Cambridge Centre for Alternative Finance

UNIVERSITY OF CAMBRIDGE Judge Business School

MARCH, 2018

BUSINESS ACCESS TO ALTERNATIVE FINANCE

A DEEP-DIVE INTO MEXICO & CHILE

WITH THE SUPPORT OF

IDB Invest

IDB Inter-American Development Bank

CONTENTS:

FOREWORD ... 2

RESEARCH TEAM ... 4

INTRODUCTION ... 5

P2P LENDING ... 7

DEMOGRAPHICS ... 7

FUNDING EXPERIENCE ... 9

POST FUNDING IMPACT ... 14

INVOICE TRADING ... 17

DEMOGRAPHICS ... 17

FUNDIING EXPERIENCE ... 19

POST FUNDING IMPACT ... 23

EQUITY-BASED CROWDFUNDING ... 25

DEMOGRAPHICS ... 25

FUNDING EXPERIENCE ... 27

POST FUNDING IMPACT ... 30

REWARD-BASED CROWDFUNDING ... 32

DEMOGRAPHICS ... 32

FUNDING EXPERIENCE ... 34

FINTECH REGULATION IN LATIN AMERICA ... 39

ACKNOWLEDGEMENTS ... 43

FOREWORD

Juan Ketterer. Connectivity, Markets and Finance Division Chief at the Inter-American Development Bank.

FinTech platforms have changed the way in which the financial industry offers products and services to firms and individuals in Latin America and the Caribbean (LAC), as well as in the rest of the world. FinTech industry has strengthened throughout the region with more than 700 platforms that offer financial solutions based on new technologies. Of these, 32.7% are in Brazil, 25.6% in Mexico, 11.9% in Colombia, 10.2% in Argentina and 9.2% in Chile. Leading activities in the region are alternative finance, with 25.6% of the total platforms dedicated to this business, and payments (25.2%), followed by business finance management (13.2%)[1].

FinTech platforms have been responding to the gaps and asymmetries that persist in the region on the allocation of credit, mainly to Micro, Small and Medium Enterprises (MSME). Following this pursuit, the Alternative Financing (AF) market in LAC, even though it started small, is growing notably. According to the figures calculated by the Universities of Cambridge and Chicago, in the second edition of "The Americas Alternative Finance Benchmarking Report", in 2016 the segment tripled its size with respect to 2015, reaching US $ 342 million. The study also shows how alternative finance concentrates its growth in a very relevant niche: commercial loans, which represent 71% of the total volume of origination for 2016.

The study also emphasizes that the regional leader in origination is precisely Mexico with US $ 114.2 million (33.3% of the total) [2], demonstrating the importance of deepening in the understanding on how this alternative finance ecosystem works. It also identifies Chile as the second largest market in the region, with an origination aggregate of US$97.8 million and as the largest crowdlender in the region. These results demonstrate the importance of deepening our understanding of the alternative finance ecosystem.

in this order, this study pretends to answer simple but deep questions such as: who are the individuals and enterprises who build upon the demand for money; which are the maturities, rates and other financial characteristics of the deals; also, who and where are the platforms. The answers come from 243 individual surveys, 23 platforms and 15 direct interviews in a joint effort to understand the Mexican and Chilean AF ecosystem.

As the ecosystem grows up, policymakers and regulators both rely on the financial inclusion possibilities of FinTech at the time the latter want to properly regulate it. It is very relevant to highlight that the Inter-American Development Bank has been cooperating with the region in the issuance of regulations and policies to both foster and regulate the FinTech ecosystem in the region. So far, the Bank has supported 6 countries authorities and FinTech ecosystems: Mexico, Chile, Argentina, Brazil, Peru and Paraguay. Currently, the Bank is also working with the Pacific Alliance (Chile, Colombia, Mexico, Peru) to advance in common principles for regulation.

---

[1] Banco Interamericano de Desarrollo y Finnovista. (2017). "FINTECH: Innovaciones que no sabías que eran de América Latina". Available at: https://publications.iadb.org/bitstream/handle/11319/8265/FINTECH-Innovaciones-que-no-sabias-que-eran-de-America-Latina-y-Caribe.pdf?sequence=2&isAllowed=y

[2] Ziegler et al. (2017). "The Americas Alternative Finance Industry Report. Hitting Stride." Cambridge, United Kingdom: The Cambridge Centre for Alternative Finance. Available at : http://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-05-americas-alternative-finance-industry-report.pdf

The support received by Mexico derived in specific contributions to the FinTech Act draft of 2017, which by the time of this publication is passing through its National Congress. Many countries are using Mexico’s draft as a reference for their own regulations, given the diversity of ecosystems co-existing in the region.

Chile, in particular, has made important strides in creating the right type of dialogue among authorities, FinTech platforms, and other incumbents of the financial services industry. For example, in January of 2018, the Central Bank of Chile and the IDB co-organized a “Fintech Seminar” where national and international regulators shared their views on regulation with an abundant number of industry members.

This document is the first effort in the region to deeply understand the AF ecosystem in specific countries (Mexico and Chile) and could work as a reference for the platforms and the traditional financial sectors to understand their industrial organization. At the same time, regulators and policymakers will be able to understand the composition of the different building blocks of the business to adequately regulate it under the principles of balance and proportion.

RESEARCH TEAM

Tania Ziegler

Tania is the Senior Research Manager at the Cambridge Centre for Alternative Finance, Cambridge Judge Business School. She leads the global alternative finance benchmarking initiative at the Centre, spanning Europe, the Americas, Asia-Pacific and Middle East and Africa. She has co-authored ten industry reports with the Centre since 2016. Her research interests include small business economics and SME utilization of alternative funding models. Tania holds a master's degree from the London School of Economics and was a Fulbright Scholar in 2009-2010 in Beijing, China.

Horacio Blume

Horacio Morales-Blum is an adjunct professor at the Department of Industrial Engineering at the University of Chile where he holds a lecture on Alternative Finance. He previously co-founded CrowdyLab and as such in 2013 he participated in the first UK alternative finance benchmark report. He currently serves as Senior Research Manager at global real estate firm CBRE and has a master's degree in Engineering for Sustainable Development from the University of Cambridge.

Thales de Paula

Thales is completing an MBA at the Cambridge Judge Business School and is a researcher assistant at the CCAF. Prior to joining Cambridge, Thales spent seven years working as a quantitative strategist and portfolio manager in investment management at companies such as BlackRock and AllianceBernstein. Thales holds a BSc in Economics from the University of Surrey and an MSc in Finance from the Warwick Business School.

INTRODUCTION

This report summarizes the key findings from the 2017 Small Business Alternative Finance Impact survey, which focused on Mexican and Chilean businesses and how they utilise alternative funding channels such as P2P Lending and Equity Crowdfunding. This report serves as a continuation to the 2nd Annual Alternative Finance Benchmarking Report- Hitting Stride that highlighted the incredible growth of the alternative finance ecosystem throughout Latin America.

With $324 million generated by alternative finance platforms across Latin America in 2016, Hitting Stride underscored that online alternative finance is blossoming in the region and has a particular focus on business funding. As alternative finance continued to grow at triple digit rates (209% per annum), our research discovered that this fast-paced development is rooted in funding to sole-proprietors, small and medium sized businesses, equating to $233.8m in 2016. Just over two-thirds of the volume derived from Chile ($97.1 million) and Mexico ($69.5 million).

With this in mind, the Cambridge Centre for Alternative Finance and the Inter-American Development bank have partnered to conduct additional survey-based research to examine the impact of alternative finance channels for Chilean and Mexican businesses.[3] The resultant report presents the key findings and analysis from this survey.

DATA SOURCES

This report is based upon survey-data collected between July 2017-October 2017, with responses from 243 businesses in Mexico and Chile. Responses came from top-level management (typically the business owner or managing director), who could speak directly on the funding journey of the business in question and were either solely or partially responsible for financial decisions in their firm. The survey was supported by 23 alternative finance platforms and two industry trade bodies based in Chile and Mexico[4]. These partners were crucial to our outreach campaign, as they promoted the survey to their business fundraisers through a direct mail campaign and social media. The survey was administered in Spanish, and consisted of 32 questions.

Respondents were asked to identify the type of alternative finance channel utilised and subsequent questions related to their experience as related to that finance instrument. The four models reviewed corresponded with the key models in Mexico and Chile which drive business funding, namely P2P Business Lending, Invoice Trading, Equity-based Crowdfunding and Reward-based Crowdfunding. Upon completion of the survey, each response was reviewed and sanitized. Approximately 60 responses were incomplete or false-entries.[5] The research team anonymized all data prior to analysis. At completion, the data was encrypted and used exclusively for this project.

---

[3] The Inter-American Development Bank has been working to create financial regulation and policy to ensure the development of the sector, especially with respect to financial inclusion for businesses. To generate bargaining power and public awareness within the context of Fintech in Mexico and Chile, IDB is collaborating with these governments and their Fintech-related regulatory efforts to foster the growth of a sound ecosystem.

[4] Platforms based in Chile: Becual, Broota, Cumplo, Facturedo, Founderlist, GoSocket, RedCapital, Weeshing
Platforms based in Mexico: Briq.mx, Creze, Fondeadora, Fondify, iKiwi, Konfio, Konsigue, Kueski, Micochinito, Mutuo Financiera, Play Business, Prestadero, Proyecto Pyme, Raisehub, Axend
Trade Bodies: AFICO, FinTech Hub Mexico

[5] Several entries were deemed repeat entries, where a respondent submitted an incomplete entry or submitted dummy information in order to review the full survey before completing a correct and verifiable entry. Those responses were removed from the overall analysed data set. There were also a handful of entries with just contact details but no recorded responses to core questions.

Of the businesses represented in this survey, 202 (83%) entries came from respondents based in Mexico. The most prominent model utilised by respondents was that of P2P Lending (72%), followed by Invoice Trading (13%), Equity-based Crowdfunding (8%) and Reward-based Crowdfunding (6%). The below table provides a brief description of the models included in our study, alongside the total volumes recorded in each country.

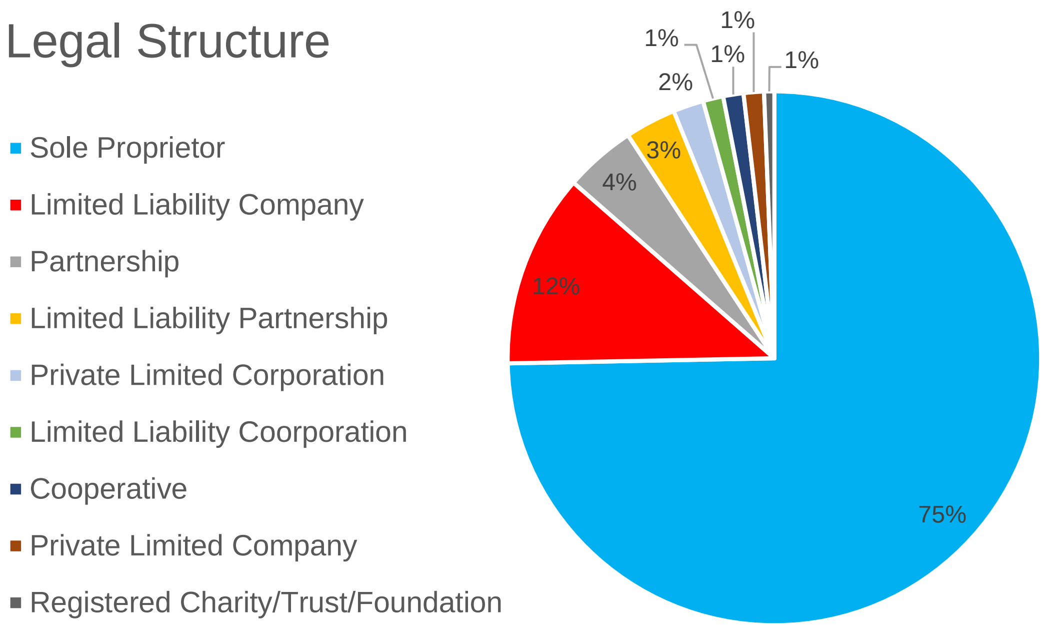
MODEL	DEFINITION	2016 TOTAL MODEL VOLUME	
		MEXICO	CHILE[6]
P2P Lending	Individual or Institutional funders provide a loan to a borrower, typically a business.	$24m[7]	$15m
Invoice Trading	Individuals or Institutional funders purchase invoices or receivable notes from a business at a discount.	$34m	$78m
Equity-based Crowdfunding	Individuals or Institutional funders purchase equity issued by a company.	$3m	$1.4m
Reward-based Crowdfunding	Backers provide finance to projects or companies in exchange for non-monetary rewards or products.	$.60m	$3.5m

[6] In HITTING STRIDE, the figure presented for P2P Business Lending in Chile included the Invoice Trading model figure. For the purpose of this paper, we have extracted the volumes solely related to Invoice Trading.
[7] This figure includes volumes from Balance Sheet Business Lending in Mexico.

P2P LENDING

DEMOGRAPHICS

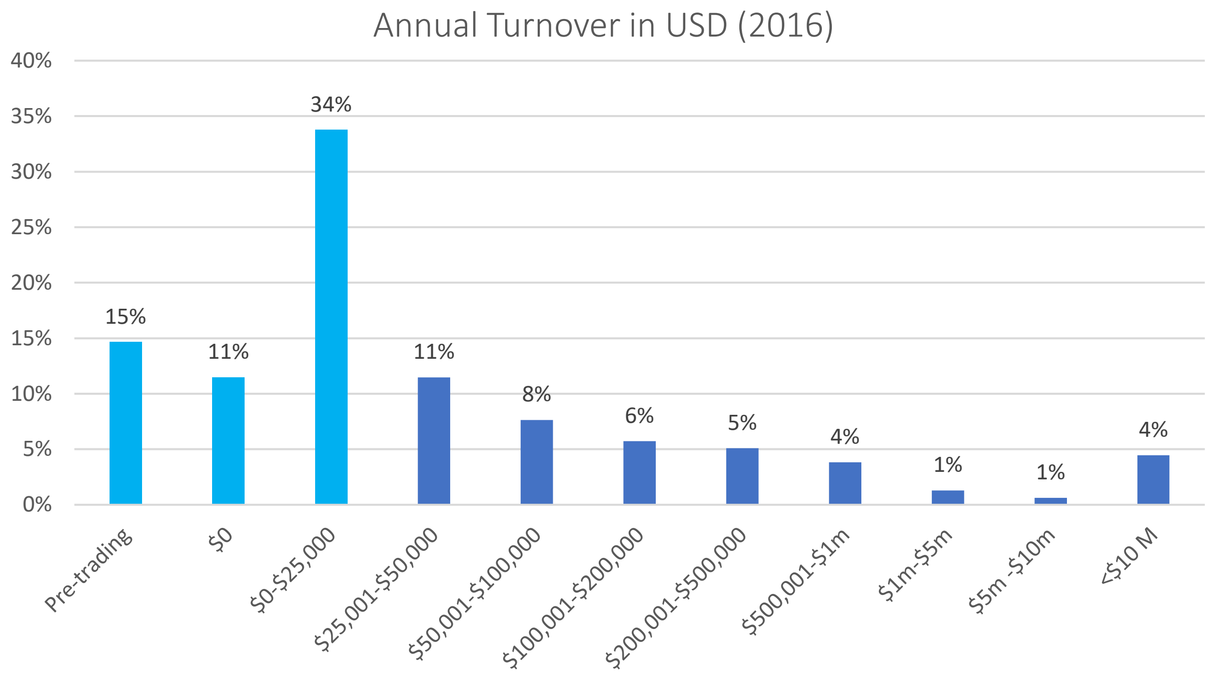
As noted previously, respondents to the survey predominantly used the P2P Lending model to fund their business activities. These business respondents came from a mix of Consumer Lending and Business Lending platforms. The vast majority of responding businesses (92%) were based in Mexico.



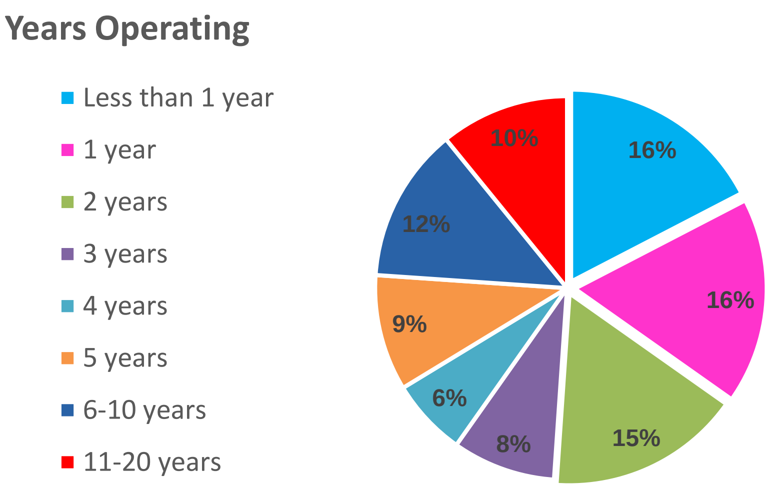
Top 3 Represented Sectors	
Clothing & Fashion (Manufacturing)	18%
Food & Drink	15%
Retail & Wholesale	12%

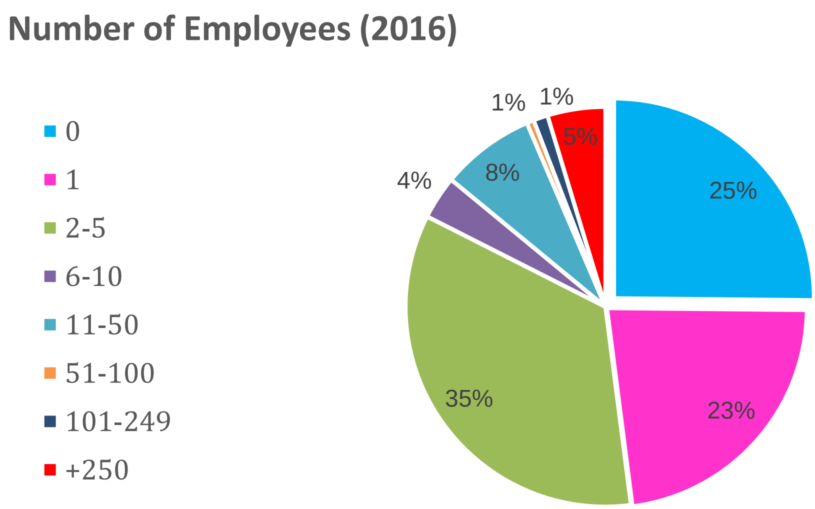
A variety of legal structures were represented by businesses utilising this model, though the majority (75%) characterized themselves as a Sole Proprietor, and 12% as a Limited Liability Company. Respondents also came from a variety of industries and sectors, indicating that the P2P Lending model was relatively sector agnostic. From comments collected by respondents, many of these businesses catered to other business customers, rather than consumers. With respect to the gender of the business lead, 65% were led by men and 35% by a female lead.

With respect to annual turnover, respondents were also asked to indicate their annual turnover in 2016. The majority of these businesses had turnovers below $50,000, with 34% up to $25,000. A handful of businesses were pre-trading (15%) or had no recorded turnover in 2016 (12%). It is notable, however, that 81% of these businesses indicated an increase in turnover in the subsequent year.



The number of employees varied across respondents, though these businesses did skew towards fewer employees. Not surprisingly, a quarter of these businesses had no additional employees aside from the sole proprietor, 23 % had one additional employee and 35% had between two to five additional employees. Finally, in terms of time operating, just under 50% of these businesses had been operating up to two years.

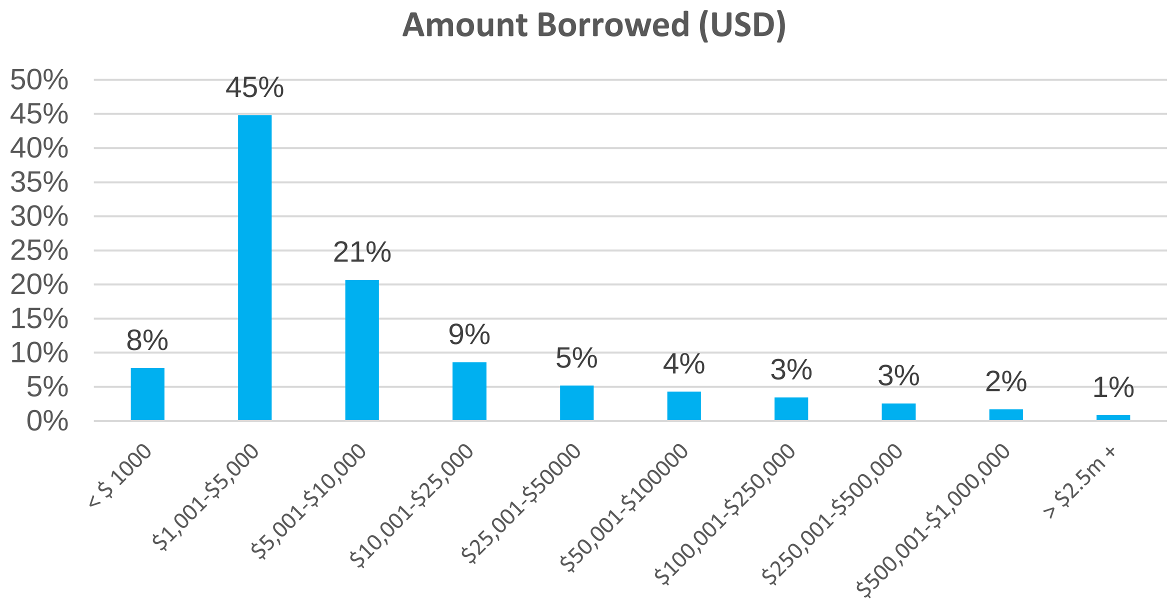




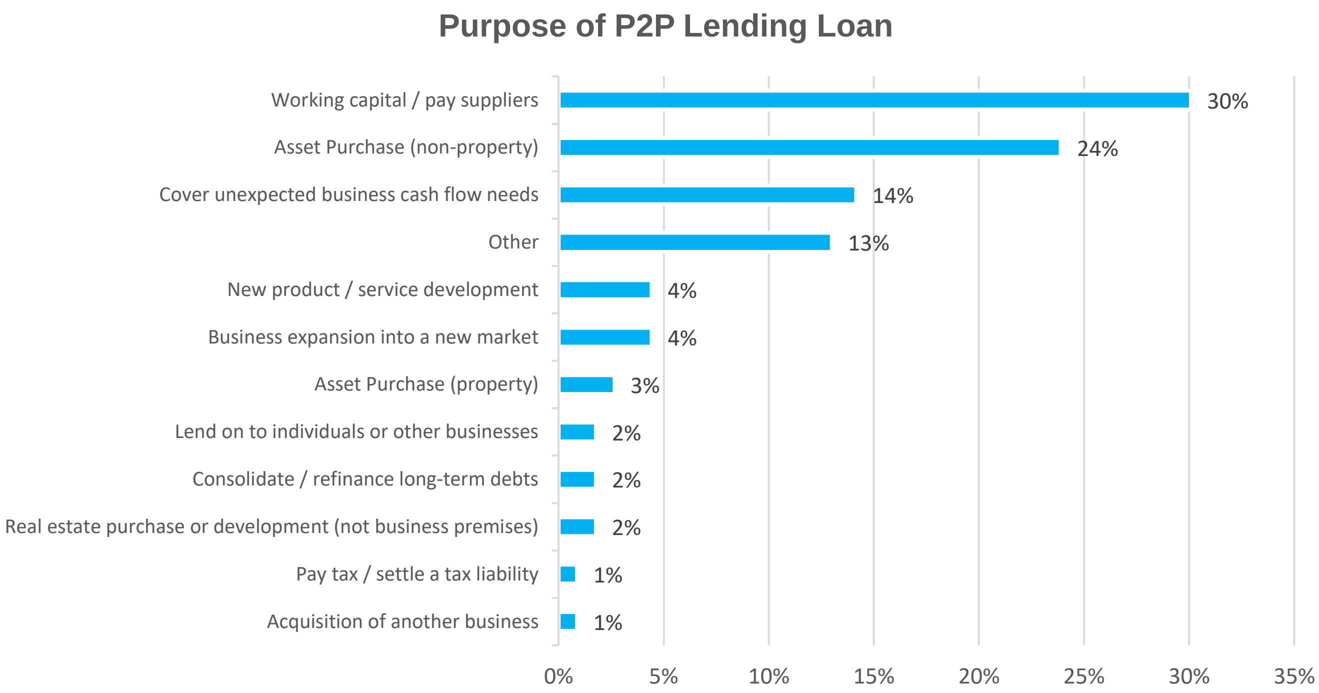
FUNDING EXPERIENCE

Respondents were asked a series of questions to understand their fundraising experience using a P2P Lending platform, and the subsequent outcome.

Businesses were asked to indicate how much they had borrowed via the P2P Lending platform in a 12 month period. Forty-five percent of businesses borrowed between $1,000-$5,000 USD, while 21% borrowed between $5,000-$10,000. Less than 10% of these businesses borrowed more than $100k. Of these businesses, 84% of them indicated that they had used the P2P Lending platform more than once in the calendar year. Half of these business had used their platform more than five times.

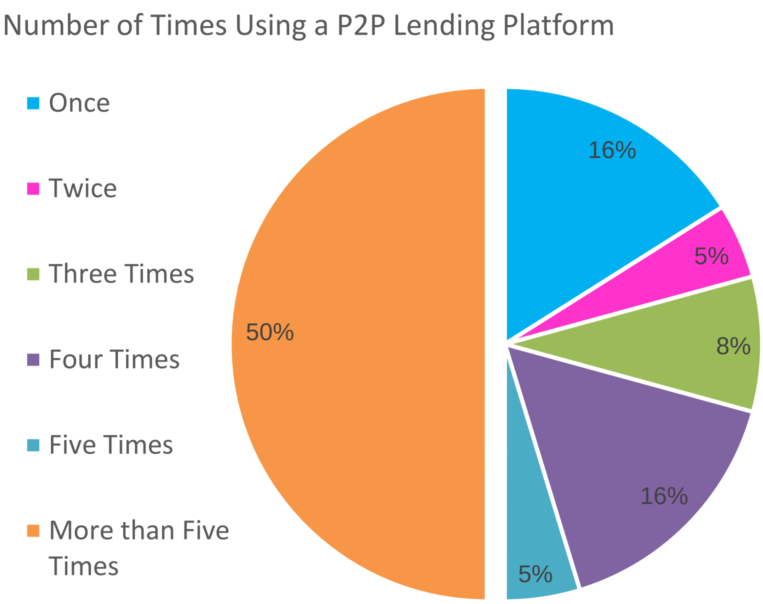


The businesses used their P2P loan for a variety of purposes. For 30% of the businesses surveyed, the loan's purpose was to cover working capital/supplier payment needs, while 24% indicated that they used their loan to purchase additional, non-property assets.

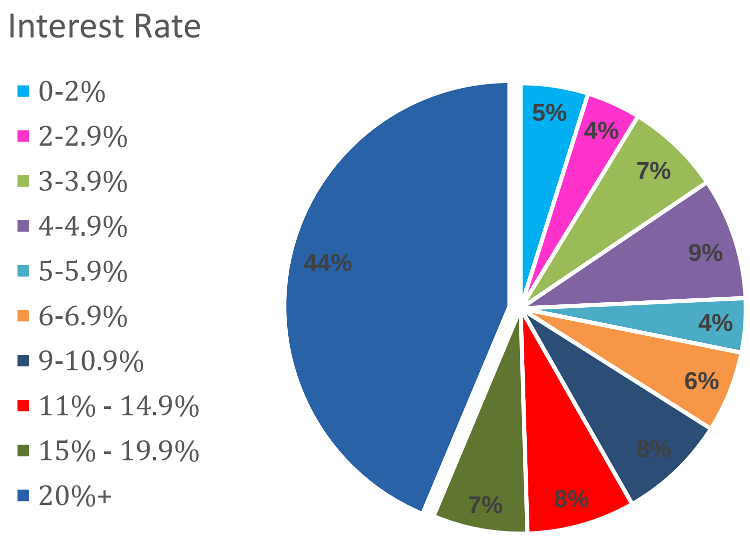


The businesses surveyed were also asked about the likelihood of raising funds had they not received a loan from a P2P Lending platform. Only 33% of respondents felt that they would have been able to receive a funding offer had alternative finance not been an option. Thirteen percent said that they would not have received a funding offer, while 52% were unsure of their fundraising success. The remaining respondents preferred not to respond.

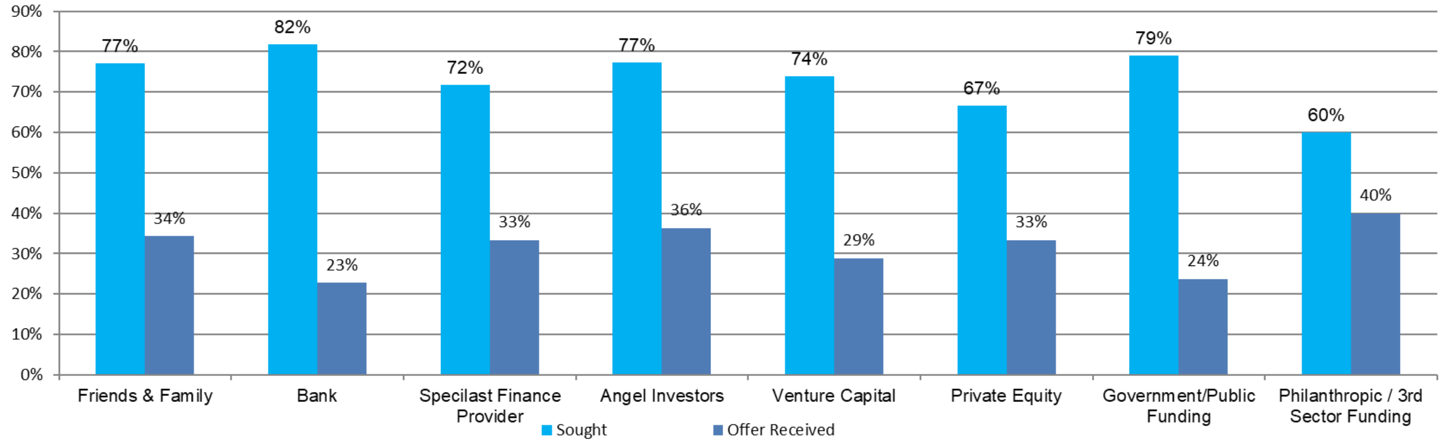
Forty-four percent of the businesses received an interest rate of 20% or more, indicating that the loans on offer were more costly than that of the typical bank loan. This indicates that the cost of financing was not as significant a barrier as initially considered by the research team.



In order to understand the flavour of the respondents' previous fundraising experiences, the businesses were asked to indicate which other facilities they had sought previous to using P2P Lending.



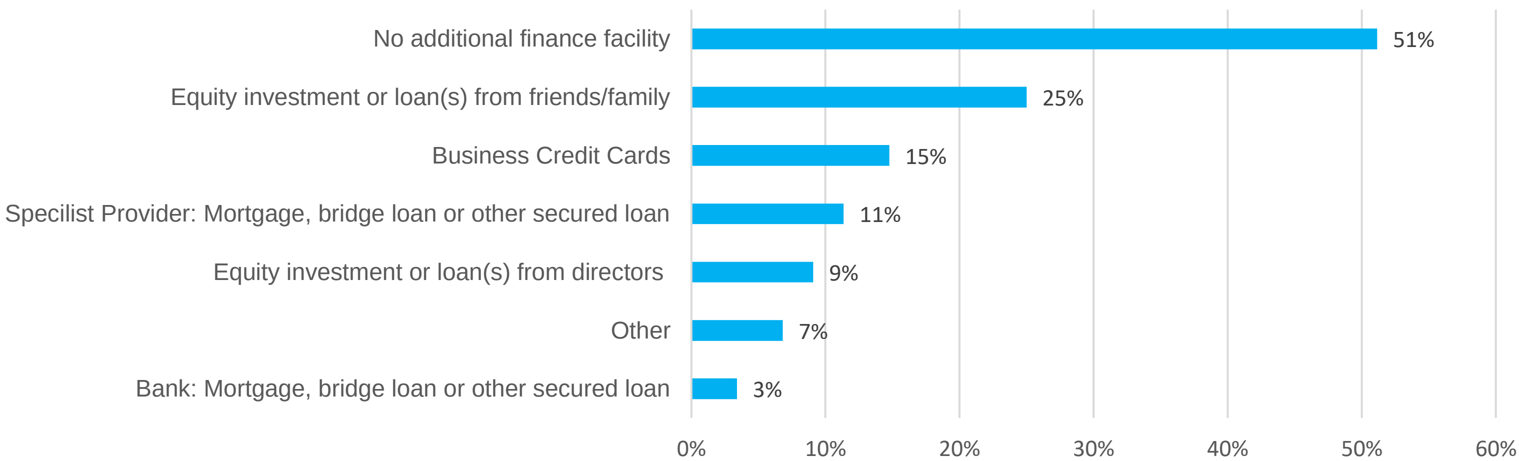
Funding Sought vs Received Pre-Alternative Finance Facility



The above chart indicates the facilities which they sought against offers received. For instance, 82% of businesses applied for a finance facility from a bank, but only 23% received an offer. It should be noted, many of the respondents indicated that the offers they received were not necessarily prudent or suitable for the business. As such, many noted not utilising the facility offered to them. The reasons they stated included pejorative terms or obligations associated with the funding offer, or that the funding offer was insufficient to their actual needs.

Respondents were also asked to indicate any additional finance facilities used by the business. Just over half of businesses had no additional finance. Approximately 9% of the businesses had additional equity investment or loans from the directors, and 25% from friends and/or family. Only 3% of the respondents were using a facility from a bank, while 11% were using a facility from another specialist provider. Business credit cards were used by 15% of respondents.

Additional Finance Facility Utilised by the Business

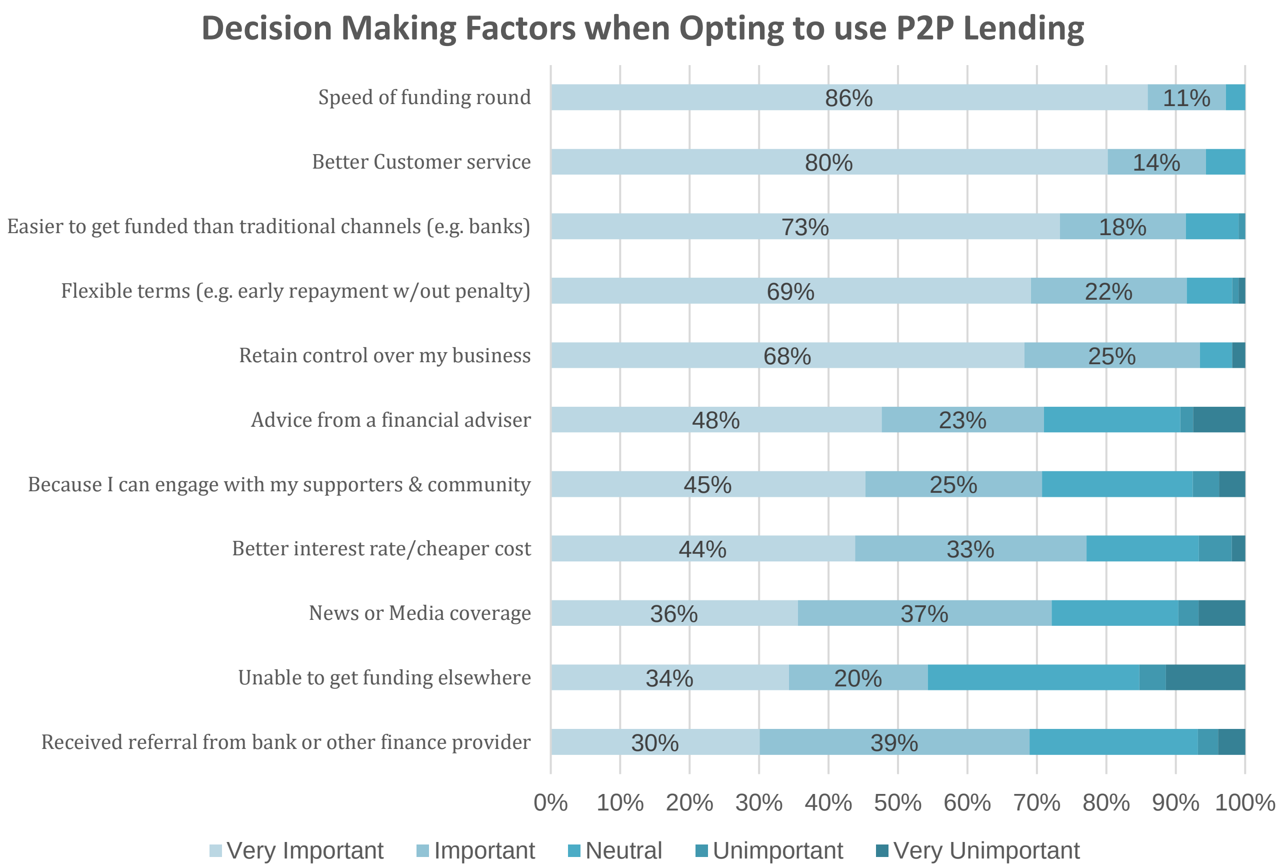


When asked to rank the importance of different aspects of the funding process, respondents denoted 'speed of funding' (86%) and 'better customer service' (80%) as very important factors towards their willingness to borrow from a P2P Lending platform. From qualitative

comments collected during subsequent interviews, business owners indicated that speed was critical in terms of receiving the funds but also in terms of decision making. Nearly all of the businesses spoken to mentioned that a major barrier to finance was not receiving a decision from their bank or specialist provider on their funding application. As such, a platform's speed in providing a 'Yes or No' was viewed as critical.

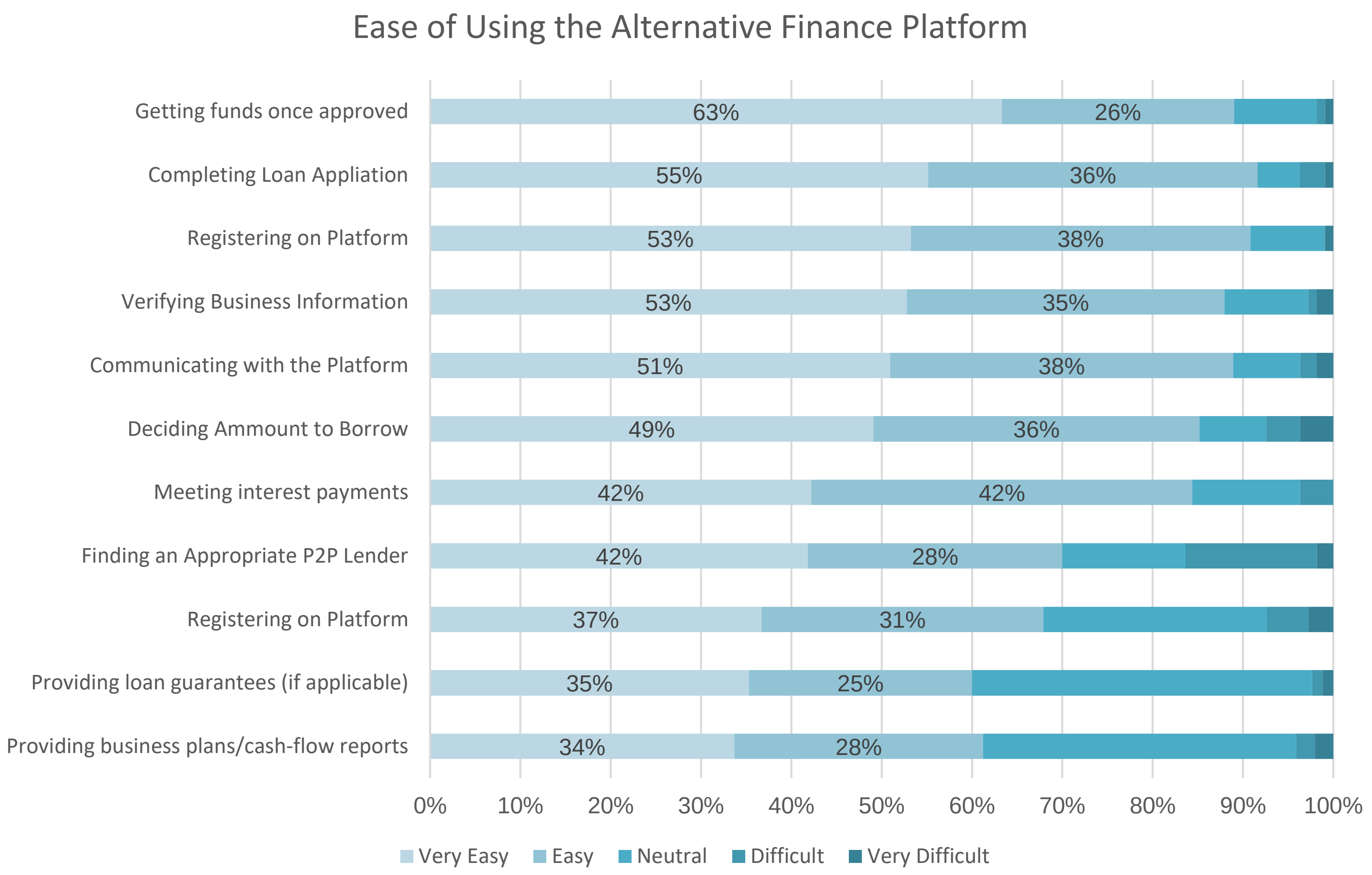
Flexibility of terms was also viewed as 'very important' for 69% of businesses. Qualitative comments collected in the survey indicated that many businesses opted to use a P2P loan due to the terms they received. Flexible payment (especially early repayment terms) was a common theme in the comments received. A handful of business interviewed also stated that they had received loan offers from their bank that did not match the amounts they had originally applied for, with the bank requiring them to borrow more than they needed.

The businesses were also asked to rank the 'ease of use' when considering the funding process on the P2P Lending platform. Overall, the process was viewed as very easy, with 'getting funds approved' (63%) and 'completing loan application (55%)' as 'very easy'. From comments collected, the businesses indicated that the process was easy due to the fact that all forms/requirements were easy to input within their platform's systems. They also indicated that the applications differed from typical bank or specialist loan applications, as they were viewed as shorter and 'easier to



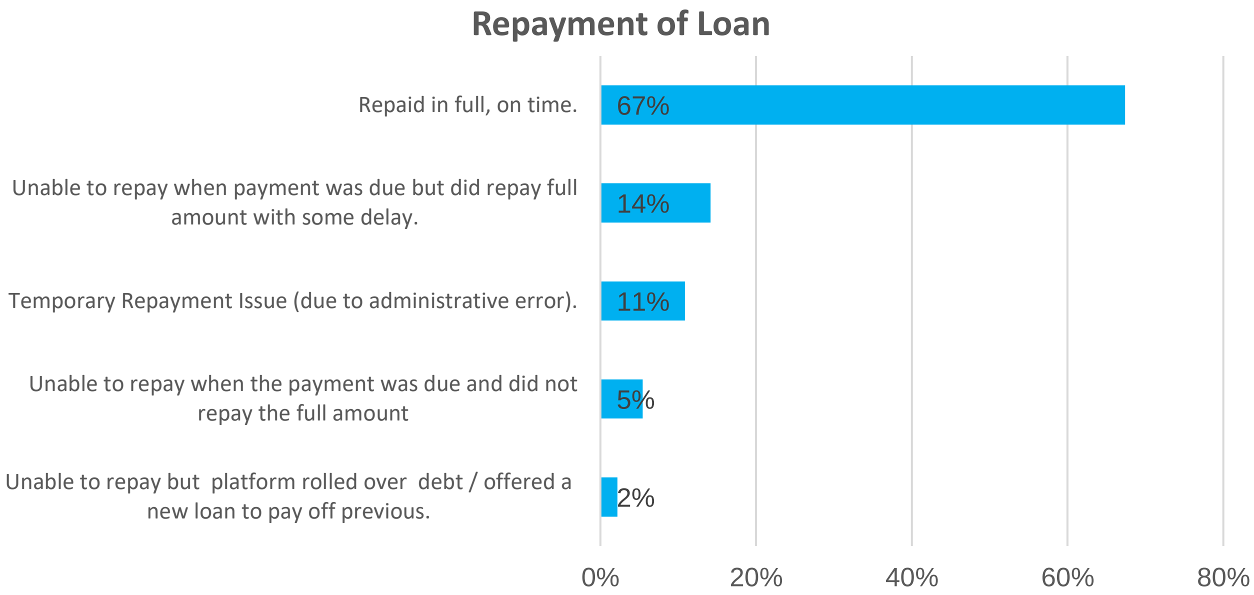
understand'.

Providing loan guarantees was viewed as very easy or easy by 60% of the businesses. One of the business interviewed shared their experience on providing additional guarantees, explaining that some of the difficulties arose from the communications between the lending platform and their bank, who had a claim on the same asset being used for the guarantee. Overall, the businesses interviewed felt that it was appropriate for the platform to require a guarantee, with most of the business owners noting that they did provide a personal guarantee. In subsequent research, all respondents will be asked to indicate their experience with personal and business guarantees, as this is often viewed as a barrier to businesses when trying to access funds.

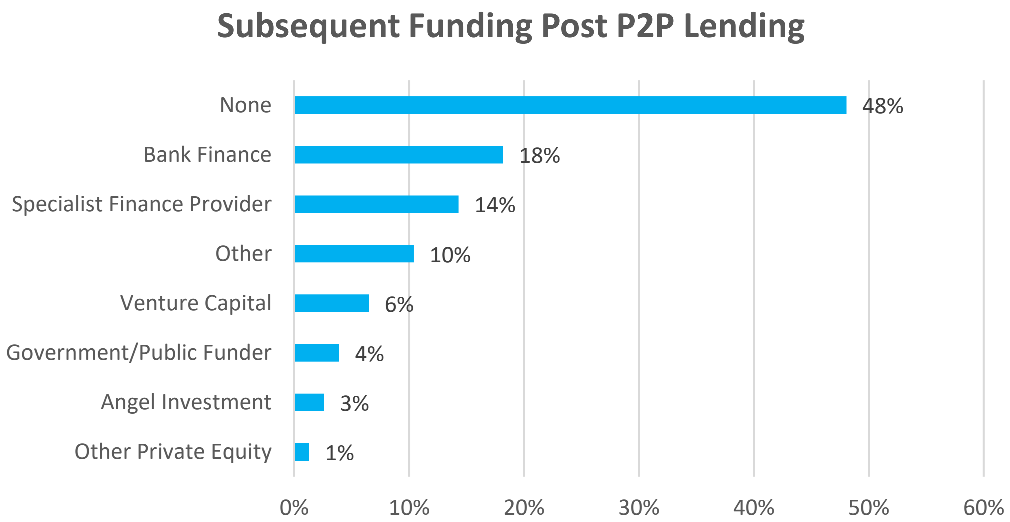


POST FUNDING IMPACT

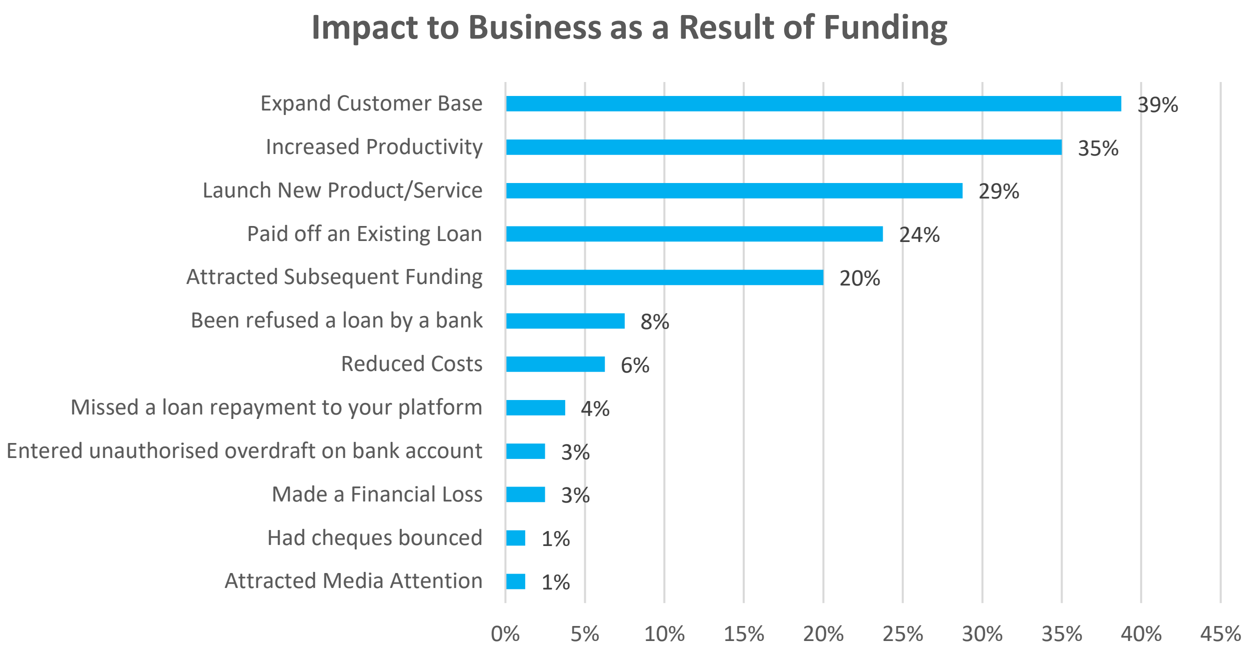
The businesses were also asked to discuss their post-funding experience, beginning with their repayment abilities. Sixty-seven percent of businesses indicated full repayment on time, with 5% of respondents defaulting on their loan. A handful of respondents indicated delays in repayment due to administrative errors outside of their control (11%)[8]. Fourteen percent of borrowers could repay their entire loan, but did indicate late repayment. Finally, 2% of businesses refinanced their loan with the platform.



As a result of receiving a finance facility from an alternative finance provider, a number of businesses were able to leverage the success of their P2P loan to receive subsequent funding offers. For instance, 18% of businesses were able to secure bank finance. Qualitative comments collected by

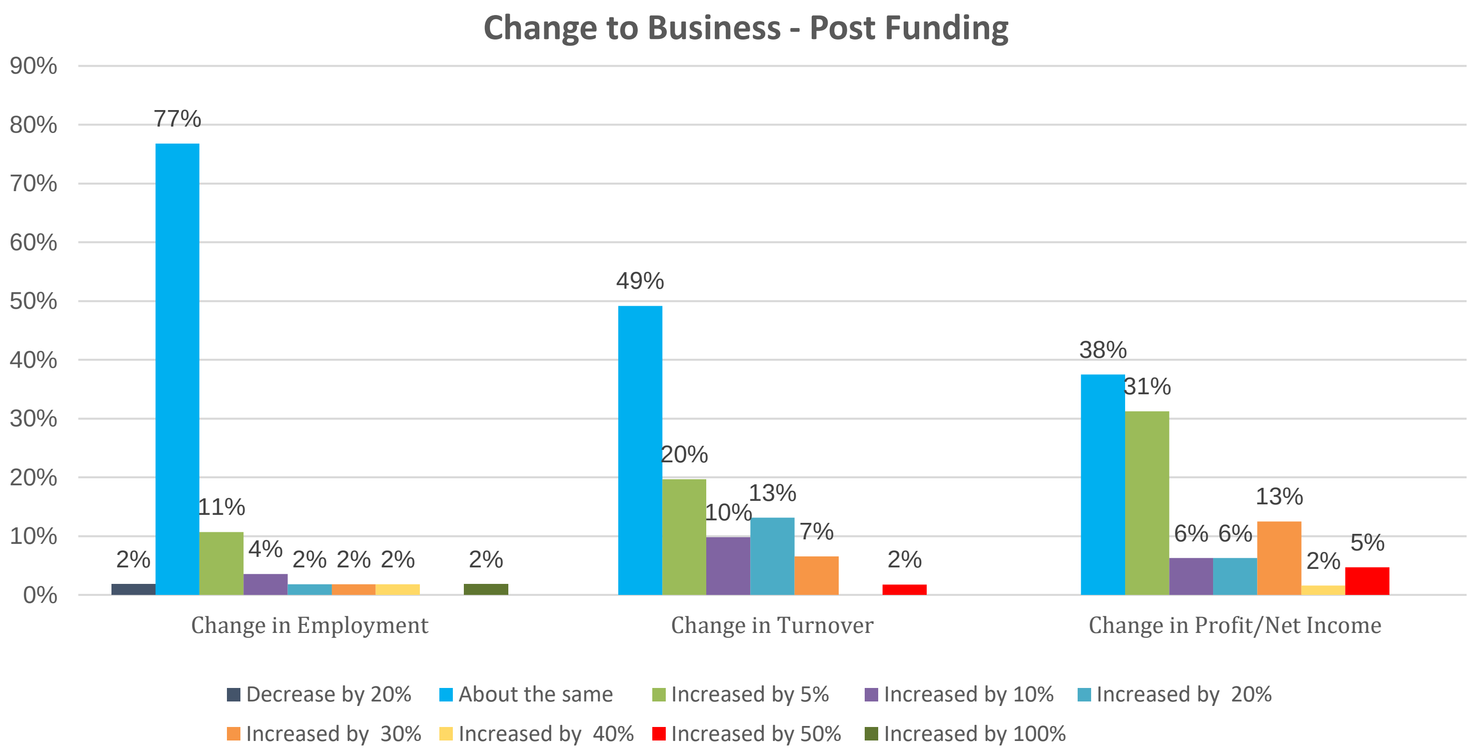


[8] In the case of administrative issues, this related to technical issues with the platform in use and their bank or other payment methods. In these instances, the platforms were made aware of repayment issues and corroborated that these late payments were related to system failures and not to customer behaviour.



the respondents indicated that their ability to receive a bank overdraft or additional facilities from their primary banking relationship were impacted positively by the businesses ability to demonstrate success with the P2P Lending platform. Eighteen percent of the businesses were able to attract finance from a specialist finance provider, and indicated that their loan from the platform played a significant role in securing the additional facility.

It should be noted, in a subsequent question, nearly 70% of the businesses indicated their preference of using a P2P Lending platform in lieu of traditional finance (i.e. instead of a bank loan), and 74% were actively planning on applying for a new loan via their platform within the next 12



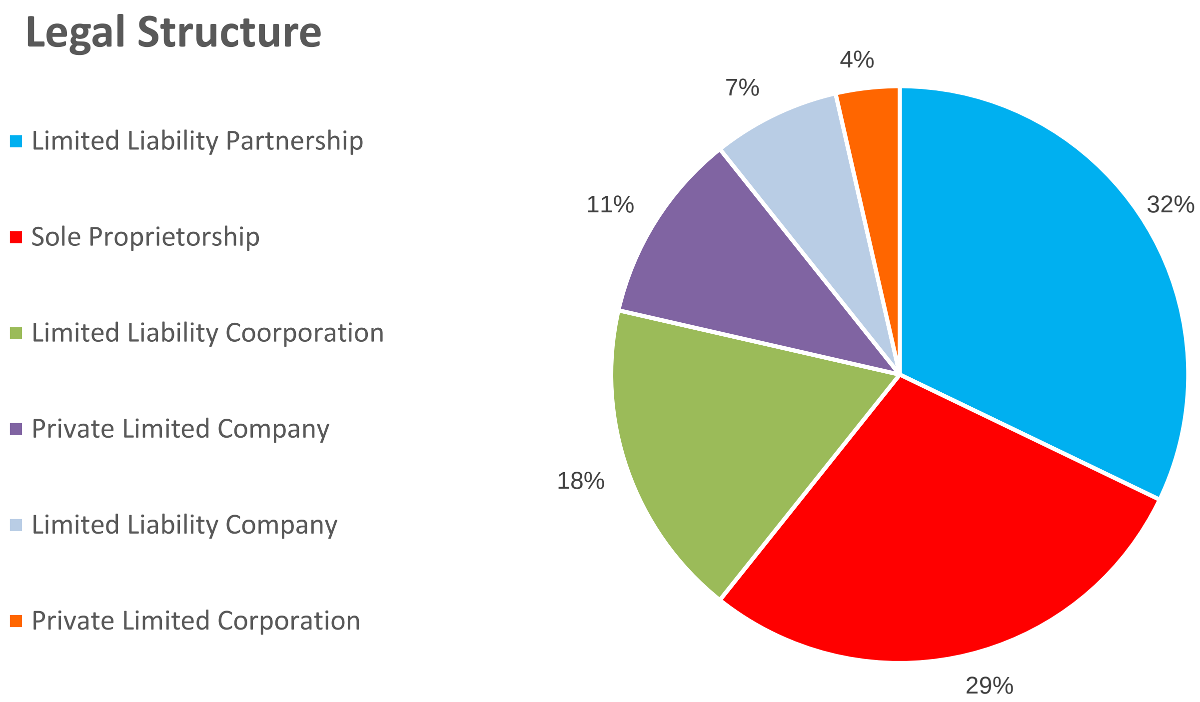
months. The businesses were asked a series of questions related to the direct impact of their loan to their business. Thirty-nine percent of the respondents said they were able to expand their customer base as a direct result of their funding, and 35% said they had noted ‘significant increase in productivity.’

The businesses were asked to provide some details around specific changes to their business post funding. Specifically, change in number of employees, change in turnover, and change in profits. Just over half of all respondents saw an increase in their turnover, while 49% saw no real change against the previous year. Profitability was the most markedly changed metric, with only 38% of businesses indicating no change. Thirty-one percent of businesses noted an increase of 5% in their profitability, and 13% an increase by 30%. Finally, change in number of employees largely remained the same, with 77% of respondents noting no change.

INVOICE TRADING

DEMOGRAPHICS

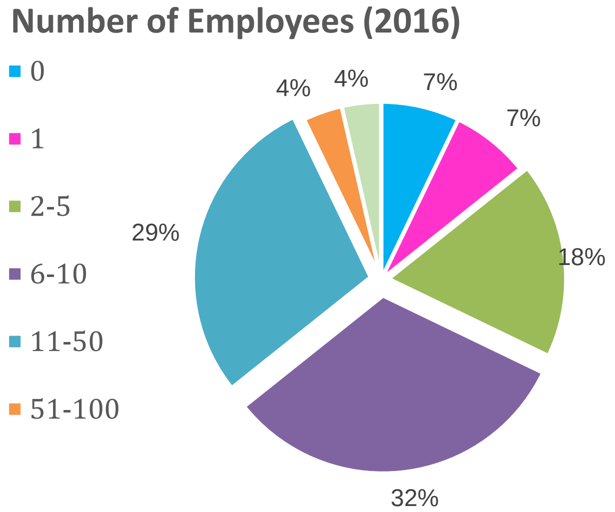
The invoice trading model was utilised by 13% of respondents to the survey, with nearly 90% of these businesses based in Chile. All of the business respondents catered to other businesses. Seventy-nine percent of the business leads were male and 21% female.

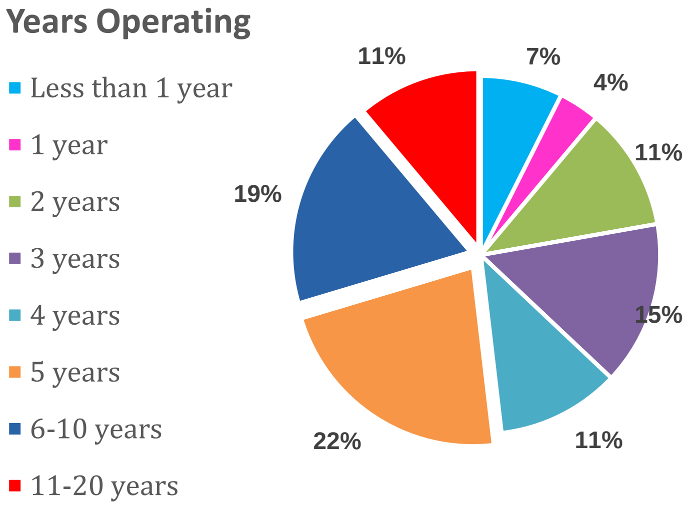


The legal structure of these businesses varied significantly, with 32% indicating their legal structure as a limited liability partnership, 29% as a sole proprietorship, and 18% as a limited liability corporation. The respondents also represented a variety of industries and sectors. The top three were Business & Professional Services (19%), Manufacturing & Engineering (12.5%) and Construction (12.5%).

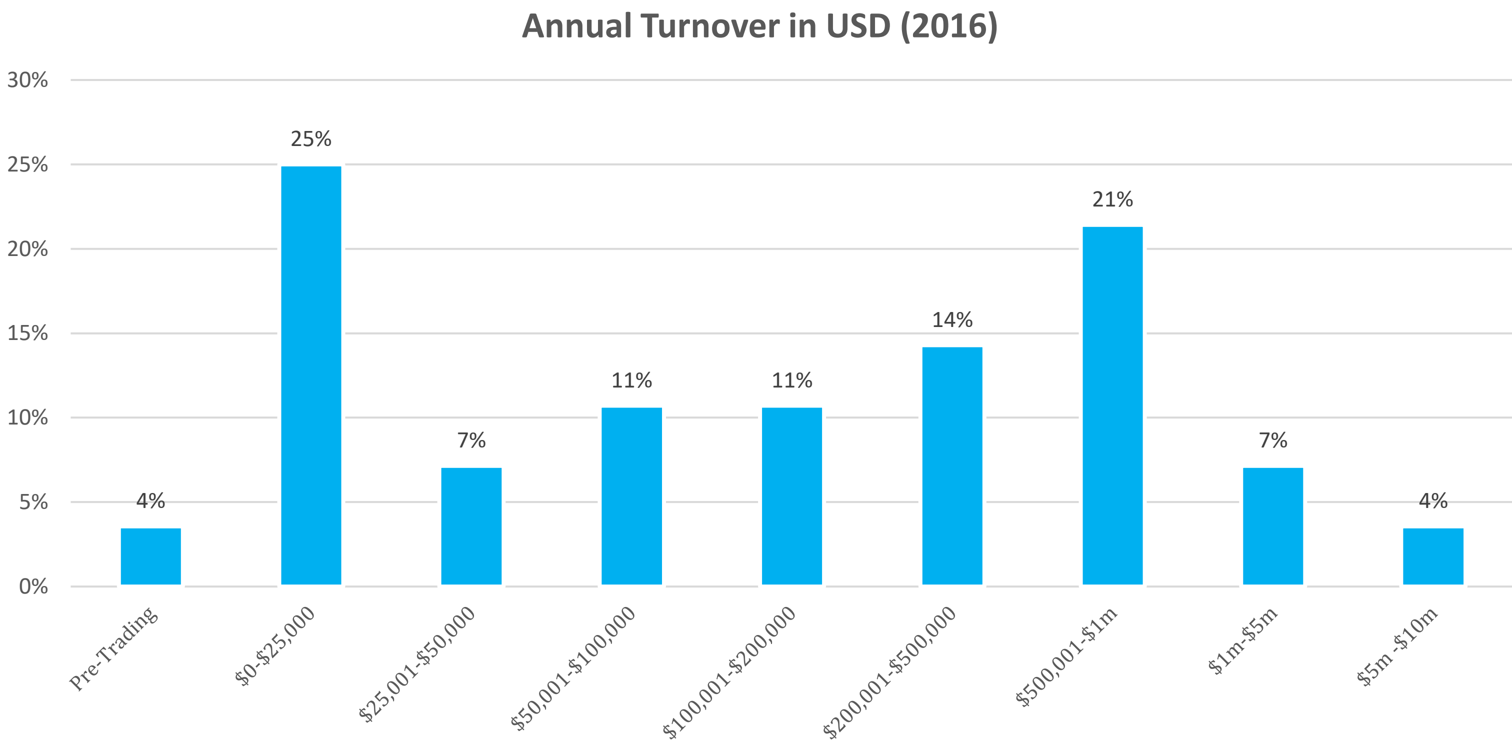
Top 3 Represented Sectors	
Business & Professional Services	19%
Manufacturing & Engineering	12.5%
Construction	12.5%

Unlike borrowers of the P2P Lending model, respondents that borrowed through an Invoice Trading platform tended to be larger businesses, revealing a wider spread of turnovers and number of employees. Whilst a quarter of these businesses had turnovers up to $25,000, 32% percent of these respondents indicated a turnover of over $500, 000. Only 4% were ‘pre-trading’.



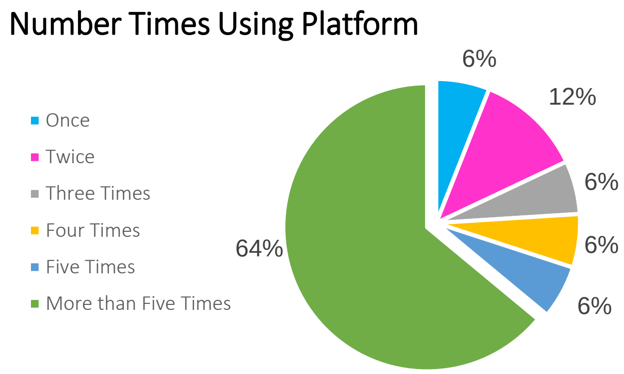


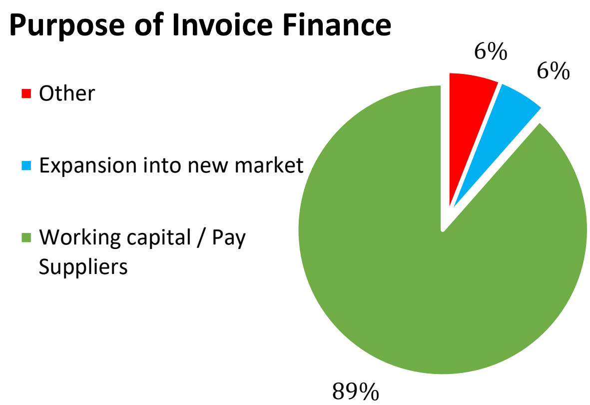
The number of employees varied significantly in this subset of respondents, though skewing towards larger businesses. Eighteen percent employed between 2-5 people, 32% employed between 6-10, and 29% between 11-50 employees. In terms of years' operating, over 50% have been operating for 5+ years.



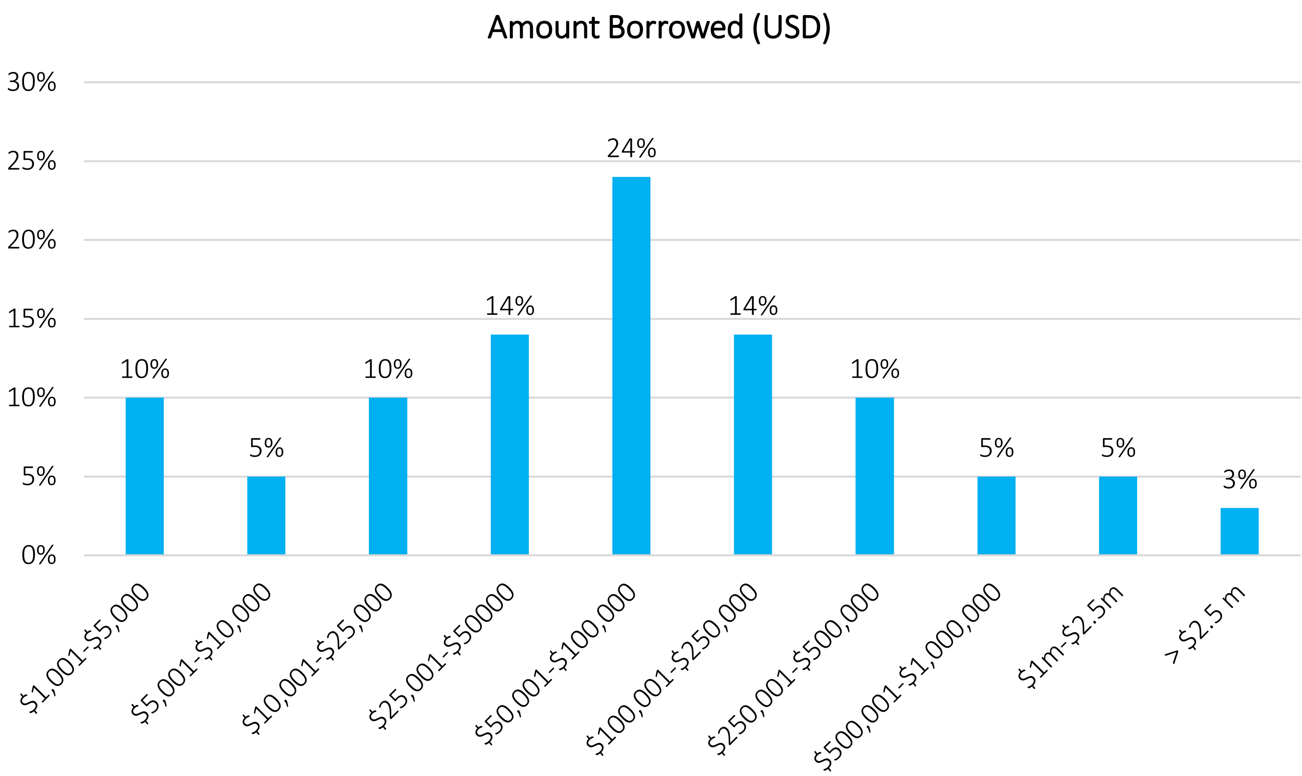
FUNDIING EXPERIENCE

The businesses that utilised an Invoice Trading platform borrowed more per loan in comparison to the P2P Lending businesses. In fact, 37% of businesses borrowed over $100,000 and 24% percent of respondents borrowed between $50,001-$100,000. Nearly all of the businesses that responded to the survey had used their Invoice Trading platform more than once, with 64% having used the facility five or more times. Sixty-four percent of the respondents had used the invoice trading platform for a new loan in the 30 days prior to responding to the survey.

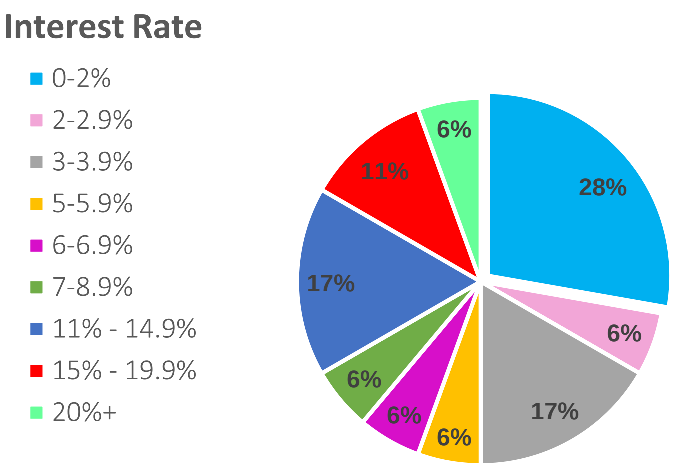




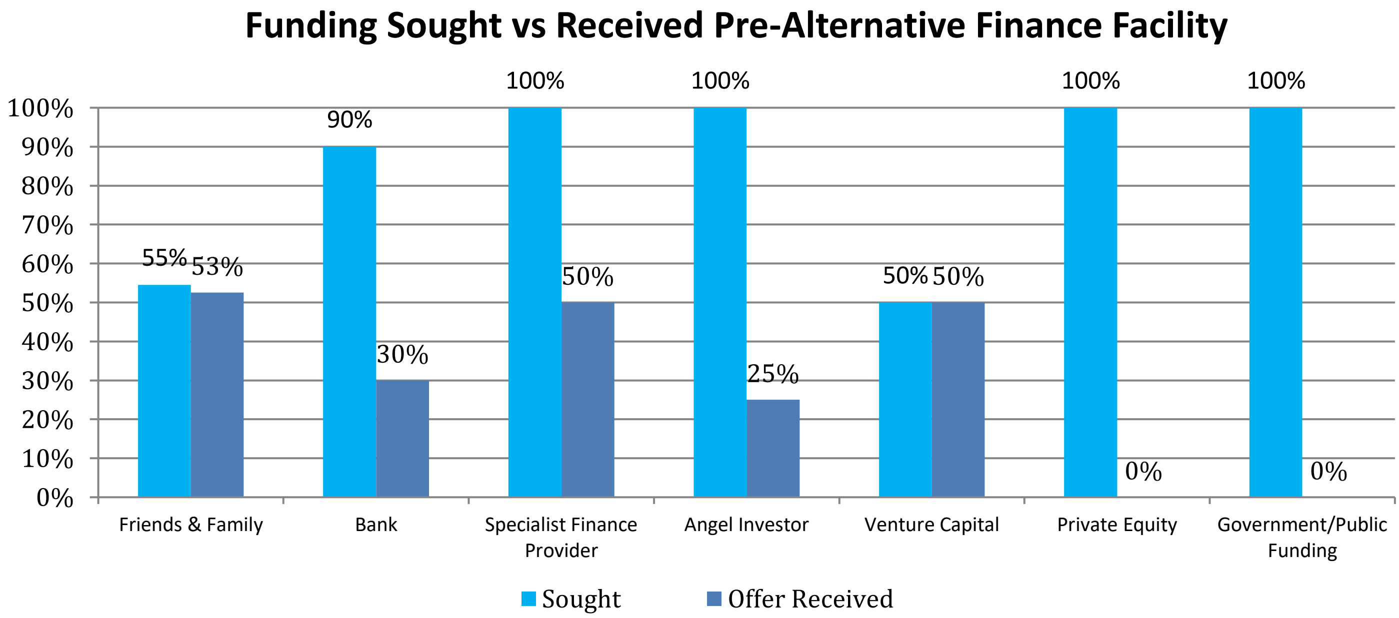
Not surprisingly, the vast majority (89%) of businesses used their invoice financing towards working capital, while 6% noted that the facility was used towards expansion into a new market.



The interest rates received by the businesses varied significantly, with just over half of the respondents receiving an interest rate below 6%. Unlike the businesses from the P2P Lending section (with a large proportion of >20% interest rate loans), only 6% of Invoice Trading respondents received an interest rate over 20%.

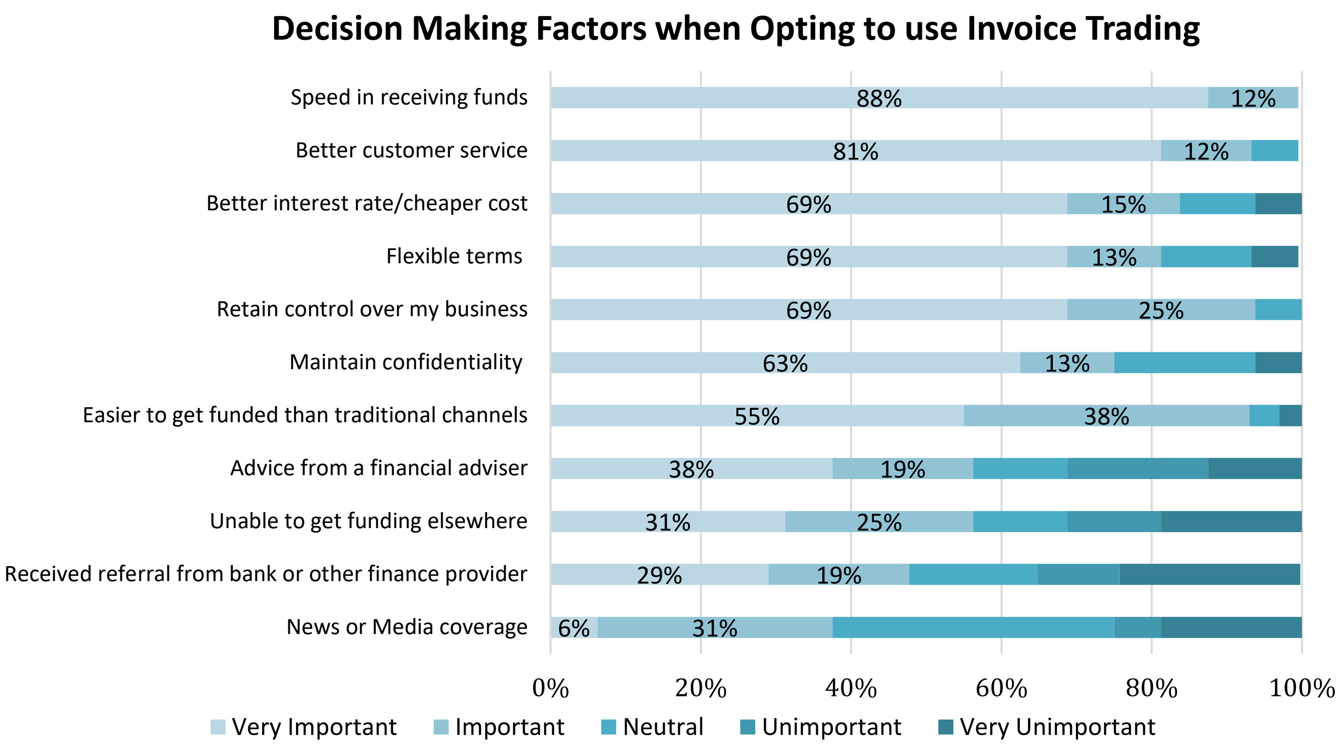


The businesses were also asked about the likelihood of raising funds, had they not received financing through the Invoice Trading platform. Forty-seven percent felt that they would have been able to procure financing had the facility from the invoice trading platform not been successful. Eighteen percent indicated that they would not have been able to receive funding, and 35% were unsure of alternate fundraising.



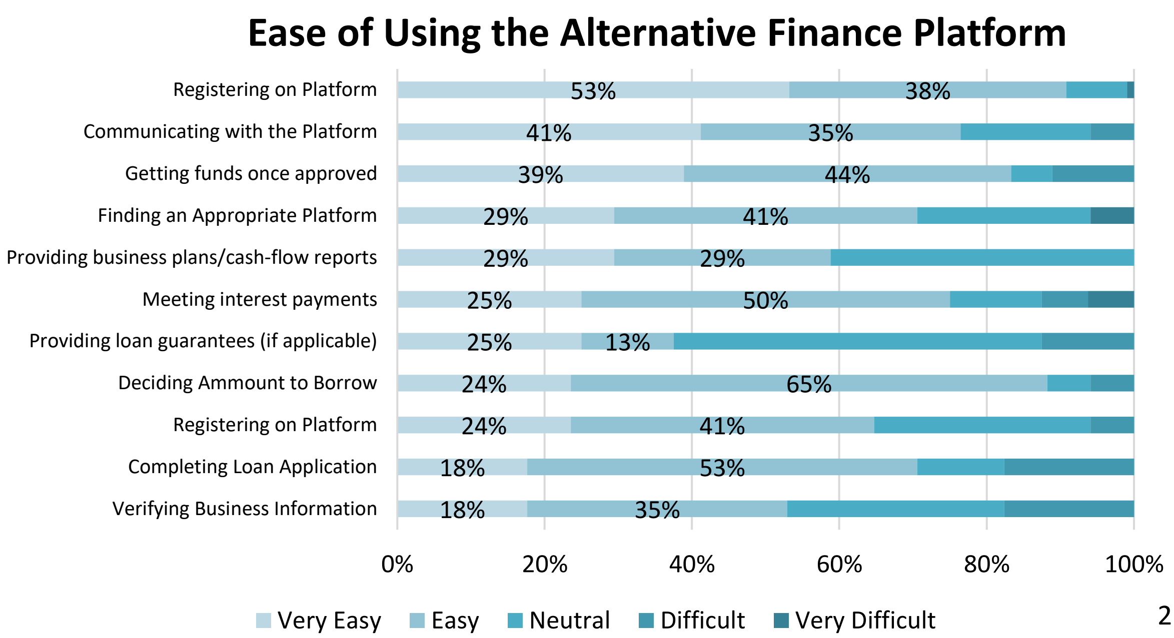
The businesses were asked a series of questions about their previous fundraising experience. All of the respondents sought financing from a specialist provider, with half receiving a subsequent funding offer. Ninety percent had applied for bank finance, with 30% receiving a subsequent offer. Nearly all of the business respondents in this section indicated that they had an existing bank account with at least one bank. Despite having an account with a bank, their comments indicated that it was still very difficult to receive approval for a bank loan or sufficient overdraft facility.

Businesses were also asked to identify any additional finance facilities in use by the business. No

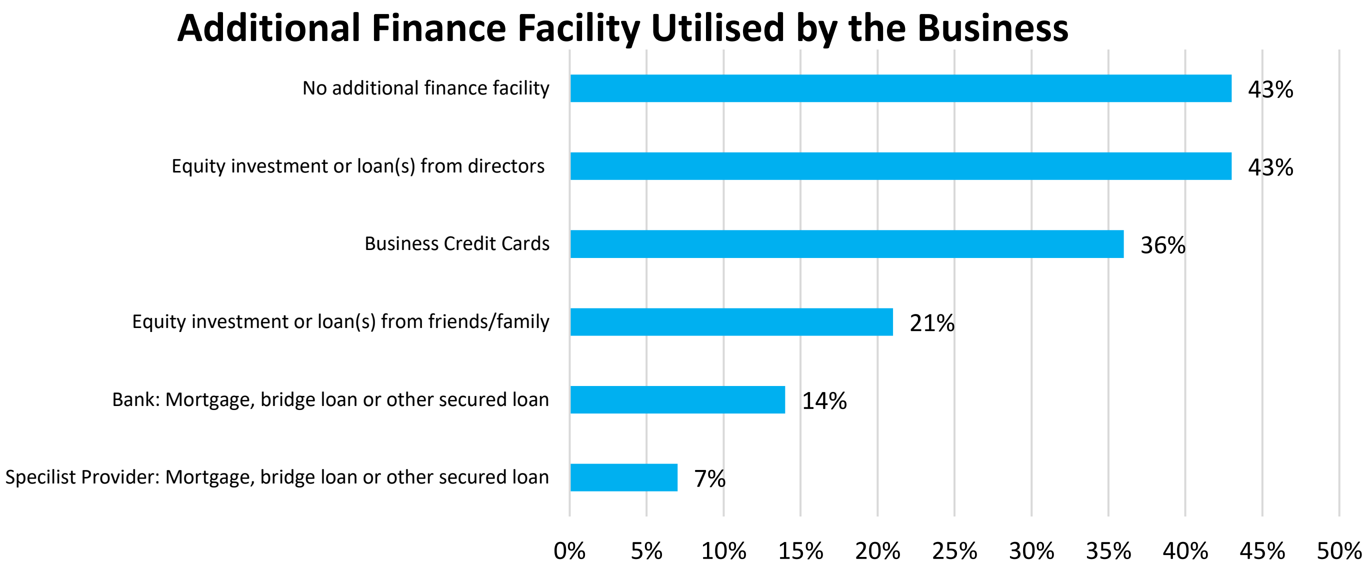


additional facility was in place for 43% of respondents. Investments or loans from the directors was in place for another 43% of respondents, followed by 36% of respondents using business credit cards. Only 14% of the respondents had additional banking facilities in place, while 7% had received financing from a specialist provider.

With respect to key decision-making factors for using an Invoice Trading platform, 88% of businesses indicated 'Speed' as very important. Sixty-nine percent of businesses also viewed 'cheaper cost', 'flexible terms' and 'control' as very important. In comments collected, the businesses felt that they were able to maintain control over which invoices were leveraged, and were able to manage the communications with the invoiced party. One of the businesses said that it was important to them that their customer not know their invoice was being factored, as there exists negative assumptions about businesses that use invoice factoring services.

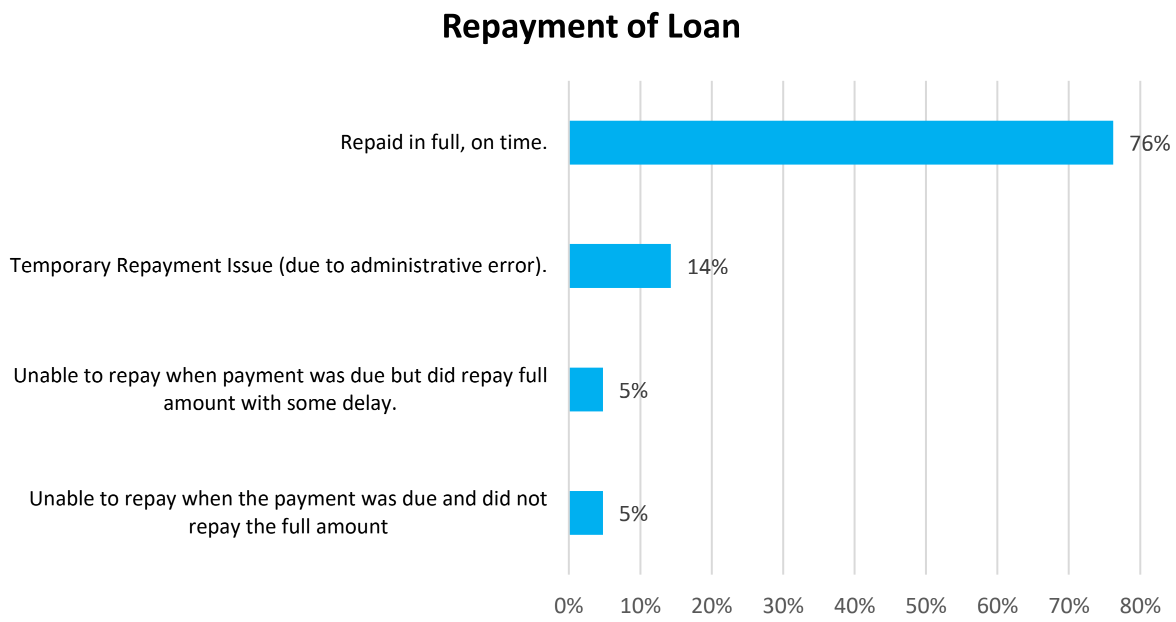


Overall, the businesses found it easy to use alternative finance platforms. When speaking with these businesses, they indicated that communication was easy since there were a number of ways to interact with the platform. The businesses noted that although all transactions happened online, they had all spoken at least once with someone from the platform and had a point person within the platform. The businesses also stated that the process of providing the invoices and/or other information needed for verifying receivables was fairly straightforward, though did require a bit of additional work offline when submitting.

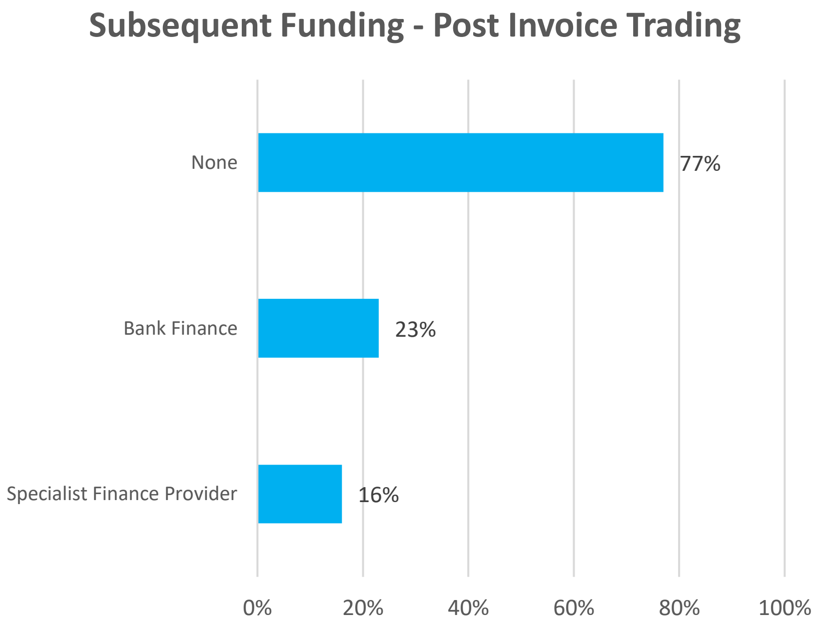


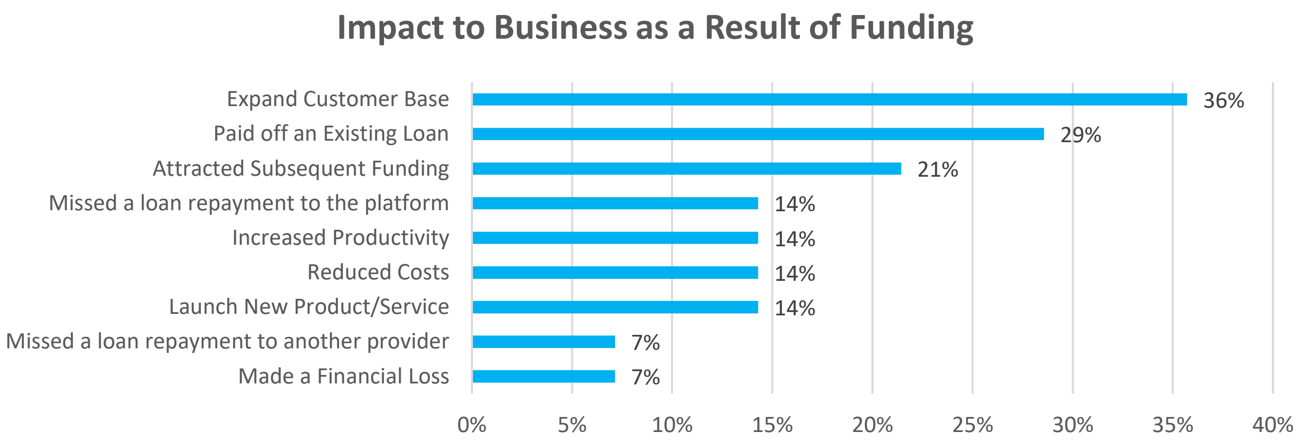
POST FUNDING IMPACT

The respondents answered a series of questions related to their post-funding experience, and the impact of their funding on their business and operations. With respect to repayment, 76% of businesses had no problems with their repayment and paid back their loan in full and on time. Fourteen percent of businesses noted temporary payment delays related to technical errors around the administration of their loan. These businesses were able to repay their loan once these issues were resolved. Five percent of the businesses did experience late payments throughout the course of their loan, but were able to pay back the full amount. A final 5% defaulted on their loan.



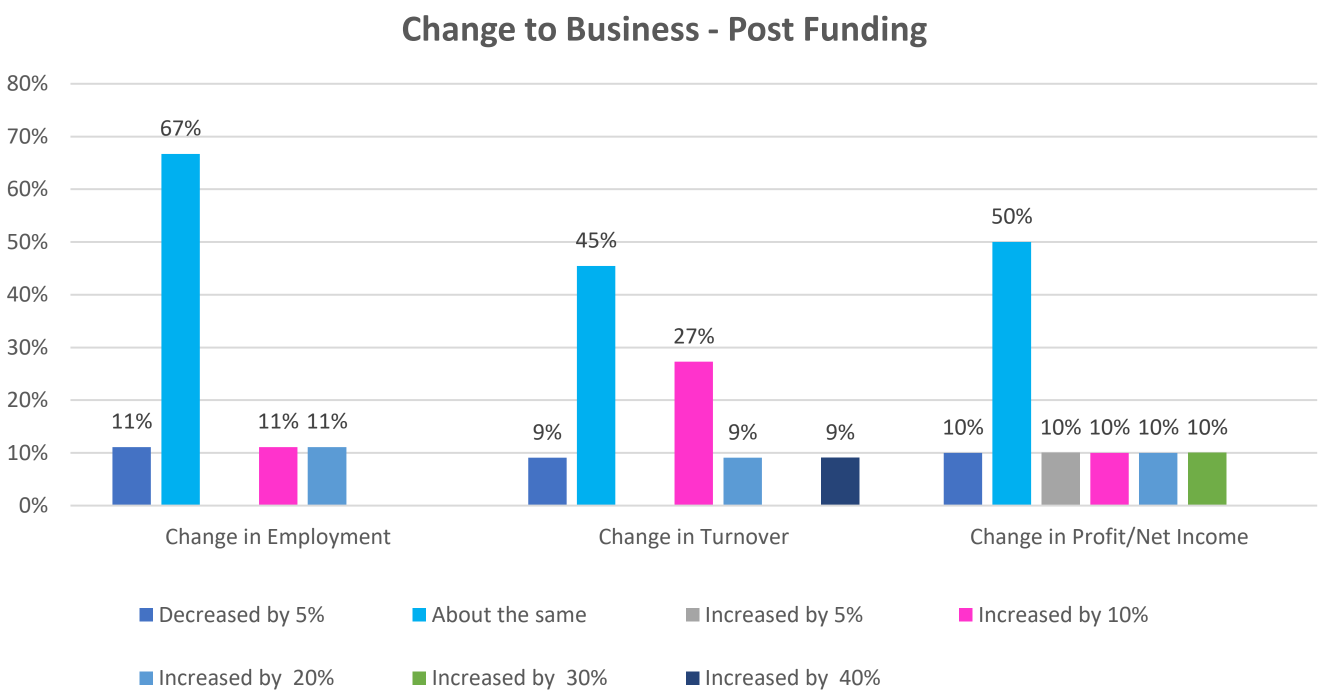
With respect to subsequent funding, 77% of the businesses indicated that no additional facility was required. Twenty-three percent of the businesses were able to procure bank finance, and 16% took up additional credit from a specialist finance provider. From the comments collected by these businesses, using invoice trading platforms successfully had a significant impact on expanding their existing banking relationships. Overall, 21% of businesses indicated that their ability to attract additional funding related directly to their alternative funding experience.





Thirty-six percent of businesses indicated that they were able to expand their customer base as a direct result of procuring alternative funding.

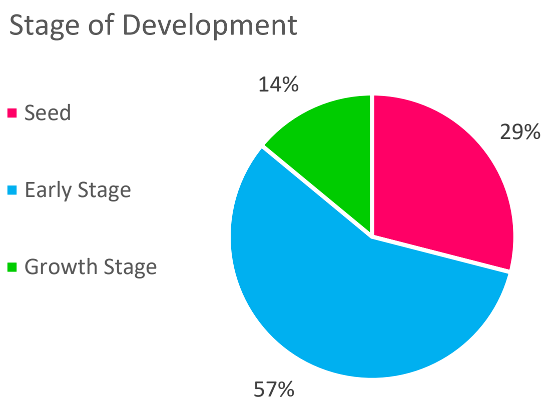
Finally, the businesses were asked to reflect on the changes to their business since using Invoice Trading. Changes were mostly positive, though a handful of businesses did see decreases in their number of employees, a decrease in turnover and a decrease in profit. With respect to workforce, 67% of businesses noted no real change, while 11% of respondents noted a 10% increase of their workforce, and another 11% noting a 20% increase in their workforce. For 45% of the respondents, no change in turnover was noted and nearly 10% actually experienced a decrease in their turnover, by about 5%. Alternatively, 27% of the respondents noted an increase in their turnover by 10%, another 9% indicated a 20% increase and a final 9% noted a 40% increase in their turnover. Finally, half of the respondents indicated no change in their profitability, while 40% noted an increase in their profitability to varying degrees. Ten percent of the businesses noted a five percent decrease in their profitability.

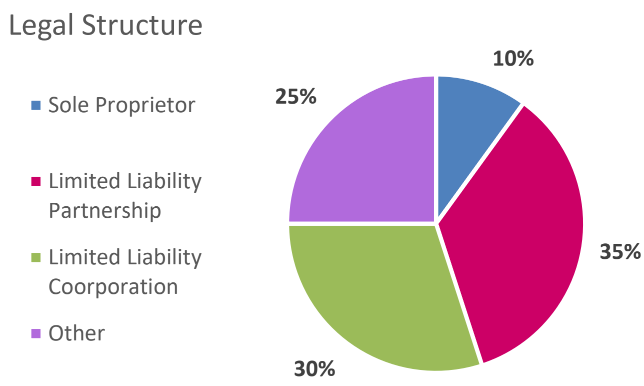


EQUITY-BASED CROWDFUNDING

DEMOGRAPHICS

Businesses using the Equity-based Crowdfunding model represented 8% of the overall dataset, with 66% coming from Mexico. All of the respondents were male. Fifty-seven percent of these businesses categorized their stage of development[9] as 'early stage' companies that were pre-profit. Twenty-nine percent were seed level while 14% identified as 'growth businesses' that were already profitable. A variety of legal structures were represented by the businesses, with 35% indicating their status as a limited liability partnership, 20% as a limited liability corporation, and 10% as sole proprietors.





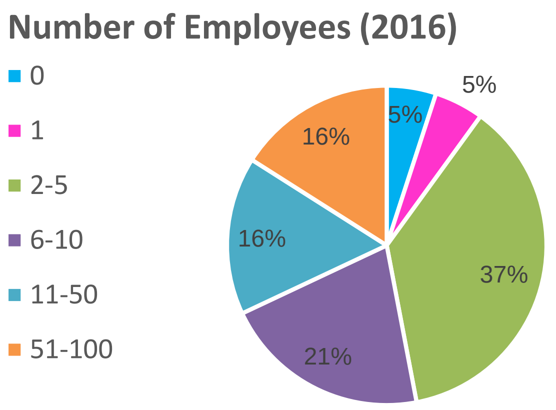
Respondents also represented a number of different industries, though 38% were from the finance sector, and 17% were in Internet & E-commerce and 15% in Real Estate and Housing.

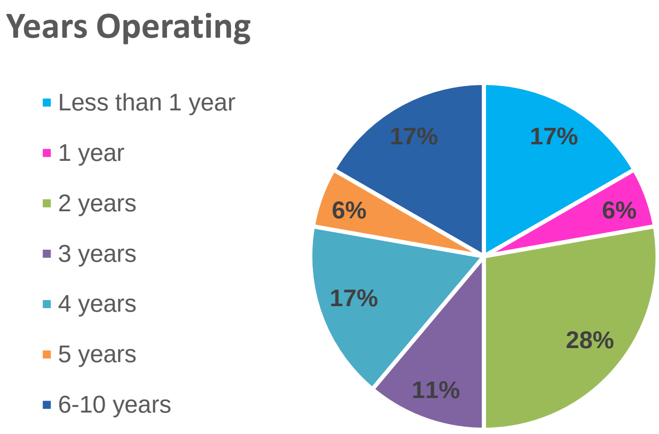
Top 3 Represented Sectors	
Finance	38%
Internet & E-commerce	17%
Real Estate & Housing	15%

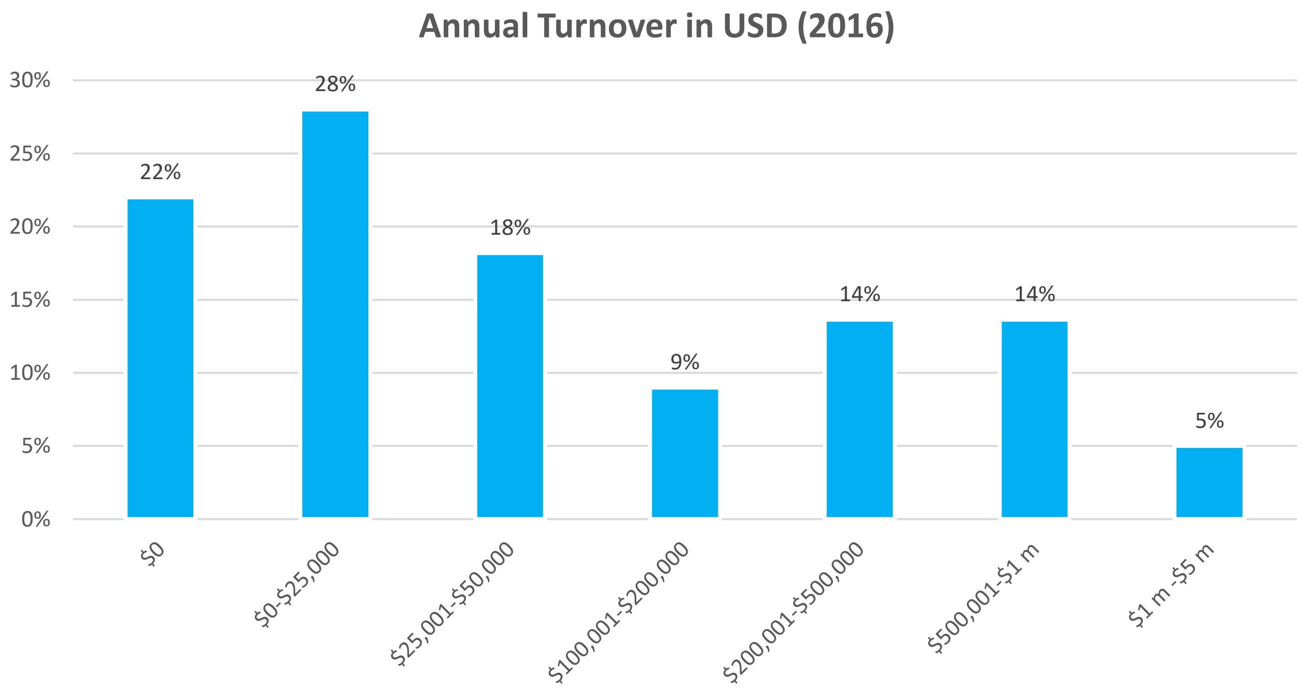
Since most of the firms seeking finance were early stage or seed level, it is not surprising that annual turnovers tended to be smaller than in comparison to the other models. Twenty-two percent of the firms had no annual turnover in the previous year, while 28% had a turnover between $0-$50,000

[9] The definitions provided to the businesses were as follows:
Seed (pre-revenue; insider-financed; spending on R&D; produced development and initial marketing)
Early Stage (pre-profit; some external equity funding; spending on post-product development; sales support; and expanding operations)
Growth business (profitable; some external equity and debt financing; spending on expansion into new markets)

USD. Notably, 78% of these businesses indicated an increase in turnover in the following year. The number of employees varied significantly, with 37% of firms employing between two to five people. Just over half of the firms had been operating for under 2 years.

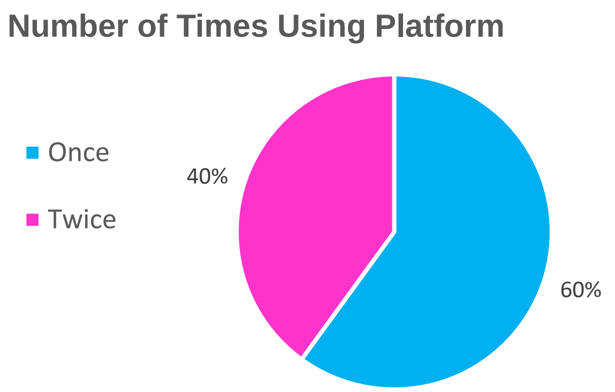




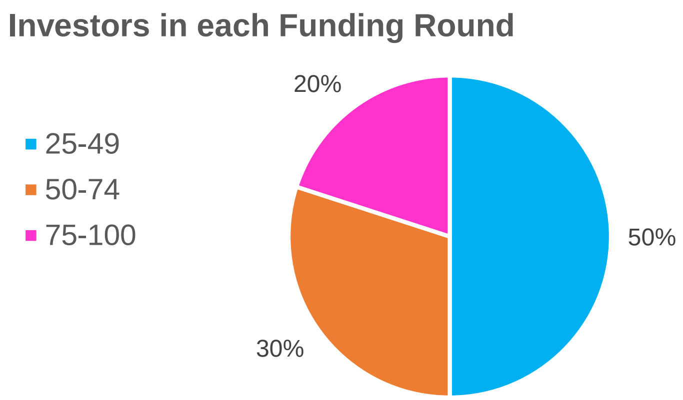


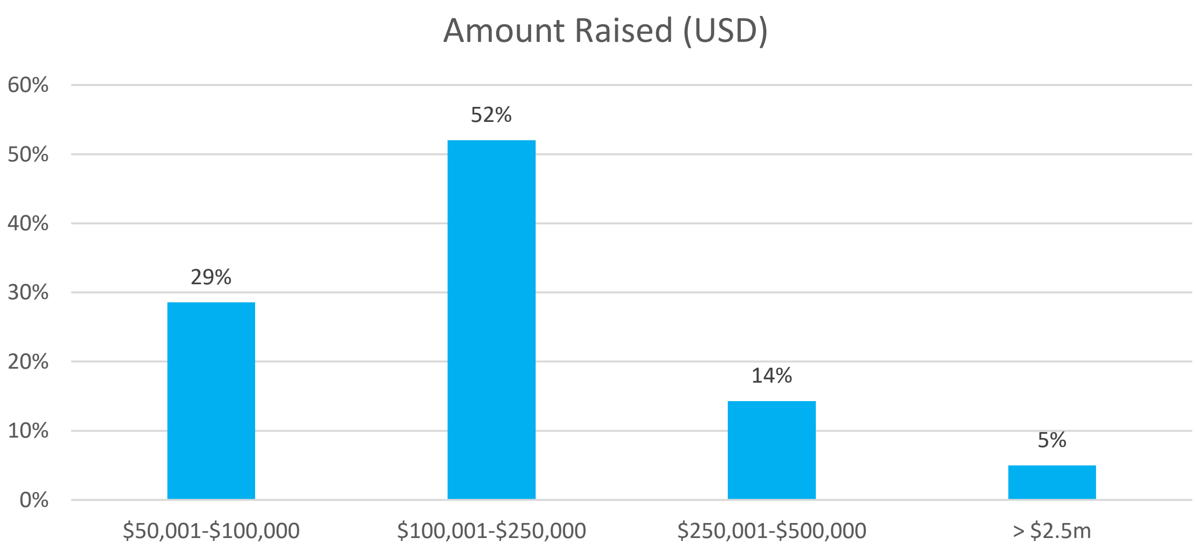
FUNDING EXPERIENCE

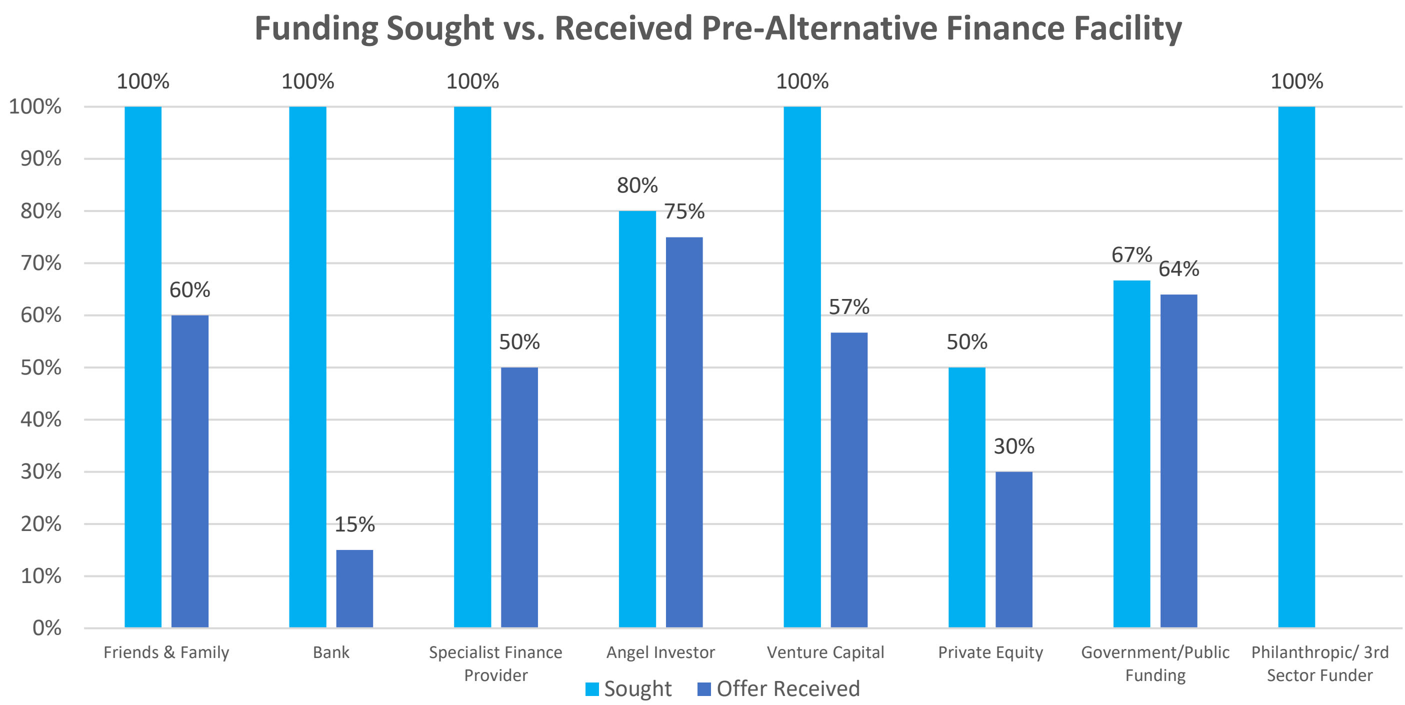
The respondents were asked to indicate how much they had successfully raised on their equity crowdfunding platform. Just over half of all respondents indicated raising between $100,000 to $250,000 USD, while 29% raised between $50,000-$100,000, and 14% between $250,000-$500,000. Five percent of firms indicating raising over $2.5 million. The businesses were asked of their likelihood to raise funding had equity crowdfunding not been a possibility, with 84% stating that they do not believe they would have been able to raise funds outside of the crowdfunding campaign. Sixteen percent of firms felt that they would have been able to raise funds, though noted that the delay would have had a negative impact on their ability to grow their business.



The number of individual investors that purchased shares from the firm varied, with half of the businesses adding between 25-49 new shareholders. Thirty-percent added between 50-74 new shareholders, while 20% added 75-100 shareholders. Given the large number of new shareholders, the businesses were asked if these individual investors had voting rights. Seventy percent stated that the shareholders had no voting rights, 25% indicating that a majority of the new shareholders had individual voting rights. Slightly worrying, 5% of the firms indicating that they were not sure if their new shareholders had voting rights. Over half of the firms only had one fundraising campaign (60%),



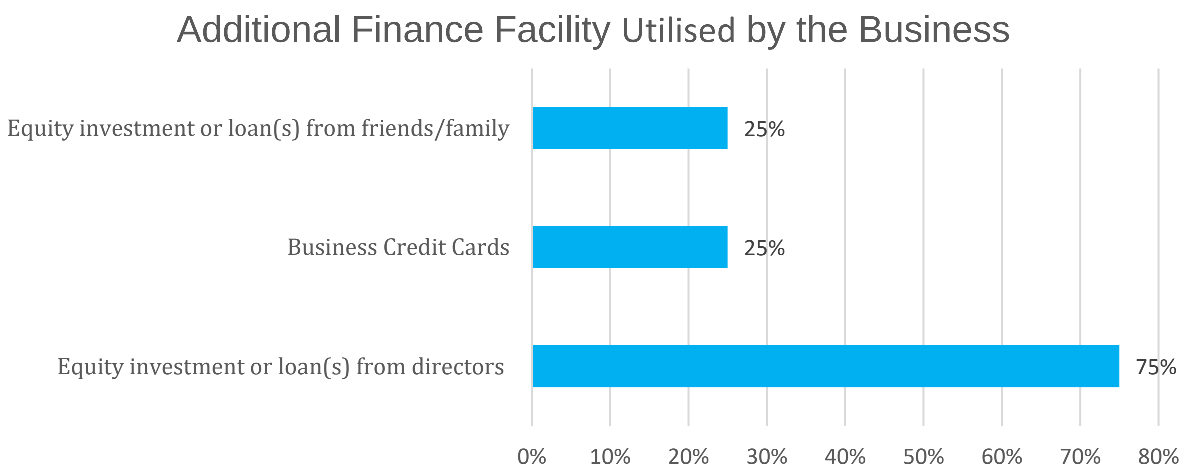


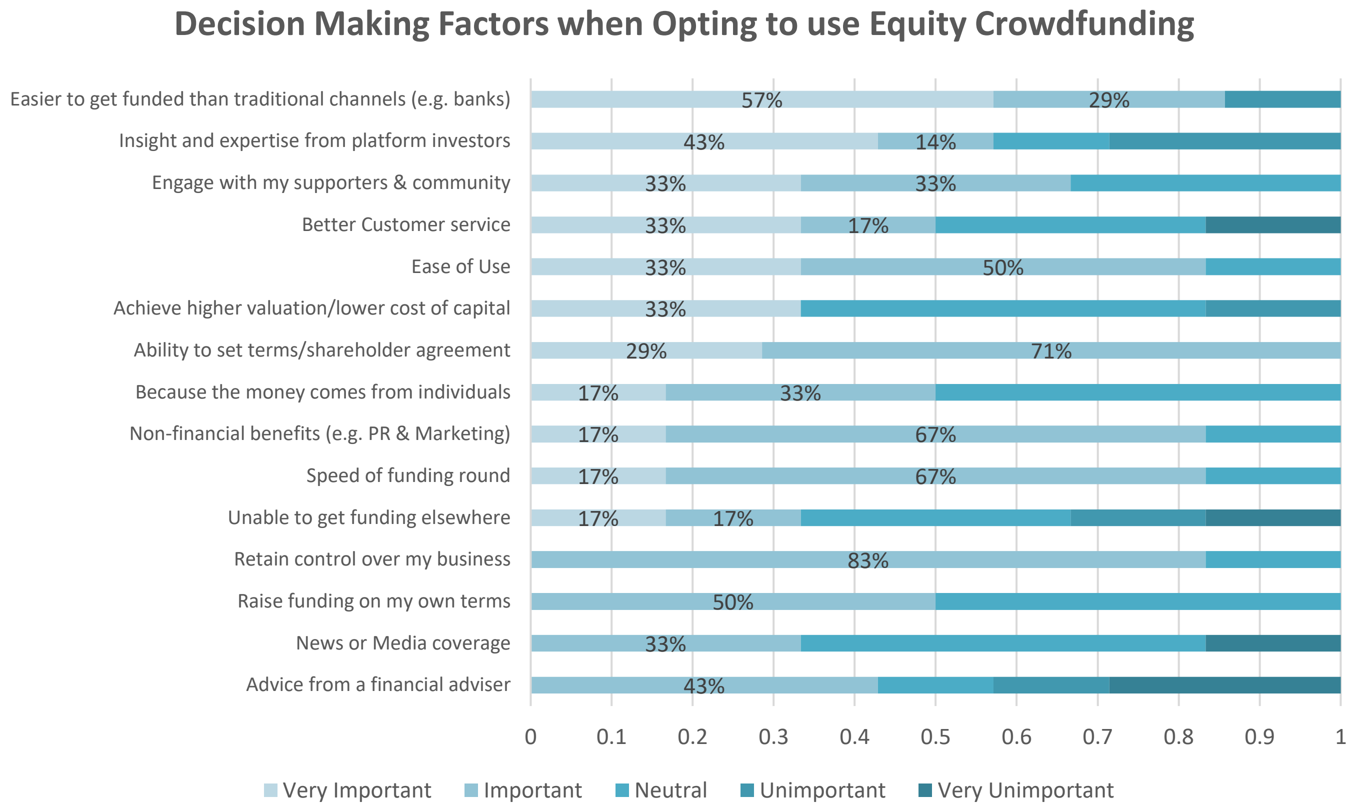


though 40% had undergone two fundraising campaigns on their platform.

The firms also provided some context on financing they had sought throughout the life-cycle of their business. All of the firms sought funds from a bank, though only 15% received a finance facility. It should be noted, all of the firms had some sort of banking relationship (i.e. a bank account). Previous to launching a crowdfunding campaign, 80% of businesses sought angel investment, with 75% of them receiving said funding. All of the businesses sought VC funding, with 57% of them successfully receiving an offer. Some of these businessses commented that although they had received a funding offer from a VC or angel, the offers were somewhat incompatible with the existing shareholder structure or required the business to give away more equity than they were willing to give.

In addition to the funds raised through the crowdfunding campaign, the firms indicated that 75% were using equity investments or loans from the directors, and 25% from friends and/or family. Another 25% of firms were utilising business credit cards.



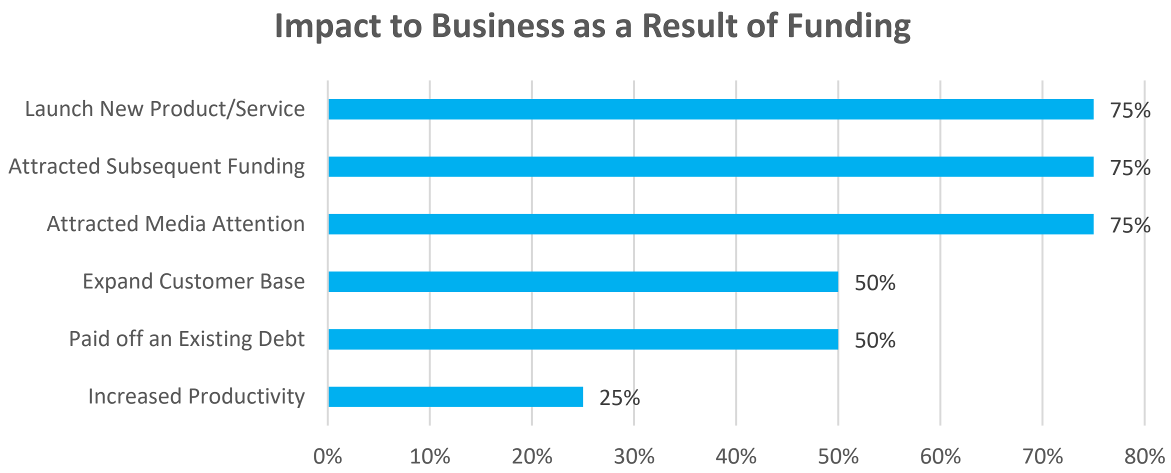


Unlike the findings from previous models, 'speed' was less important when compared to other factors. With most campaigns lasting several months, this result is not surprising. The most significant factor was 'easier to get funded than through traditional channels', with 57% viewing this as very important. As noted previously, many of the businesses represented by this model were early and seed-stage businesses. Comments collected in the survey suggested that due to their stage in development, they did not have many of the pre-requests to receiving traditional debt finance (ie three or more years of company financials) or were too small to receive a significant offer from a VC or angel.

Insights and expertise from their new shareholders and investors was also viewed as very important (43%), followed by 'engagement', 'customer service' and 'lower cost of capital' as very important for 33% of firms.

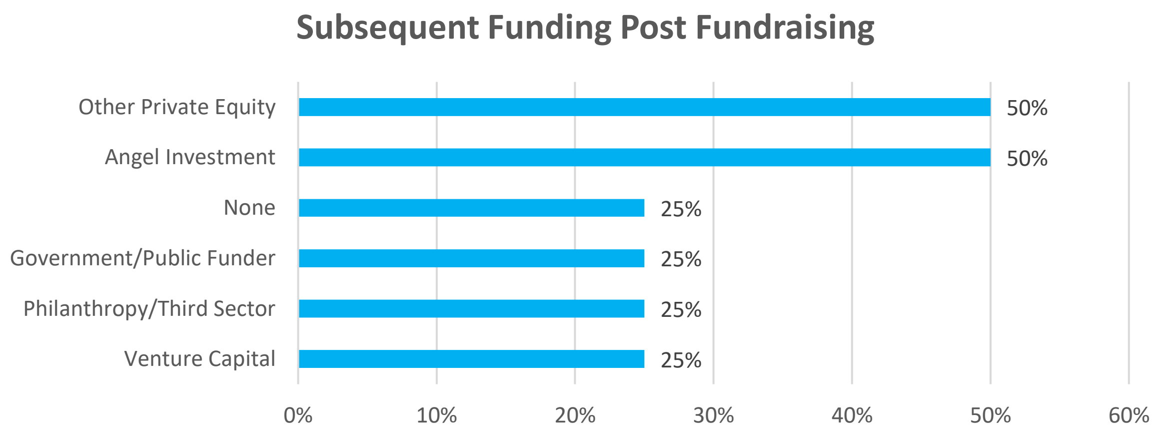
POST FUNDING IMPACT

When discussing their post-funding experience, the businesses were asked to identify the key impacts on their business operations. The businesses stated that as a result of their fundraising they were able to launch new products/services (75%), attract subsequent funding (75%) and attract media attention (75%). They also were able to expand their customer base (50%) and pay off existing



debts (50%). Finally, 25% noted an increase in their productivity.

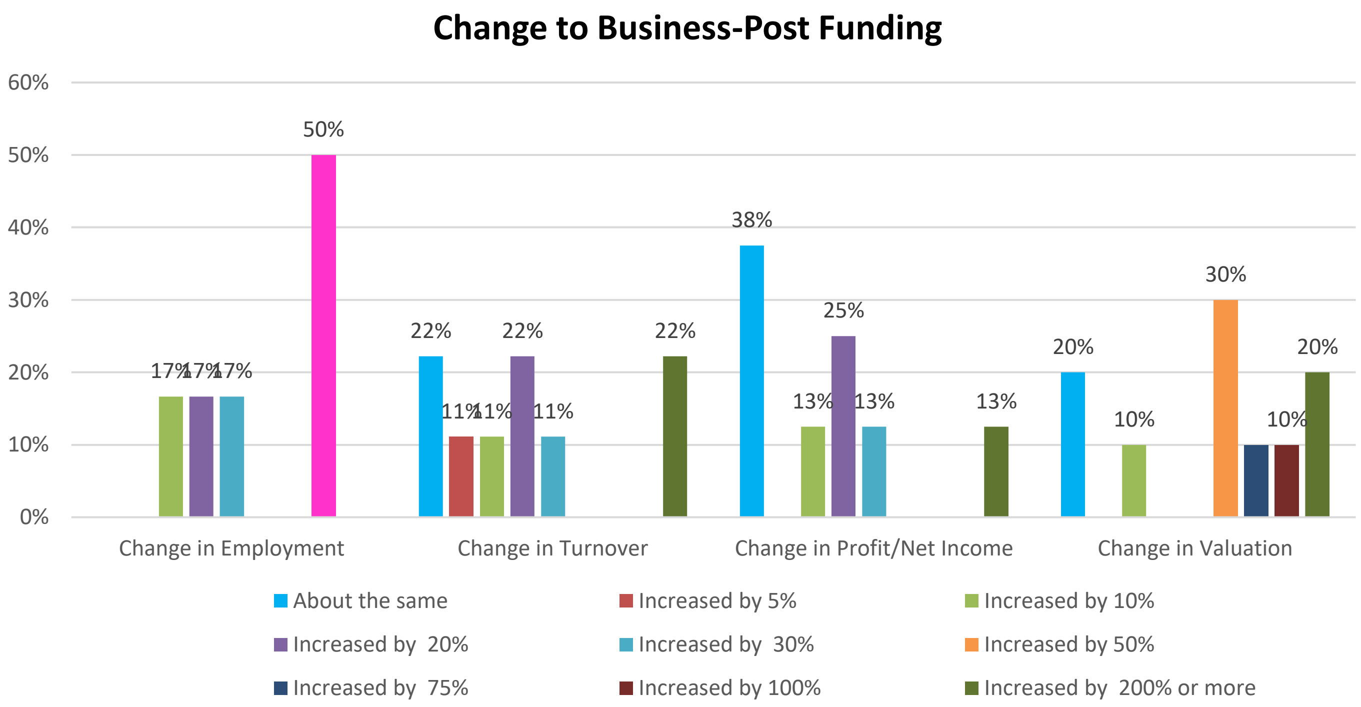
They also indicated the makeup of any subsequent funding achieved as a direct effect of their equity raise. Fifty percent of the businesses noted subsequent funding from an angel investor and other



Private Equity opportunities. Twenty-five percent received additional VC funding.

Overall, the changes to the business were very positive. All of the firms were able to hire additional employees, growing their workforce significantly. With respect to turnover, the majority of the firms saw an increase in their annual turnover, with 22% noting an increase of twenty percent.

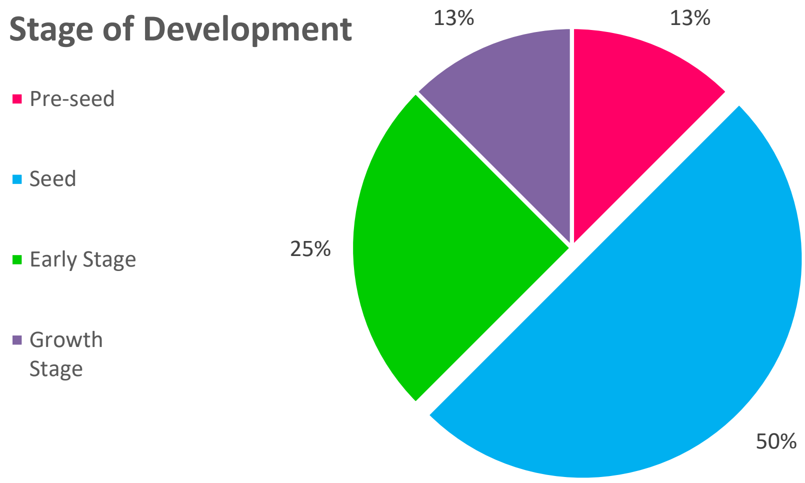
Similarly, the change in profit also increased for most businesses (62%), and 25% of businesses noting an increase of twenty percent in their profit. Valuation was also impacted positively, with 80% of the firms noting an increased valuation of their company. This was viewed as a particularly positive outcome for the businesses that were able to secure subsequent VC or private equity funding. One area of concern that became apparent in discussions with some of the businesses was that of dilution practices in the event of a significant valuation change and the advent of professional investors. There also seemed to be a level of unfamiliarity with the stipulations of the shareholder agreements they had entered into with individual investors gained in the crowdfunding campaign.



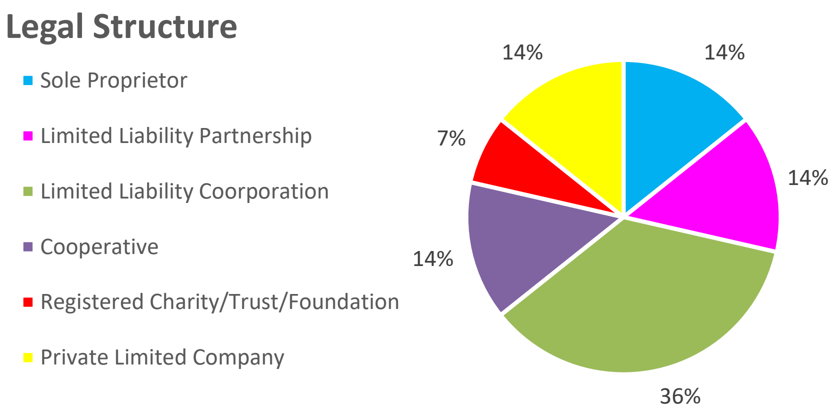
REWARD-BASED CROWDFUNDING

DEMOGRAPHICS

Reward-based Crowdfunding was the only non-investment model included in the survey, representing 6% of the businesses surveyed. Eighty-six percent came from Mexico. The firms represented a variety of legal structures, with 36% categorized as limited liability corporations.

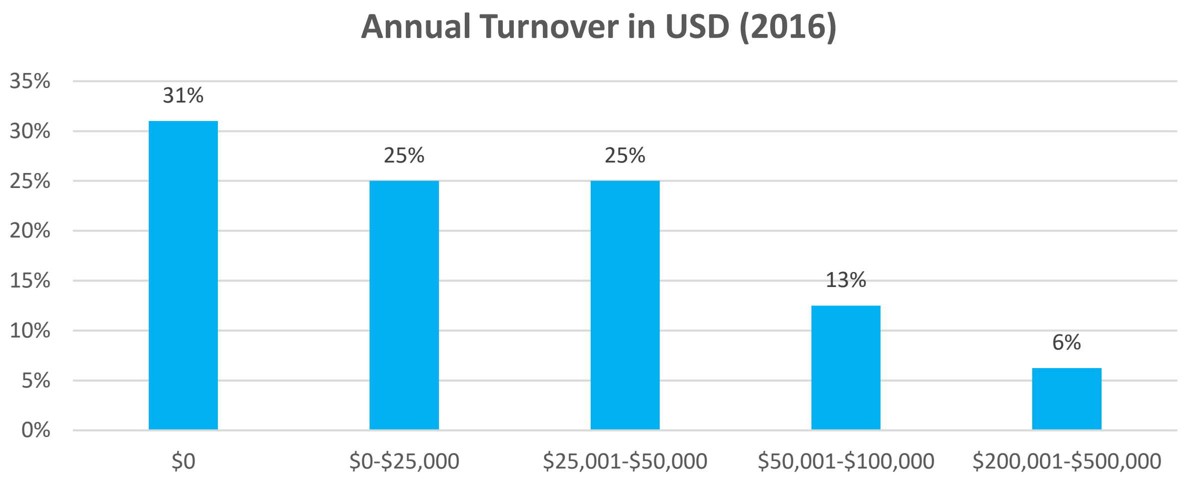


Similar to the Equity model, the businesses tended to be at the start of their development.[10] Fifty percent identified as 'Seed' stage firms, while 25% identified as 'Early stage'. An additional 13% categorized themselves as pre-seed and another 13% as 'Growth' businesses. Fifty-seven percent of the businesses were led by males and 43% by females. The businesses represented a variety of industries, with only Clothing & Fashion appearing as a 'top' represented sector (16% of respondents). The businesses tended to be consumer facing, with many of the rewards on offer related to proto-types of products they wished to introduce in the future. From comments collected in the survey, funding raised through the reward crowdfunding campaign was to facilitate existing production or to test new products.

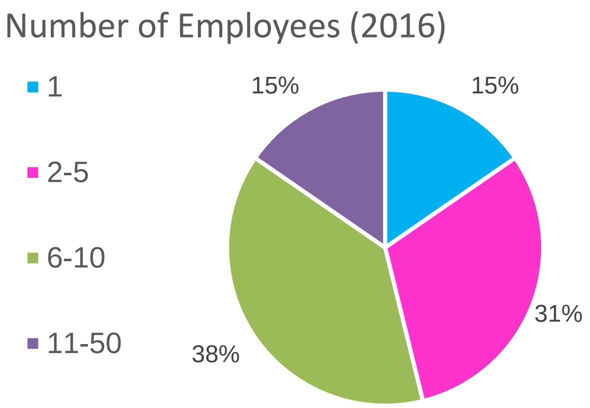


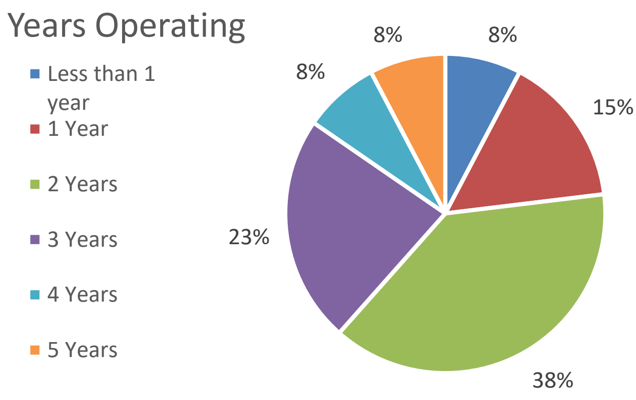
Given the emphasis of early and seed stage businesses, it is not surprising that the annual turnovers were modest in comparison to the other businesses reviewed in this report. Thirty-one percent reported no annual turnover in 2016, and 19% of firms with a turnover greater than $50,000 USD.

[10] The definitions provided to the businesses were as follows:
Pre-seed (pre-revenue; insider-financed; building a prototype or proof of concept)
Seed (pre-revenue; insider-financed; spending on R&D; produced development and initial marketing)
Early Stage (pre-profit; some external equity funding; spending on post-product development; sales support; and expanding operations)
Growth business (profitable; some external equity and debt financing; spending on expansion into new markets)



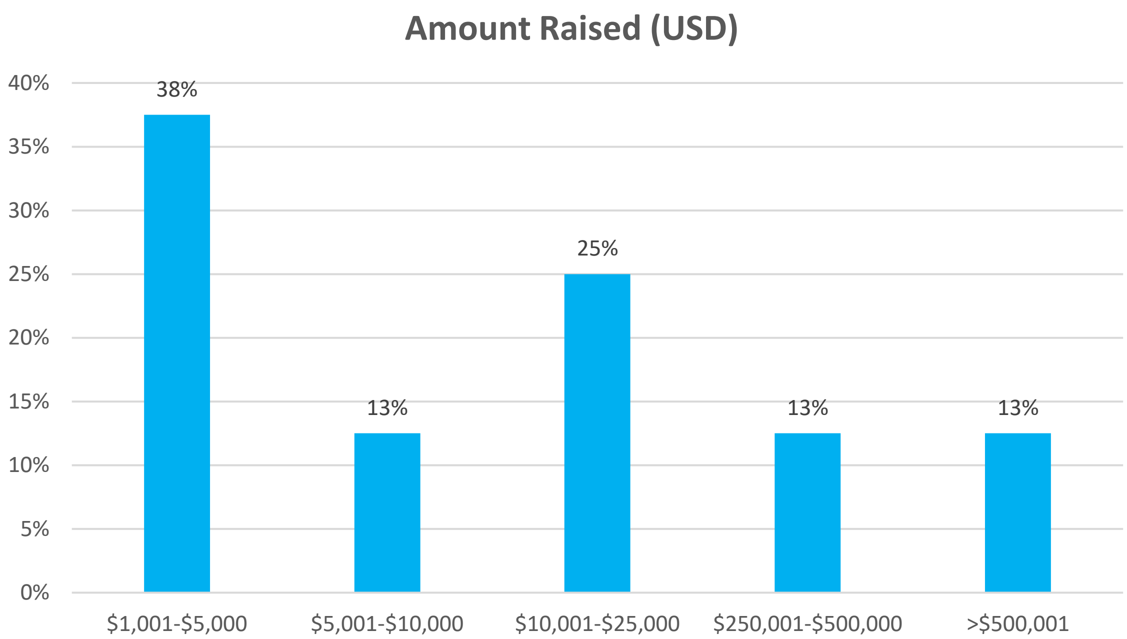
The businesses were also fairly young, with 38% operating for 2 years, and 15% for a year. Regarding the number of employees, 38% of respondents employee between six and ten people, while 31% employee between two and five.



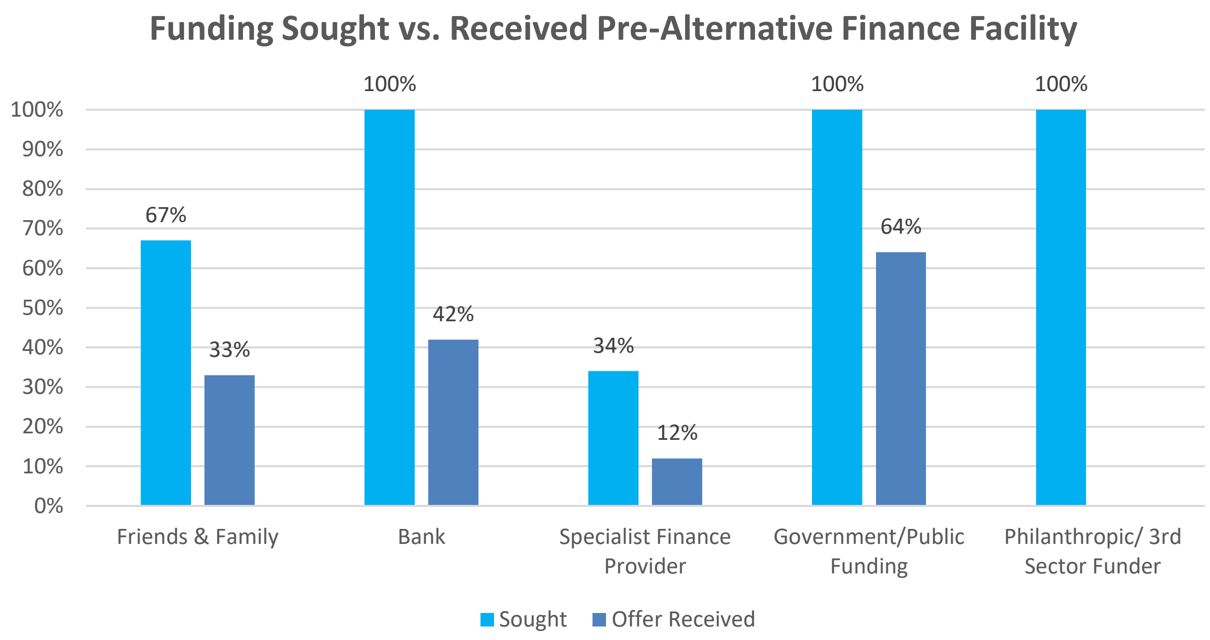


FUNDING EXPERIENCE

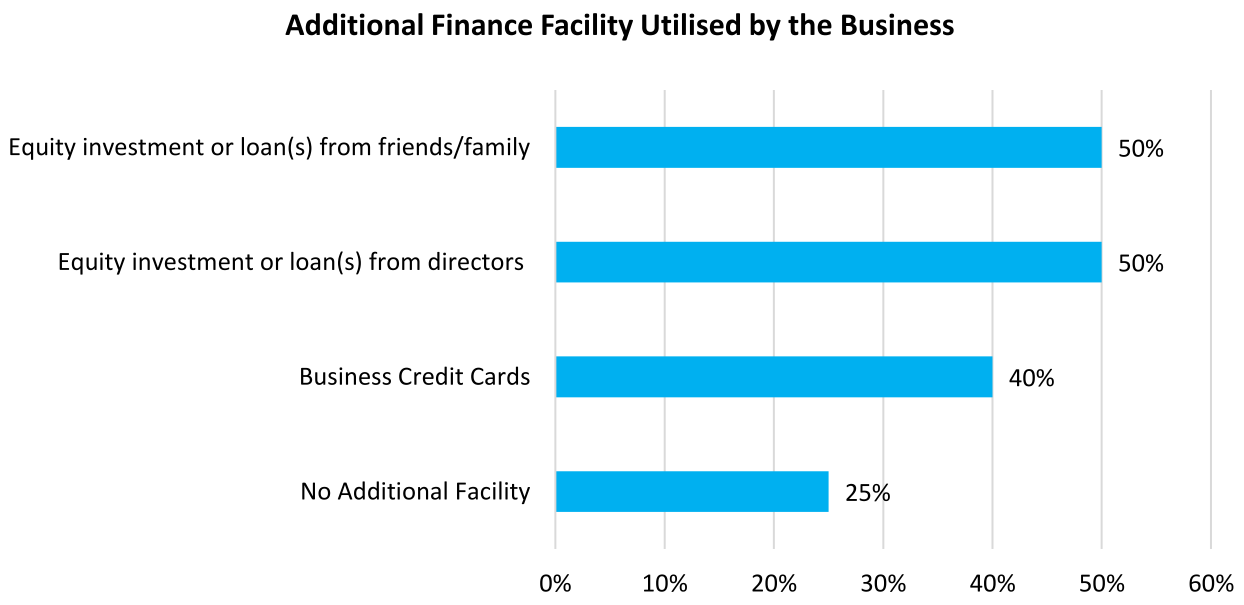
Respondents were asked a series of questions to understand their funding experience when using a reward crowdfunding platform, beginning with the amounts they raised. The amounts varied significantly from small amounts (38% raising between $1,000-$5,000) to more significant sums (26% raising over $250,000). More than half (58%) of the respondents had only used the platform once, with the rest having raised funds through reward crowdfunding twice. Twenty-five percent of the businesses felt that they would not have been able to raise their needed funding had reward crowdfunding not been an option. In the absence of reward crowdfunding, 50% felt that they would have found another funding option, but also indicated that another option would likely be in the form of self-financing through credit cards or a director's loan. The remaining 25% were unsure of potentiality of fundraising without reward crowdfunding.



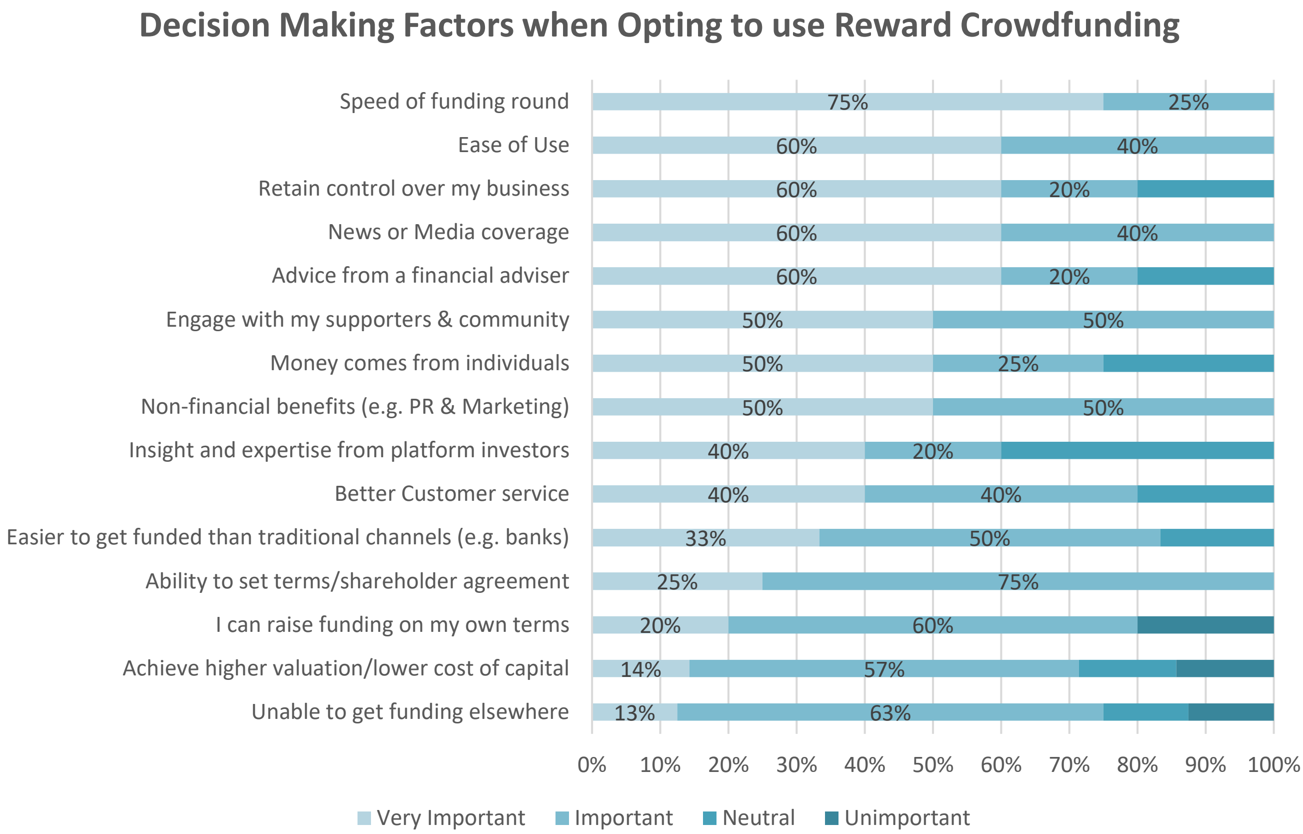
The chart below indicates the funding facilities the businesses sought against offers received, before opting to use a reward crowdfunding platform. All of the businesses had applied for government or public funding, with 64% receiving a financing offer. In contrast, all of the businesses had also applied for philanthropic or third-sector funding, with no successful offers. All of the firms also applied for bank financing, with 42% receiving an offer.



The businesses also indicated any additional financing used in addition to the funds procured by the reward crowdfunding campaign. Half of the firms made use of investments or loans from family & friends, and from the directors. Forty percent used business credit cards as well. Finally, twenty-five percent of these businesses noted no additional facility.

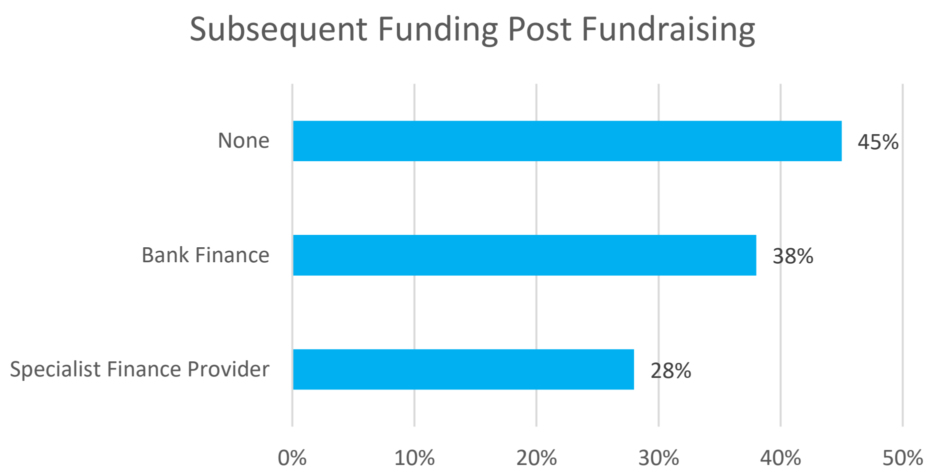


When asked to rank different decision-making factors as related to the businesses decision to use reward crowdfunding, 75% of the respondents indicated that the speed of the funding round was 'very important' to them. 'Ease of use', 'control', 'media coverage' and 'advice from an adviser' were viewed as very important factors for 60% of the businesses.

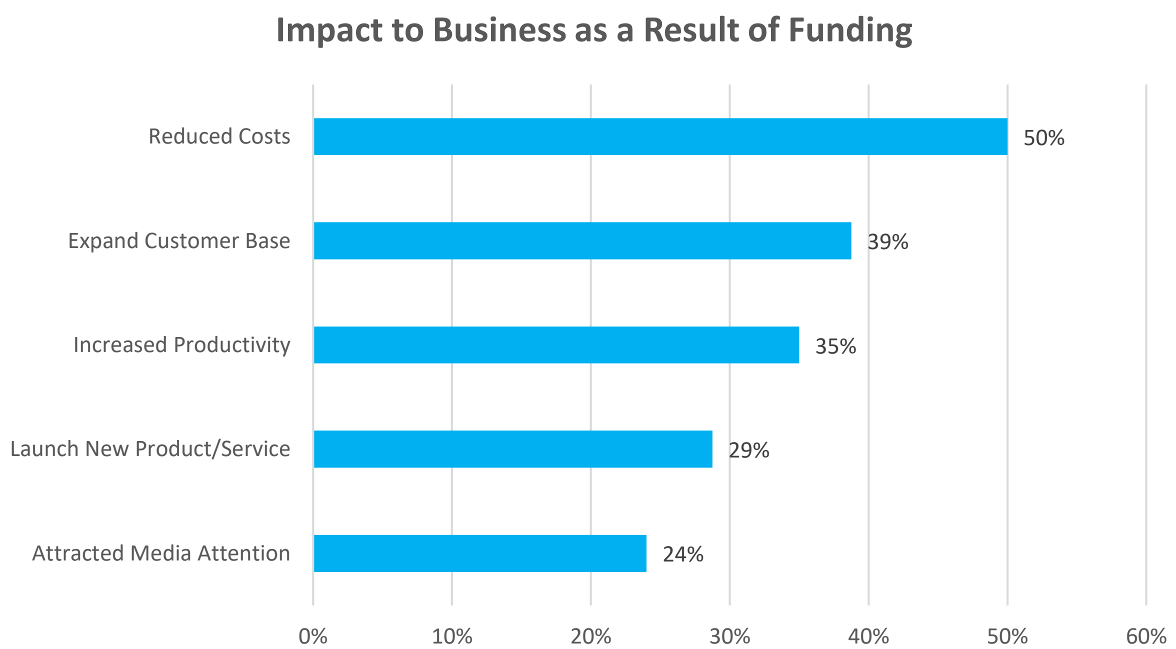


POST FUNDING IMPACT

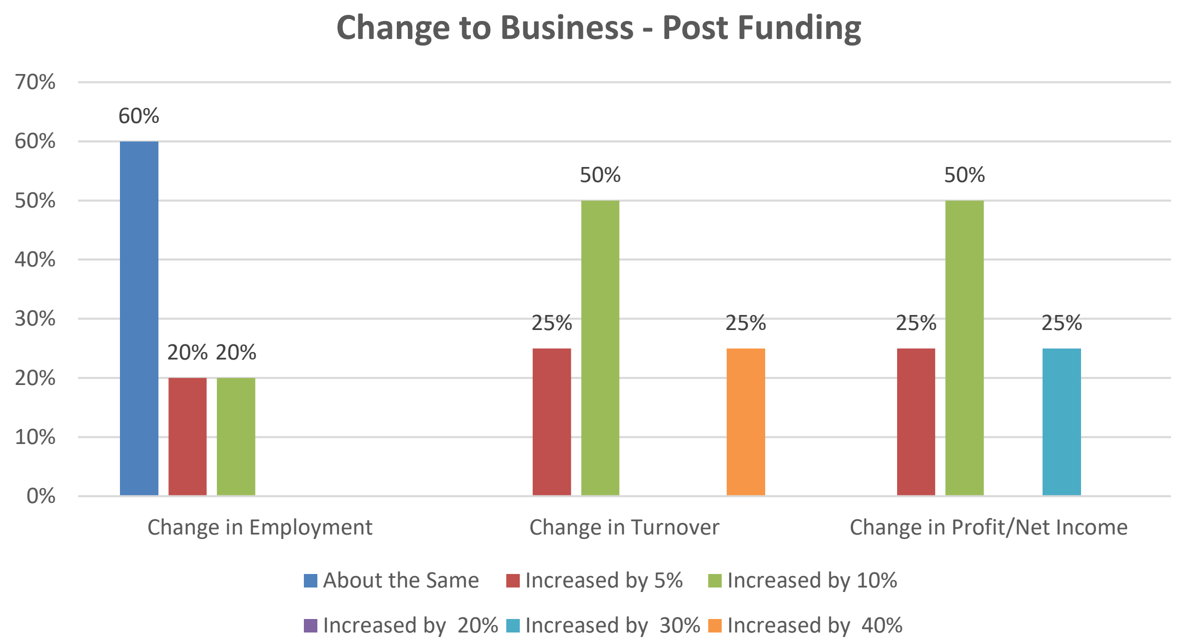
The businesses were also asked to discuss their post-funding experience. As a result of their reward crowdfunding raise, 38% of respondents were able to attract bank financing, and 28% were able to attract specialist provider financing.



Half of all respondents indicated that they were able to reduce operating costs as a result of their fundraising, and 39% were able to expand their customer base. Thirty-five percent indicated an increase in productivity, 29% were able to launch a new product or service and 24% attracted media attention. The businesses were also asked if they had fulfilled all reward obligations as related to their reward crowdfunding campaign. Eighty percent indicated that they had already fulfilled any obligations, with the remaining 20% indicating that they were in the process of fulfilling rewards. Only one business indicated some concern regarding their likelihood to fulfil the reward as specified in their campaign.



Though 60% of the respondents saw no change in their workforce, the remaining 40% were able to increase their workforce. All of the firms recorded an increase in their annual turnover, with 50% indicating a ten percent increase against the previous year. Finally, all of the respondents registered an increase in profitability, with 50% noting a ten percent increase, and 25% a thirty percent increase.



FINTECH REGULATION IN LATIN AMERICA

Contributing Author:
Diego Herrera
Connectivity, Markets and Finance Senior Specialist at the Inter-American Development Bank.

1. The ecosystem

Fintech, but specifically, Alternative Finance platforms are challenging the traditional financial industry incumbents with new business models and new channels to serve individuals and businesses in Latin America and the Caribbean (LAC). Ziegler et Al. (2017) show how Chile has the largest crowdlender in the region with originations close to US$100 million for 2016.[11] Alternative finance is now large enough to claim the attention of Chilean regulators and supervisors. The Central Bank and the new Financial Markets Commission are closely following the fintech developments in the country. Chilean platforms are financing small firms using factoring of invoices as a tool, meaning that alternative finance is aiding in covering the gap in providing financial services to such enterprises.

2. Policy and Regulation

The prospect of alternative finance platforms solving some of the persistent asymmetries that limit access to financing within the region and their rate of growth in countries such as Mexico and Chile, demands actions from policymakers and regulators. Both groups are knowledgeable about the evolution of Fintech industry and are working in policies and regulations within their countries and regions. This “dynamic duo” is necessary to guarantee growth of the fintech industry while enabling proper supervision.

On the side of policy, it is of vital importance to have an institutional and policy framework that enables technology, including those advances required for FinTech to prosper. Also, policy that fosters innovation within the financial sector is relevant for Fintech to grow up in the region. In fact, across the region, productive development and financing agendas are including more and more references to Fintech. On the other hand, since public savings and economic welfare closely related to Fintech’s activities, a regulatory framework is necessary. Such regulatory framework should comply with the essential objectives of protecting financial consumers, ensuring competition efficiency and transparency, and mitigating systemic risks. In this sense, governments -many with the support of international organizations such as IDB[12]- are in their way to creating regulations for crowdfunding, fintech and sandboxes: Mexico (where a Fintech Law was approved by Congress and signed as a Decree by the President)[13], Argentina (where a crowdfunding General Resolution was

---

[11] Ziegler et al. (2017). “The Americas Alternative Finance Industry Report. Hitting Stride.” Cambridge, United Kingdom: The Cambridge Centre for Alternative Finance. Available at : http://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-05-americas-alternative-finance-industry-report.pdf

[12] IDB has taken the edge of supporting governments in identifying and supporting policy and regulatory initiatives for crowdfunding, fintech and regulatory sandboxes in: Mexico, Argentina, Chile, Brazil Peru and Paraguay. Currently, the Bank is working in a set of principles for Fintech regulation in the Pacific Alliance countries: Chile, Colombia, Mexico and Peru.

[13] Secretaría de Gobernación de los Estados Unidos Mexicanos: “DECRETO por el que se expide la Ley para Regular las Instituciones de Tecnología Financiera”. Available at: http://www.dof.gob.mx/nota_detalle.php?codigo=5515623&fecha=09/03/2018

issued)[14], are the most tangible examples of such advances. In all the cases where a policy or a regulation has seen light, dialogue between fintech platforms and financial authorities has been a crucial component. Understanding and listening, on both sides of the equation is necessary to make the proper decisions.

This is the path that Chile is moving through with an extended dialogue with the lead of the financial authorities which includes a recent Fintech Seminar[15] and the issuance of an academic paper on fintech on the side of the Central Bank[16].

Mexico Fintech Law is a pioneer example on how to tackle with Fintech regulation from a holistic perspective. The 'Fintech Law' focuses mainly on four areas: i. Financial Technology Institutions (ITFs), composed of financial crowdfunding companies and electronic payment institutions; ii. virtual assets (cryptocurrencies); iii. Applied Programming Interfaces (APIs); iv. Temporary authorizations for innovation tests (Sandboxes), for previously regulated entities and for Fintech entrepreneurs, separately. For information only, it is useful to mention that Financial Technology Institutions are regulated within the draft subject to an authorization regime with four main aspects: i. Entry and licensing requirements, ii. Minimum operational requirements, iii. Responsibility for consumer protection and iv. Designated supervision from the Banks and Securities Commission (Comisión Nacional Bancaria y de Valores -CNBV-), the Central Bank (Banco de Mexico) or the Financial Consumer Protection Commission (Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros -CONDUSEF-). Finally, regarding alternative finance, the draft identifies three types: Debt, Equity, Royalties or co-ownership. Many other aspects of the draft are not related here and the reader is encouraged to directly read and understand them.

Regulation in Latin America and the Caribbean is not an easy task, mainly because of the Civil Law tradition inherited by many countries, which makes mandates and powers of financial regulators and supervisors very binding and specific. In general, experience has shown that a specific regulatory framework is necessary for fintech, including: new mandates and powers for regulators, the creation of new registered and licensed activities within the regulatory perimeter, regulatory sandboxes, dialogue and a lot of coordination amongst regulatory agencies. For the case of alternative finance an essential group of principles -replicable for other Fintech segments- is recommended, based on Herrera (2016)[17].

3. Alternative Finance Regulation: A few recommendations for the region

In accordance with the discussion above, minimum contents for specific principles to regulate alternative finance are proposed here. These are based on a set of three specific principles that would serve to create harmonic regulations across the region.

3.1. General Principles for the Regulation of Alternative Finance:

The general principles will allow for the existence of a guiding axis for the specific principles, while at the same time, they work as the basis for regulatory interventions.

[14] Comisión Nacional de Valores de Argentina: "CNV reglamenta el Sistema de Financiamiento Colectivo". Available at: http://www.cnv.gob.ar/web/secciones/prensa/comunicados.aspx?id=213

[15] http://www.bcentral.cl/en/-/seminar-on-fintech-and-financial-stability

[16] Marcel et Al. (2018): « FinTech and the Future of Central Banking at a Crossroads". Available at: https://www.researchgate.net/publication/321158987_FinTech_and_the_Future_of_Central_Banking_at_a_Crossroads

[17] Herrera, Diego: "Alternative Finance (Crowdfunding) Regulation in Latin America and the Caribbean: A Balancing Act". Available at: https://publications.iadb.org/handle/11319/7837#sthash.krHqWzzx.dpuf

i. **Proportionality:** Regarding to regulating the activities that the platforms are effectively carrying out and their risks, under the understanding that their business model is different from that of the traditional financial sector.

ii. **Balance:** Ensuring the competitiveness and stability of the platforms and the financial system in general.

3.2. Specific principles for Alternative Finance in the Region:

The specific principles refer to the aspects that should be regulated so that the platforms can perform their social function properly, considering risks, consumer protection and the stability of the financial system. Alternative Finance platforms may require specific secondary regulations, which depending on the legal system of each country, will grant powers to one or other financial supervisors (when there is no unified supervision entity).

i. ***Clearly define the subjects of supervision and oversight:*** We recommend identifying present, and if possible, future participants within the AF ecosystem. This means definitions for platforms, investors, and project owners. Defining the activity as such, should also mean changing the paradigm of regulation, but it is a must. In addition, the definition of investors is relevant in terms of choosing, or not, the path of categories of accredited and non-accredited investors. The regulatory implications of one or the other regime will affect the type of investor protection that the regulation should include

ii. ***Authorization and supervision regime:*** Clear principles for the process that grants authorization powers to an economic or financial authority. A single supervisor responsible for the activities should be defined. Also, specific and proportional requirements and specific due dates for registration and licensing must be established within the regulation. A platform must be operational or close to being operational when authorization to operate is requested, and a list of requirements must be developed.

iii. ***Minimum capital requirement:*** It is recommended to establish the financial supervisor that will be responsible for oversighting the minimum capital requirements for the platforms to guarantee their operational activities. The ratio criterion should be determined by principles.

iv. ***Due Dilligence:*** Harmonic principles with international AML / CFT standards, including responsibilities for platforms, investors and customers.

v. ***Business conduct:*** Principles for handling and sending information to authorities, information required to platform's financial consumers, information directed to investors on platform risks, collection, among others.

vi. ***Protection and independence of client resources:*** Regulation should include principles for the separation of resources from clients and those of the platform, segregation mechanisms such as escrow accounts, among others.

vii. ***Financial Consumer Protection:*** Principles for the applicable provisions for the protection of investors and other financial consumers, depending on the segment. Clear definition of powers amongst consumer protection authorities.

viii. ***Supervision, monitoring and sanction regime:*** Principles for delivering information to authorities such as financial statements. Also, principles to define inspection powers, financial misconducts and crimes and sanctions regime (fines, other administrative procedures).

As said before, secondary regulation plays a vital role for this principles-based recommendations. Since Fintech is so dynamic, adaption for regulators and supervisors is a must. Rules should be adapted to the local ecosystem but thinking of the possibility of regional convergence in regulation. In this sense, country to country cooperation is key, as it is the creation of regulatory tools. Of the many options available, we recommend regulatory sandboxes as a very useful tool, even more when they are regional.

4. Regulatory Sandboxes: Towards regulatory convergence

The Fintech phenomenon transcends national borders. According to the aforementioned study on the ecosystem in LAC (IDB and Finnovista, 2017), of 393 entities that responded to a survey included in it, 19.6% indicated that they operate in more than one country. Of this subtotal, 35.1% is present in two countries, 26% in three, 11.7% in four, while the remaining 27.2% has activity in 5 or more countries.

International cooperation is essential to share experiences and best practices and avoid situations of regulatory arbitrage. That is why it is recommended to promote memorandums of understanding or cooperation agreements. In this way, a common framework could be jointly agreed upon, based on general principles, which can then be adapted to each market and the legal regime of each country and facilitate the implementation of regulatory sandboxes in the region, with homogeneous criteria. Even more, the possibility of creating a regional sandbox is an idea to move forward. The same applies in general for the implementation of FinTech regulation in general. Ideally, in the future such agreements would recognize the validity of authorizations or licenses granted in other markets, since it would allow the platforms to operate in several countries.

This type of cooperation could be extended to other markets outside the region, as mentioned above. In this way, it could attract talent and companies and take advantage of the experience of more advanced ecosystems.

In the same fashion of the mentioned general and specific principles for regulation, applicable principles for the establishment of sandboxes are recommended.

i. **Flexibility:** Adapting the legal requirements to the particularities of the entities and the services they offer
ii. **Cooperation:** First among countries who have experience in a certain segment. Second, because it requires close collaboration between the supervisor and the companies to define the rules of operation.
iii. **Transparency:** Providing updated information and controlling the risks associated with putting the sandbox into practice.

The sandboxes could finish with the assignment of a specific license for financial innovation that is presented as a basis for platforms of the same business segment that want to enter into operation in the market.

In conclusion, the adaption of best international practices for alternative finance regulation is possible for the region. However, the best regulation is the one that properly fits the local ecosystem and projects the possibility of letting platforms to grow regionally, in a delicate balance.

ACKNOWLEDGEMENTS:

We would like to thank the Inter-American Development Bank for their support of this research programme. In particular, we would like to thank Diego Herrera for his continued support, advice and guidance as the Centre furthers its research programme on Latin American Fintech.

This report would not have been possible without the support of key alternative finance platforms and industry leaders in Mexico and Chile. The research team would like to thank the following platforms based in Chile and Mexico for their partnership and help during this study.

Becual, Briq.mx, Broota, Cumplo, Creze, Facturedo, Fondeadora, Fondify, Founderlist, GoSocket, iKiwi, Konfio, Konsigue, Kueski, Micochinito, Mutuo Financiera, Play Business, Prestadero, Proyecto Pyme , Raisehub, RedCapital and Weeshing were crucial to the success of our Mexican and Chilean outreach campaigns, directing their business fundraisers towards our survey and providing us with feedback as we developed this study. We are also grateful to AFICO and FinTech Hub Mexico for distributing our survey link to their associations and via social-media.

The research team would also like to thank Bryan Zhang and Mia Gray from the University of Cambridge for their counsel, guidance and feedback throughout the study.

Finally, we would like to thank Charles Goldsmith, Kate Belger and Philippa Coney for their continued support in producing and publishing this report.