to compete face to face in the future with organizations with tens of years of history and a valuable know-how accumulated? Everything indicates that the future will be hybrid.

The banking industry might stop being the only player, but both ecosystems will coexist asserting their respective strengths. Here are some reasons that lead us to believe it.

- The strengths of the banking industry
- The potential of new finance
- Learning from others
- Complementary businesses
- Multimillion agreements ahead

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Many of the largest financial institutions have more than a century of experience providing services to customers. They have spent decades competing with each other, merging, absorbing the weaker... and this translates into greater experience when analyzing risks and better knowledge of the industry and its distribution channels, from traditional branches to working in the field with the clients and even online and mobile banking.

Besides technology giants, few companies have more information about their customers than banks. Many organizations are already exploring the potential offered by big data in order to personalize the services offered to customers and, ultimately, compete better. The time to monetize this data approaches.
It is not only that alternative finance grow fast; in some cases they do it well, with low default rates and taking advantage of their low maintenance costs. They allow investing small amounts of money in instruments that until recently banks reserved to wealthy individuals. And they offer more interesting types of interest to those who don’t mind taking risks. In short, it is a disruptive business model against a formidable competitor such as the banking industry, but one that is used to play alone.

The potential of new finance

Learning from others

Alternative financing has brought new ideas that can be exploited by banks, which also have their own online channels where they have invested millions of euros in recent years. BBVA Research already alerted in 2013 about the potential of this kind of financing, and indicated in a study some of these new ideas that the banking industry can adopt.

If the success of some crowdfunding platforms lies in making available to retail investors financial instruments that require little investment, “traditional banking can
imitate them through their online banking platforms or specific new ones”, something that, to a greater or lesser extent, has already started to happen.

According to the BBVA Research study, this would decrease intermediation costs and also allow banks to enter the business of crowdfunding. Along with this, new scoring or risk assessment strategies, obtained through digital connections (reputation, number of visits to the website, interaction in social networks), can complement the face to face relationship at branches.

**Complementary businesses**

The main difference between both businesses can also be a source of collaboration. Banks collect deposits, something that online platforms don’t do, and count with resources that have already allowed them to reach agreements with them, as we will see below. They don’t exactly lend money to the same customers either. In many cases crowdfunding and crowdlending have funded initiatives that due to their risk, their long maturity or low profitability fell outside the traditional banking industry.

There is thus the possibility to share customers or even that banks themselves implement their own platforms.
In recent months there have been several news reflecting the growing interest of banking in the fintech sector, one of the most dynamic in the market, where they have started to invest.

Thus, in a decision aligned with its commitment to innovation, BBVA invested last April in Prosper Marketplace, a pioneering crowdlending platform that has already lent more than 5 billion dollars. The 160 million dollars that Prosper got from the Spanish bank, in recent months there have been several news reflecting

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In 2014 BBVA had already reached an agreement with On Deck, a US platform specialized in SMEs, and it has also made direct purchases, such as the online bank Simple. It is just an example, because the last months are full of agreements between new actors and traditional banking: platforms like Kabbage, Funding Circle, Avant or SoFi have received hundreds of millions of euros from major banks and various capital funds. The banking industry may have smelled the danger, but it has also spotted the opportunity... and is already reacting.
With just a decade of life, the alternative finance market is starting to show who are going to be its main actors in the future. They are young companies -the oldest were created in the middle of the last decade in the United States- that have grown in a legal limbo, whose real value probably still need to be adjusted, and that are just starting to operate beyond their countries. But for volume, history, technology, differentiation or projects funded, some winners are already beginning to emerge in a race that has just begun.
Lending Club

There is no market as large as the United States. And there is no crowdlending company that has reached the volumes of Lending Club, a platform specializing in personal loans, for companies or for medical expenses. Located in San Francisco, by mid 2015 it had already over 11 billion dollars in loans, more than half of them intended to refinance previous loans or credit card expenses. Its growth is exponential: by the end of 2009 it had more than 8,000 credits and about 78 million euros in loans. Six years later, it multiplies by 100 both quantities. It is publicly traded at 14 dollars, even though after its debut at the end of 2014 it exceeded 20 dollars per share. The company is currently valued at more than 6 billion dollars.
Prosper Market Place

A pioneer in the market of loans between individuals, Prosper was born in 2005 and is also headquartered in San Francisco. It was chosen by BBVA in 2015 to invest, representing one of the biggest bets of a Spanish-speaking bank in the new digital ecosystem. With about two million borrowers and more than 5 billion dollars granted in loans, debt consolidation (grouping several loans into one, reducing the interest rate) is also one of the main business lines of the platform directed by Stephan Vermouth, which works as a meeting point between lenders and borrowers. In the past three years it has shown it is as an increasingly profitable business, with revenues of 80 million euros in 2014, four times more than in the previous year.
Another hot fintech company in the US is OnDeck, created in 2006 in New York and now run by Noah Breslow, who replaced its founder, systems engineer Mitch Jacobs, who left the firm in early 2012. Jacobs created his own system of risk analysis taking advantage of a niche left by major banks, not interested in spending time or money evaluating loans under 100,000 dollars. Its success is based on that and also in its agility: the requests are analyzed in minutes. Once the loan is granted, the cash is available in just 24 hours. Growing at a fast pace since late 2012, OnDeck has gone through several financing rounds (Goldman Sachs, Deutsche Bank, Google Venture) and reached agreements with traditional banks, including BBVA, to do business together. About to be sold in 2012, it is now a listed company valued at about 1.5 billion dollars.
South of the United States, the market is experiencing a very different phase. Companies are little more than startups and the volume of money raised is much more modest, in an environment of less wealth and unclear regulations. This is the context in which Fondeadora was born, a Mexican crowdfunding platform that has already raised more than 60 million pesos, around 3.5 million dollars.

Created in 2011 to fund student investigations, it expanded its range of action in 2013 to cultural and social projects, offering a small reward to investors and charging a fee over the total amount collected. René Serrano and Norman Müller are the names behind this platform, which also has small offices in Colombia, Argentina and Chile, representing around 10% of its business.
Kubo Financiero

Also from Mexico, Kubo Financiero is an online platform that since mid 2015 is also a full financial institution, authorized to take deposits, a differentiating factor over its local competitors, such as Prestadero. At the end of the second quarter of the year, Kubo, directed by Vicente Fenoll, had financed more than 2,200 projects with 43 million pesos. After testing its technological and risk assessment systems for nearly two years using its own resources and loans from other institutions, Kubo is now starting to employ the resources of its lenders. It aims to have 25,000 customers within three years.
Since last spring, the Spanish market of P2P loans and crowdfunding has its own regulation, which should serve to consolidate a very atomized sector. Comunitae, created in 2009 by Arturo Cerveza, leads the market in Spain, having captured more than 23 million euros from investors. After incorporating in 2015 a line for financing working capital of companies through ‘confirming’, that adds to another one for cashing promissory notes, the company expected to close 2015 with a new three-digit growth. The main claim for investors is its profitability (more than 6% in the case of personal loans) and the minimum amount necessary to participate: 50 euros.
The Crowd Angel

This is a platform with a different profile, as it defines itself as the first one that allows to “invest online in technology-based startups with the thoroughness and soundness of venture capital.” Created in 2012 by the Inveready fund, it combines the virality of crowdfunding with a careful selection process, funding only those projects it considers most promising. Directed by Ramón Saltor, it has completed the funding of 10 projects that have raised 2.29 million euros. It mainly targets accredited investors, who have a minimum contribution of 3,000 euros and acquire a stake in the company.
Bestaker-Davalor Salud

Considered the largest crowdfunding initiative in Europe, the Visión project of Davalor Salud is a very special case. It has used its own platform, an increasingly widespread trend among major projects, and it has raised over 12 million euros from 2,300 individual investors and even the government of Navarra, which has signed a shareholder loan of one million euros.

The project aims to transform optometry, as its promoters have designed a machine capable of analyzing a person’s vision in minutes and at a low cost using 3D videogames. The machines will be distributed throughout opticians and connected to a database in a clinic. The contributions to the project, now set at a minimum of 1,000 euros, have been
made through its own website (Bestaker) announcing returns, in three or four years time, of up to 17 times the investment.

It was launched by Juan José Marcos before the approval in 2015 of the Spanish law, which currently limits the maximum contribution per project. Without having reached the stage of marketing yet, the company already pays the salaries of more than 30 people. Prototypes are already designed and have been built by Jofemar, and sales should start this year. The company expects revenues of 30 million euros in 2019.
Handiscover

Born in Sweden, this is a holiday booking website designed specifically for people with reduced mobility. It follows the model of Airbnb or Homeway, based on the collaborative economy, but takes advantage of the gap left by these platforms for a specific niche of customers: around 10% of the population has physical disabilities. Thus, depending on the degree of limitation, the web created by Sebastien Archambeaud preselects certain accommodations suiting the customer’s needs. The company opened a round of funding of 55,000 euros that transferred to investors 10% of its capital. It obtained the money 10 months ago through Crowdcube. For now, it concentrates its community only in the UK and Sweden.
Tenoli

Mexico’s urban landscape is dotted with about one million tiny grocery stores (‘abarrotes’ or ‘colmados’). Many of them are run by vulnerable women (single mothers, widows...), have a vital role in the lives of hundreds of thousands of families, and represent a traditional way of consumption with increasingly difficulties to remain competitive. Tenoli, which means bridge in the Nahuatl language, tries to integrate these stores into the formal economy by providing them tools to improve.

The first help center, already assisting 30 stores, offers services and workshops (accounting, how to apply for a microcredit, legal advisory for business management...) and provides access to new products that can be sold by these small shops. This reward crowdfunding project has risen through Fondeadora more than 300,000 pesos (16,500 euros), with which it can serve about 60 stores.
There are projects that can only take shape through crowdfunding. And one of them would be Star Citizen, a video game in development phase that has broken all records and has raised nearly 90 million dollars in three years. It was launched in 2012 with an initial target of 500,000 dollars, but with almost one million believers supporting it through donations, its creators have been gradually enhancing this galactic universe (a virtual reality helmet, development of languages for each tribe of aliens...). There is no completion or launch date for Star Citizen, which currently employs about 300 people. Created by Chris Roberts, donations have been channeled through Kickstarter and, above all, its own platform.
Hemav

The boom in the use of drones for different activities explains the launch of Hemav, a Spanish company that offers solutions based on these unmanned aerial vehicles. Created in 2012 in Catalonia by a group of young engineers led by Alex Gomar Manresa, the company turned to crowdfunding in order to strengthen its capital. And the goal was achieved with a remarkable success: Hemav attracted 450,000 euros in less than a week, distributing 20% of its capital between 70 professional and non-professional investors, with an average contribution of 6,000 euros. Its aim is to focus on the agricultural and environmental fields, facilitating decision making in crop management. The company hopes to produce its first dividends (5% of the capital) in 2016. If the business plan is met, profitability will triple.
Hispabooks Publishing

Even though the cultural industry, and especially the publishing sector, has gone through a severe crisis in recent years, it also offers opportunities. The creators of Hispabooks saw one in the US and UK readers, to whom they will offer contemporary Spanish literature translated into English. Created four years ago in Madrid by Ana Pérez Galván and Gregorio Doval, it has 25 publishing contracts with global exploitation rights. Through Socios Inversores, it closed a round of 210,000 euros, which required a minimum contribution of 3,000 euros. Among its distributors are Amazon and Central Books, and its authors include Lorenzo Silva, José Ovejero, Marcos Giralt and Pedro Zarraluki.
In depth

A list of links to other useful tools and resources that you may find useful as a supplement to the information offered on the ‘Alternative finance’ report.
Red


PwC, *Capital Markets 2020*.

IFM, Shadow Banking Around The Globe: How Large and How Risk?

BBVA Research, Observatorio Económico EEUU, *Tecnología financiera: cambiando la manera de ahorrar y de invertir*.

Garrigues, *Una nueva ley para el shadow banking*.


Business Insider, *This is how a new crop of companies is trying to reinvent banking*.

New York Times, *Quirky, an Invention Start-Up, Files for Bankruptcy*.

Normative

Directiva 2007/64/CE Servicios de pago en el mercado interior

Directiva 2009/110/UE Business of Electronic Money

Ley 5/2015 de Fomento de la Financiación Empresarial

CNMV, Plataforma de Financiación Participativa en España

SEC (Securities and Exchange Commission) USA, Marzo 2015

Financial Conduct Authority (FCA) en Reino Unido