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Alternative Funding Options: E-platforms

With every passing week, a brand new electronic platform pops up in another location across the different market segments offering financial services to clients. In fact, a definitive and reliably updated list of these *arrivistes* no longer exists because it hardly seems feasible. Nevertheless, we can still list the commonalities and points of interest amongst these new players and examine the causes and effects, as well as risks and rewards.

7.1 Why E-platforms?

The beauty of launching an electronic platform (or E-platform) is the low costs, with barely any entry barrier to speak of; technology costs are thus increasingly reduced and the software market offers ready-to-use platform functionality. In turn, E-platforms leverage the connecting power of the Internet to provide a highly effective alternative to traditional models in financial mediation, a function historically performed by commercial and investment banks. Needless to say, this is not news in other industries such as travel services, retail products or services, where players such as Airbnb, Uber, Expedia, Amazon and Thumbtack have re-defined entire industry segments by challenging the competitive status quo.

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In many of these cases, challengers have confronted existing market regulations and struggled with incumbent players. This challenge has occurred in different fashions across individual geographical markets. The emerging competitive scenario in such a situation is that of a leaner distribution chain, a more direct user/supplier relation that often crowds out the middleman. Regardless of the industry, the leading development pattern has been to define a scalable service model in a large enough geography (typically, the US market), then roll it out internationally in a "global-to-local" sequence. Internet technology has facilitated this pattern, including the offer of multi-lingual and multi-currency user experiences. Such an approach has allowed a series of unexpected positive results in terms of the speed of international development and client ownership. These two factors appear to prevail on revenues or profit as key drivers of today's E-platforms equity valuations – leadership has its privileges.

The outcome in these cases generally results in a pro-innovation landscape in less regulated businesses, with more regulated markets – such as, for instance, taxi services, or the distribution of pharmaceutical

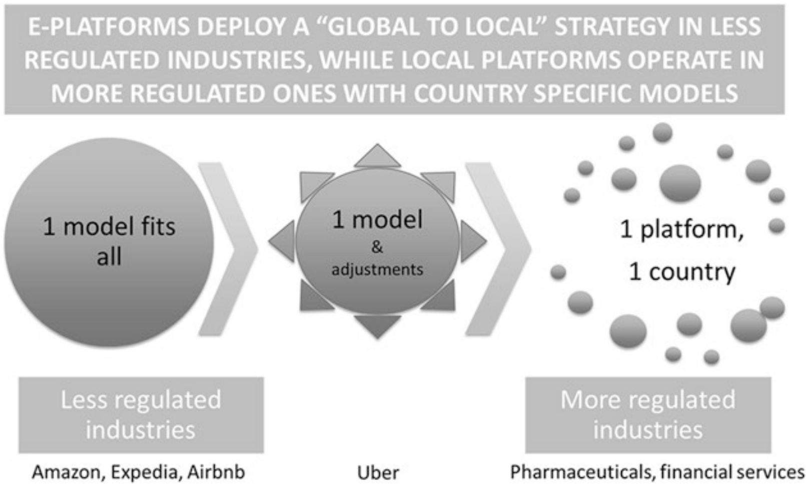

Fig. 7.1 E-platform business model

products – witnessing higher tensions. Think of how Uber somehow mitigated its momentum in Europe as it (thus far) abstained from the full deployment of its model following the UberPop disputes with local authorities and incumbents (see Fig. 7.1).

7.2 Upstream (of Capital)-Side Driven Opportunities

Upstream opportunities are emerging in today's current economic scenario as a consequence of low returns on debt securities that provoke investors to seek new territories. This is somewhat typical and goes with interest rate cycles: in market phases with low inflation and interest rates, investors are inclined to take more risks and explore new markets and new types of investments. In today's markets, one emerging asset class is that of consumer or SME debt. These instruments have traditionally witnessed premium pricing by banks and therefore attract those investors interested in seizing the excess return premium: E-platforms appear to be the most efficient mean to access that type of risk.

In particular, peer-to-peer (P2P) E-platforms such as Lending Club (USA), Lufax (China), Funding Circle and Market Invoice (UK) or Work Invoice (Italy) offer access to a well-organized myriad of potential borrowers. Besides important access features, these P2P E-platforms provide the additional function of spreading the investor's money over multiple borrowers, hence mitigating risk via a portfolio effect. This scenario attracts new investors to the game, such as specialized funds or high net-worth individuals (HNWIs).

7.3 Downstream Opportunities

Downstream opportunities for E-platform development appear to be structural, as they are connected both to the new technology and to the new regulation situation. In particular, the new technology available in web-based customer experiences, risk management tools and payment services allows new players to compete with highly focused offers to con-

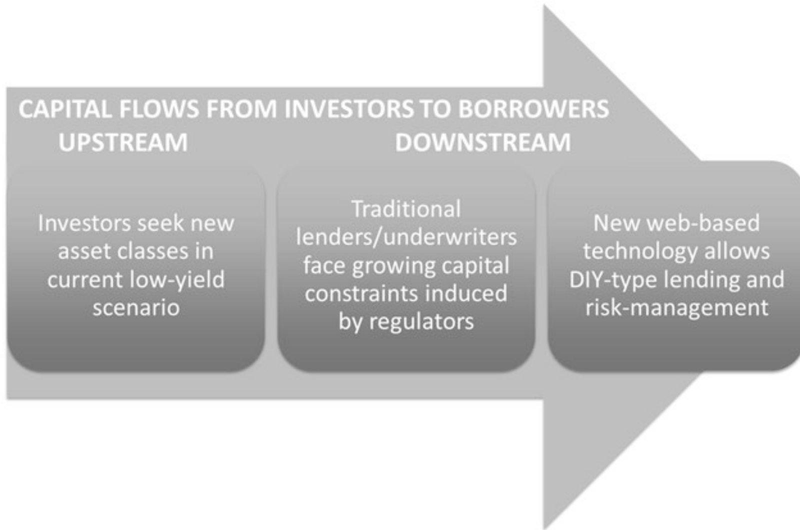

Fig. 7.2 Upstream and downstream

sumers and SMEs. Such offers range from invoice discounting, consumer lending, mini-bonds, and so on.

On the regulatory side, new capital adequacy requirements are also imposing a more selective credit approach to commercial banks and, similarly, a lighter proprietary trading approach to financial markets to investment banks, causing an overall reduction of the banking sector's ability to respond to the needs of borrowers and fundraisers. This scenario is perhaps the main instigator of all shadow banking (or better, alternative finance) E-platform initiatives (see Fig. 7.2).

7.4 The Need for Liquidity

The success of financial markets – electronic or not – is a reflection of their ability to attract liquidity. Liquidity then attracts more investors, traders, issuers, followed by more liquidity. The quality of the product itself is a necessary condition in a market's strategy for success, but it

is not sufficient. Choosing the right timing and analyzing competition create the conditions necessary for establishing a new E-platform and turning it into a success. The key point, however, comes when the new platform is able to build up volume momentum and reach that tipping point when market participants start leaving other platforms, or simply decide to start committing liquidity to the new marketplace. They do this because it is where price formation is perceived as most efficient, where it is more likely to enter in a certain investment or, in the event, trade out of that investment and cash in with minimum transaction costs.

Let us look at this as if we were bankers – say, *arriviste* E-platform bankers in search of nightlife after a hard day on the terminals; we will look at platforms as if they are dance halls.

There are basic rules for choosing which dance hall to go to: more dancers and longer queues to enter the hall are signs of success that attract further dancers. Therefore, the basic consumer benefit of a disco appears to be that there are many (interesting) people. A large number of dancers make a successful dance hall or disco. Likewise, for successful E-platforms, a crowd appears to be a defining condition in the financial services world. Platforms not only need to define their marketing strategy and be well-launched on the web, they also need to have many users. Just like dance halls, in fact, successful E-platforms are a small portion of the growing market, according to a "leader takes it all" principle that seem to apply to individual segments.

The international E-platform scene is further enriched by a variety of several different operators. Currently, E-platforms focus on individual geographical markets and there are hardly any multi-national players. However, many new formats are defining trends; for example, the P2P lending platforms, as well as the platforms dealing with securities, are attracting different types of investor. They also often focus on specific types of needs, such as short-term or longer-term financing. There is a regulatory pattern that tends to aggregate alternative finance operators into two major families that attract two different regulatory environments: lending-based and investment-based.

Lending-based crowdfunding operators are (or will be) ruled by lending/payment regulations and supervised by the relevant authorities in that area.

Investment-based crowdfunding operators are (or will be) ruled by securities regulations and supervised accordingly.

In the EU, the economic effects of this two-rule system apply to E-platform operators and could reflect the different regulatory perimeters: generally country specific for the lending business, and more EU-wide for investment services, thanks to the implementation of the Markets in Financial Instruments Directive 2004/39/EC (MiFID) as an umbrella regulation. Securities firms appear to have an easier life when setting up a multi-country EU business.

This regulatory framework appears to affect the ability to develop larger operators that can achieve the economies of scale proper to the whole EU market as opposed to that of a single country. The following sections describe several aspects relevant to qualifying as existing or emerging market segments, such as types of investor, fundraisers, types of platform and types of financial instruments.

7.5 From One-to-One Lending to Aggregators

E-platforms attract investors and fundraisers of different types seeking new financial market experiences. As far as E-platforms are concerned, investors seem to value the ability to provide improved access, higher transaction speed or lower costs. Borrowers – or, more generally, fundraisers – value the opportunity to contact multiple potential lenders/investors so as to achieve improved conditions in terms of both pricing and speed. The idea is that a greater number of players can come together in those virtual marketplaces by streamlining processes and simplifying the product offering.

The consequent concentration of liquidity and information creates the conditions for delivering competitive overall results and a superior experience is clearly relevant to the development of P2P lending E-platforms, especially if compared with the service level of commercial lending. This assumption has, in fact, driven the development of E-services and originated from the ambition to deliver a more competitive arena for the benefit of borrowers.

The starting point for this sea change came in the early 2000s with the development of aggregator web services. These allowed borrowers to access multiple banks via a single website, to compare conditions and even to send a credit application on standardized products such as mortgages or personal loans. The "end of the line" of the traditional aggregator is, nevertheless, still a bank that performs services, simply adding a commercial intermediary (the aggregator) as a customer interface. The aggregator merely acts as a broker.

Clearly, the presence of the aggregator results in twofold bad news for the banks: (a) more competition in pricing, and, hence, a lower interest margin; and (b) lower fees, including the rebate typically due from the bank to the aggregator. However, there is some good news for banks. An active bank, large or small, can use the aggregator to reach new clients and to integrate the customer experience with its own strengths, such as physical proximity, face-to-face service and bundle pricing. The customer acquisition function performed by aggregators is often leveraged by smaller and local banks that gladly pay a fee to outsource the task of broadening their market; in this case, banks could face the risk of operating in geographical markets where their credit database is of little help in assessing risks.

Overall, it appears that aggregators have instituted a transparency process that has provided benefits to the market and to the customer. In particular, aggregators have enhanced the visibility of credit products that are comparable: in order to be comparable, products need to be simpler and therefore more understandable for clients. More aggregators, fewer footnotes. Many successful aggregators such as PersonalLoans.com (USA), LoanWala (India), PrestitiOnline (Italy) and AFG (Australia) are still active. (Fig. 7.3)

7.6 From Aggregators to E-platforms

Aggregators have pursued an improvement in access to product, transparency and overall competitiveness. Most importantly, aggregators acted as ice-breakers vis-a-vis an online customer experience: clients looking for a personal loan, families looking for a mortgage loan, small business owners

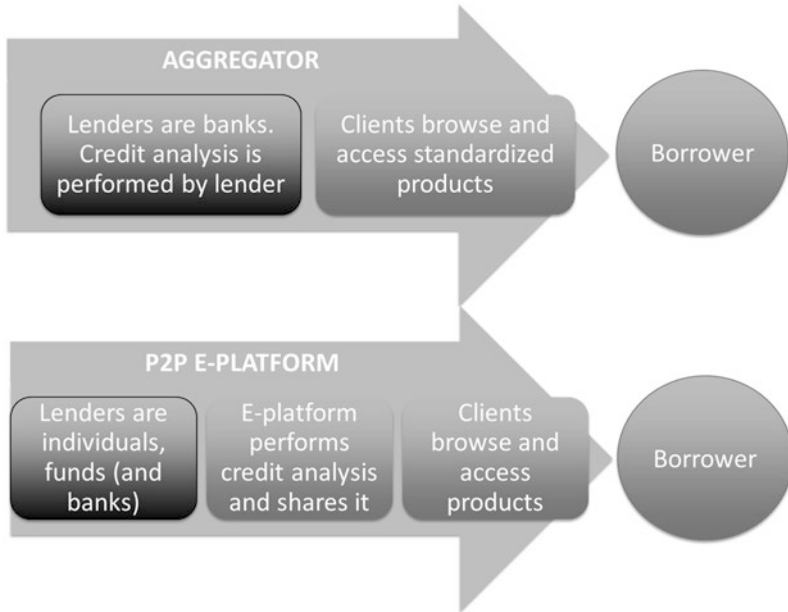

Fig. 7.3 P2P E-platforms

looking for a loan – all regularly browse aggregators to check products and compare rates. In many cases, these clients even complete their transaction online; yet, aggregators provide a mere connection function and add little value, since they act as middlemen. The analysis engine as well as the pot of lending capital stays upstream with the lending bank affiliated to the aggregator.

By comparison, in E-platforms such as Lending Club or Funding Circle, the borrower experience resembles that of an aggregator website: a credit application, background checks, and so on. However, the end of the cycle is different, since the lender is replaced by an type of auction system in which several anonymous lenders compete to fund multiple credit requests. Allowing new potential borrowers to the market, E-platforms add further strength to competition by starting to level the playing field through offering detailed credit information on potential borrowers. Actually, given their huge volume of clients and transactions, E-platforms

can develop very accurate default prediction analysis by leveraging their data sets.

Therefore, E-platforms bring in potentially more liquidity as a result of the opportunity for new and non-regulated players to join regulated entities such as banks and funds in the lending market. The platform itself is, indeed, the regulated piece of the chain as it typically performs the function of a payment hub, thus settling all micro-transactions on behalf of both borrowers and lenders. Technically, this is achieved by carving out the pure lending function (highly capital intensive) from the money management function (attracting minimal capital requirements) that is performed by a payment institution – that is, the platform. Payment institutions are regulated according to standards that differ from country to country, but it is generally true that E-platforms performing P2P lending services have much lower capital requirements than banks. At the same time, they provide a possibly superior customer experience.

Besides the effects in capital requirements, the development of P2P lending E-platforms brings a further major strategic innovation that is deserves comment. The so-called credit-engine – that is, the borrowers credit file, the credit analysis scoring and rating models, and the ability to calibrate the credit models by backtesting their predictions on empirical data – now has a potential best owner in the E-platform. It is, in fact, reasonable to expect that the appeal of a credit scoring/rating agency stands on the breadth of its data source and ability to calibrate its predictions. The leading P2P lending E-platforms' growing market share suggests that they are, or will soon be, in the best position to produce and share most accurate credit analysis. This skill will probably represent their key strategic advantage and sustainable growth factor.

All in all, aggregators have succeeded in offering access to products and better choice to borrowers. The impact of the P2P platform is clearly about access: the beauty of direct relations for both borrowers and lenders, and the opportunities granted by a wider choice.

Nevertheless one additional achievement of significance is perhaps less visible. It is also about the shift of the credit "brain", the market intelligence part of the lending engine that is moving away from being an exclusive advantage of banks. As P2P platforms grow, there is, in fact, a greater reason for them to leverage their customer flows: to develop more

accurate lender insight, thus becoming the best owner of consumer credit performance prediction models. High lending volumes could therefore lead to better accuracy and to improved business leadership. This represents a shift towards an emphasis on "quality" thresholds as a way to look at possible developments in the financial services business.

7.7 A Brief Thought on Responsible Borrowing (and Lending)

Financial products resemble prescription drugs: over-the-counter availability of lending products does not necessarily represent the best solution for the consumer: that is, price is not everything, simply because personal loans or mortgages are neither commodities nor consumer products. A loan lasts months or often years and can heavily disrupt a family's financial soundness and lifestyle. Recent events have further highlighted the risks of abundance of easy credit and ill-informed borrowing and, aside from the issue of fair pricing and the level information field, E-platforms, aggregators and hard-selling commercial banks do not appear to consider the relevance of this important responsibility. The very fact that a borrower takes on a lasting obligation with the loan (a durable liability) represents a substantial difference from non-durable or even durable consumer products. Moreover, variable rate loans are often "sold" with little regard to the potential side effects on monthly payments of future interest rates hikes.

In other words, whereas information on credit analysis can be practically shared, there is, in fact, no substantial level playing field as far as awareness and decision-making are concerned. In a regulated environment such as commercial banking, local authorities can implement borrower protection standards but, in the new world of P2P lending E-platforms, there are only self-imposed standards implemented by individual operators to address the issue of prudent borrowing: there is no clear framework. In reality, consumers need more than a wide choice, fair pricing and complete information; they frequently may be confused by the abundance of these three items and behave unwisely.

For example, they may end up entering a potentially dangerous cycle of over-borrowing and over-spending. This is because unsophisticated consumers may set their living and spending standards on the size of credit lines available at certain point in time, rather than according to a realistic assessment of their future ability to redeem debt. Consumers need honest and independent professional advice. It is therefore important to consider appropriate advisory services to ensure a substantial – and not merely formal – awareness by less sophisticated clients such as families and small businesses.

Regulators drafting the model for consumer oriented financial E-platform should cope with this need.

7.8 Lending-based and Investment-based E-platforms

The ambitions and benefits of E-platforms operating in the area of financial services appear to be common to different types of players. The key characteristics that segment this market seem to refer to:

1. The distribution model with two solutions appearing to cover the alternative finance market: lending-based versus investment-based E-platforms;
2. Investor base: E-platforms targeting all types of investors, including retail versus those with access restricted to qualified investors only;
3. Fundraisers: private individuals, SMEs of different sizes or start-up companies;
4. Type of financial instruments: loans, invoices financing, commercial paper, bonds, stocks.

Let us look at different distribution models: lending-based versus investment-based. Differences include operations, technology and regulation. The operating model of P2P lending E-platforms is the most innovative and, perhaps, complex. It applies to a large number of borrowers (typically, consumers or small businesses); hence, it involves a large number of transactions on the borrower side. The platform manages the

individual borrower's positions as well as performs ex ante credit analysis and credit monitoring. Managing a borrower's position includes activities such as "know-your-client" (KYC) procedures that are often driven by regulation guidelines in the areas of anti-money laundering and anti-terrorism. There is an intense administrative workload connected to the opening of individual memberships.

E-platforms compete in handling this issue of customer care with the highest degree of automation and smoothness of operation, possibly along a paperless process. The credit assessment procedure is often integrated within the client onboarding experience. The E-platform undertakes payments, if authorized to conduct this activity, or an affiliated financial institution can handle them. The smaller the client, the greater the number of administrative activities and the consequent need of greater investments in ad hoc technology to support a P2P lending E-platform's user experience and process controls. (See Fig. 7.4)

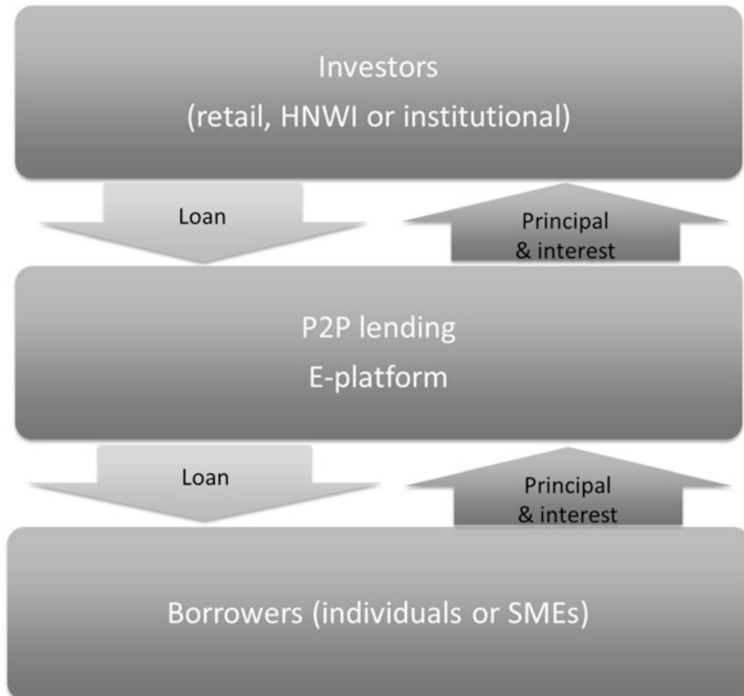

Fig. 7.4 Investors and borrowers flow

The upstream side of the process – that is, the lender side – involves the opportunities for lenders to access and possibly satisfy an individual borrower credit request. The leading models also offer lenders the opportunity to lend money to a basket of borrowers, thus fragmenting the invested sum. In these cases, the platform performs a complex activity that shields the names of the individual borrowers, highlighting different static portfolio solutions that consist of groups of loans with different degrees of credit risk.

The lender is therefore presented with the opportunity to invest in a basket of loans, each to an anonymous borrower. Baskets are defined on the basis of the combined risk effect deriving from the quality and degree of dispersion of the individual borrowers. E-platforms also offer tailor-made solutions that include the opportunity for the investor to blend different units of credit risk by calibrating the risk-weighted portions of their investments. Investors are attracted both by the possibility of fragmenting risk and the fact that the pricing of each risk-bearing micro-investment is consistently rewarding the risk.

This risk assessing and pricing activity – generally an intimate part of commercial banks' internal procedure – is made available to each investor in an extraordinary act of innovative transparency. The concept relies on an intensive technological process that achieves the spreading of relevant investment decision support data, while preserving the privacy of individual borrowers' names and credit status. At the same time, the investors are provided with up-to-date potential loss (PL) ratios and corresponding interest rates associated with clusters of specific borrowers. The decision-making chain tends to be based on three phases: Phase (1) rates to PL ratios; Phase (2) PL ratios are associated with clusters of borrowers; these clusters become the de facto lending target; (3) clusters are associated by the E-platform with the individual borrower. Phases (1) and (2) are visible to the investors; Phase (3) is generally hidden to protect a borrower's privacy.

All in all, a key success factor of the leading P2P lending E-platform consists of the ability to streamline extremely cumbersome processes, thus offering a direct procedure that is easy to use. P2P lending targeting consumers and small businesses relies on a scoring-based quantitative risk model that integrates financial, commercial and past credit performance

information. Developing, maintaining and calibrating these models in an effective manner requires large volumes of lending transactions, a large borrower universe and a sufficiently long time series of data. In this respect, those E-platforms that have succeeded in aggregating customer data in such width and depth do compete with large commercial banks in terms of credit analytics. This wealth of information is offered for the small lender's decision-making process by the unique open model provided by P2P lending E-platforms. Another significant element is brought by the reliance of P2P lending E-platforms on a fully automated credit analysis and on a risk dispersion mechanism; these functions satisfy most investors' requirements and facilitate investment in loans to anonymous borrowers. The greater the statistical universe, (potentially) the more accurate the prediction risk model offered by the platform. Investors do not need much more than that in terms of analytical support on which to base their decision, so P2P lending platforms' no-name standard for borrowers does not limit their reach to local markets where lenders require knowledge about their borrowers.

For example, Lending Club, the US P2P lending E-platform, has quickly developed nationally with a highly automated decision support system. Lending Club highlights eight steps in its service model:

1. An investor/borrower direct relationship made possible by a fully digital experience;
2. The selection of a potential borrower is performed through a KYC and credit process directly managed by the E-platform;
3. A standardized pricing process based on the assignment of a specific credit grade to each potential borrower from a seven-tier scale ranging from A to G. The consequent pricing of each borrower's loans is a direct consequence of the credit grade: one grade corresponds to one specific interest rate. This is a transparent system which is extremely easy to use and track, and that reassures all lenders as to a fair opportunity;
4. The fragmentation of risk is realized by assigning standardized securities (notes) to the borrowers. This allows investors to build a portfolio with micro units, each represented by a US$25 note, creating a Lego bricks-type model. This also allows extreme efficiency and, at the same

time, allows each investor to design and execute their investments, mixing all possible combinations of notes.

5. A monthly flow of loan interest payments acts as the heartbeat of the credit system;
6. A clear and timely procedure tackles borrowers' missing payments on a specific loan, raises a red flag and instigates possible actions against delinquent borrowers;
7. A simple math model to compute an investor total return after credit charges and fees;
8. The ability to monitor the overall E-platform credit performance, highlighting the measure of net returns in the different credit grades. This is a typical competitive advantage of large players that can improve the accuracy of their prediction models thanks to a broader statistical universe. Investors can evaluate updated default risk predictions connected to each credit grade before entering into transactions. This service allows investors the opportunity to build and adjust their lending portfolio adopting an extremely professional risk assessment process.
9. The result is a function of Lending Club's investments in technology and operations, funded by approximately US$200 million raised by the company in the first four years of its life. Retail oriented P2P lending E-platforms such as Lending Club appear to be requiring great doses of capital to fund their development. In particular, the large amount of micro transactions that are instigated by each consumer loan traded on the Lending Club imposes a solid technology platform and calls for relevant software investments. This creates the current condition of relatively high entry barriers in consumer oriented P2P lending ventures, as a consequence of the investments needed in the technology, marketing, operations and compliance areas.

In practice, today's P2P lenders face large technology investment requirements in order to cope with their volume intensive activity. In addition, they operate in a regulatory environment similar to that of banks that imposes country-specific set-ups. Consequently, the development of a multi-national strategy appears to be happening more slowly than in other industries, or even within the FinTech space, if compared

with solutions that are impacted by less country-specific regulations. Moreover, such strategy is constrained within country-specific roll-outs and therefore benefits from relatively fewer economies of scale, if compared with those available to E-platform players active in less regulated industries.

Investment-based E-platforms, on the other hand, apply FinTech innovations to the securities business, rather than to banking (or the lending business) as in P2P lending E-platforms. In this field of business, investors underwrite a security such as a bond or a stock directly issued by the fundraiser. The security is generally negotiable and can therefore be listed in a public exchange for a possible secondary market resale. When an E-platform operates in the area of securities or investments services, it typically comes across a well-defined regulatory framework. Clearly, authorities understand the evolution process that technology and market players have instigated in this area of business. It is therefore reasonable to expect specific regulatory actions with regard to E-platforms. Such actions will be aimed at updating the current regulation to make space for the innovative presence of E-platforms. In the EU, investment services aimed at both qualified and retail investors fall under MiFID.

7.8.1 A Special Focus on Investment-based E-platforms and Their Future in the European Union

The very fact that securities-based (also referred to as investment-based) E-platforms operate in a well-defined regulatory space in Europe would seem provide the following conditions:

- A solid development pattern within the already defined rules;
- A broader single market: the whole EU under a common umbrella set of rules.

The European Securities and Markets Authority (ESMA) is focusing on what it is defining as “investment-based crowdfunding”, as distinct from other kinds of crowdfunding such as donations or loans. In an

opinion paper published in December 2014, ESMA highlighted its awareness that crowdfunding's recent developments had imposed clarifications and, possibly, the introduction of new specific requirements by Member States. ESMA assessed typical investment-based crowdfunding models in order to promote regulatory convergence at EU level.

SMEs capital markets attract specific risks as a consequence of the fact that securities issuers are smaller, information is limited and investments lack the degree of liquidity that could grant the investor's ability to trade out of an unwanted investment. ESMA is also focusing on the platforms' model as a source of risk; this refers to possible conflicts of interest, the effects of an E-platform's failure and the quality of due diligence (if any) performed by the E-platform on the securities offered.

It is also clear, both to ESMA and the European Commission, that there is an opportunity cost in not facilitating the development of crowdfunding, given its potential to improve access to finance for the real economy and, at the same time, widen the investment opportunities available to investors. The innovations introduced by the alternative finance sectors appear to carry a long-lasting and positive effect, and to instigate momentum in the financial services community. Incumbents such as commercial and investment banks will need to innovate in order to keep up with the new level of competition, transparency and consequent customer awareness. In this respect, the European Commission has produced a Green Paper on a possible Capital Markets Union (CMU) that appears to have become an official manifesto of modern interaction between European retirement institutions, investors and the real economy.

The Commission has set six goals to be achieved by the CMU in order to:

1. Create a single market for capital by removing barriers to cross-border investments;
2. Improve access to financing for all businesses around Europe;
3. Diversify the funding of the economy and reduce the cost of raising capital for SMEs;
4. Maximize the benefits of capital markets, so they can support economic growth and job creation;
5. Help SMEs raise finance more easily;
6. Help the EU to attract investments from all over the world and become more competitive.

Since the Treaty of Rome in 1957, it has been noted that the free movement of capital is one of the fundamental freedoms of the EU and should be at the heart of a single market. The Green Paper defines the practical effects that the CMU implementation should bring to the real economy as the six goals are achieved: they involve, in practice, the fact that an SME can raise financing as easily as a large company and that obtaining credit through the capital markets is increasingly straightforward even across different Member States. Ideally, all investors should be joining banks in a set of market-specific benefits and capital requirements, thus competing fairly. For example, a Spanish SME should end up presenting its investment projects to multiple potential investors in different Member States and, eventually, receive financing from investors based in Germany and Italy. At the same time, for example, an investor based in France should be able to diversify its portfolio of bonds issued by pharmaceutical companies investing in SMEs from Holland, Portugal or Greece.

7.9 The UK's Focus on FinTech

Among Member States, the UK seems to be particularly persuaded that the new CMU scenario will offer a significant and brand new business space to those players adopting the FinTech recipe with an EU-wide scope of business. The CMU could, indeed, work as an alternative territory offered to those UK-based operators that experience the Eurozone's banking regulations as a barrier to achieving a smooth financial mediation channel to the real economy. Despite being out of the Eurozone, the UK is in a strong position to carry on its leadership in the financial services sector. It is, in fact, a key ambition of the CMU to provide a single market that will encourage FinTech operators to invest in technology and involve collateral technologies such as CRM, big data analytics and mobile payments.

An analysis published by the Bank of England in February 2015 highlighted that the CMU can support growth and stability by bringing together savers and borrowers and, consequently, improving the system's allocation efficiency. The study also highlighted that the involvement of

the private sector in "risk sharing could lead to lower volatility of incomes and consumption, thereby supporting economic stability". The concepts of risk sharing, diversification and transparency are among those that make E-platforms a highly effective means with which to connect multiple investors to multiple borrowers, regardless of their size or risk appetite. In general, FinTech values the ability of the Internet to connect demand and supply in a "many-to-many" paradigm.

The British Financial Conduct Authority (FCA) is particularly involved in a mission to promote the conditions that would establish the UK as the premier location for starting, growing and maintaining innovative financial technology businesses. In March 2015, the FCA published its vision regarding the role of the UK government in providing leadership and catalysis, that of academics and businesses in developing and delivering business models, and that of regulators in ensuring that existing and new risks are identified and managed effectively.

In particular, the FCA has issued a list of seven recommendations that appear to be underlying the strategic importance of this effort with regard to the financial services industry, jobs creation and UK leadership. The highlights of the seven recommendations are:

1. A clear vision from Government, combined with a stable policy environment, will encourage the private sector to invest in FinTech. However, what is also needed is coordination across Government, regulators, business and academia and we therefore propose that the Government establishes a 'FinTech Advisory Group' with representation from the Government, regulators, trade associations, academia and business.
2. Challenge competitions can be an effective way of catalyzing the application of new technologies to new areas where the market alone may be insufficient as catalyst. This leads to our second recommendation: the Government should create a program of grand challenges on FinTech for academia, business and the third sector to answer. This would enhance the exchange of ideas and knowledge and provide inspiration to the FinTech community by challenging creative start-ups and incumbents to find innovative solutions to global problems.

3. Research Councils and Innovate UK should support research in all areas of FinTech, including big data, analytics, and the social and economic impacts of FinTech. The UK should build academic and technology leadership in the FinTech sector. The Alan Turing Institute should be well positioned to take on a major role, working closely with universities and industry. A key enabler for this research will be access to world-class financial data sets. A FinTech Advisory Board working with Research Councils and Innovate UK would have a role in helping to inform the research agenda.
4. Horizon scanning will be essential to anticipate, monitor and assist in the management of emerging risks and threats in FinTech. There is an important leadership role for a FinTech Advisory Group working closely with regulators and the Bank of England.
5. FinTech modules should be included in relevant degree courses to expose students to the FinTech industry and in turn to expose the FinTech industry to an educated and work-ready body of students.
6. Government should consider developing action plans to harness opportunities to develop regional hubs for FinTech outside London and the South East.
7. Government must be an expert strategic commissioner of FinTech. It should encourage all entrants to market, from start-ups to established players. The Government is an important purchaser of technology and has an opportunity to encourage innovation by expert commissioning of products and services.

7.10 Investors

Reaching investors and attracting their money with an easy-to-use E-platform is one thing, doing so with a sustainable service model is the challenge. The Internet and FinTech have often been synonymous with "access for everyone". Providing access to products and raw information need not be not an excluding factor, some players might tend to consider investors as a whole, the new Internet-enabled arena as one single big market to be pursued.

However, differences in risk awareness and price discovery tend to segment investors in two broad categories: qualified investors and retail investors. In broad terms, qualified investors are those who are organized and experienced in assessing and managing risks, are prepared to identify the negotiated terms, and are big enough to allocate their portfolio in a diversified manner.

Retail investors are not among qualified investors; a different activist attitude seems to identify two different stances towards the developing alternative finance: that of those assuming a leadership role versus that of less active players that assume a follower's role. A three-tier segmentation of the market appears to represent today's investors' arena with regard to the different E-platforms. This takes into account business attitudes rather than only considering parameters imposed by regulation.

This segmentation is perhaps the basis of a possible growth path for those platforms that leverage the wealth of analysis and risk-taking skills embedded in certain experienced investors.

E-platforms have learned to value lead investors as a precious component of their model. Their activity enriches the platform by providing steady liquidity and professional selectivity of the primary market's pipeline of deals (see Table 7.1).

Lead investors are also a significant element in the pricing process. In order to broaden the investor base, investment-based E-platforms tend to treat potentially "lead investors" as premium clients. The strategy of some investment-based E-platforms is to focus on a small target group of investors that would act in a similar fashion as "specialist dealers" in government bonds primary markets. A loyal "lead" investor is an important element to the growth strategy of an investment-based E-platform. It facilitates demand and supply convergence into closed deals that signal the key attraction of the platform. More deals call for more investors and more issuers (see Fig. 7.5).

The very fact that transactions are endorsed by the lead underwriting of a professional and respected investor signals the quality in the evaluation process and enriches the set of information provided by the platform to "follower" investors. "Hard" information such as financial statements, independent ratings and opinion, business plans, KYC filters is complemented by the simple but enriching fact that one or more specific

Table 7.1 E-platforms key features

Market function	Leaders	Followers/backers	Marginal
Investor description	Specialized fund managers, some insurance companies, (some) qualified HNWIs, (some) family offices, banks	Family offices, qualified HNWIs, small banks, insurance companies, pension funds	Non-qualified HNWIs, retail investors
Investor profile	Have the ability to understand or assess the risks involved in investing in SMEs, and the will and resources to perform in-depth analysis of individual issuers; Play an active role in both the structuring and the pricing of capital markets transactions as lead investors; Have the financial resources to build a well-diversified portfolio of SME securities.	Have the ability to understand or assess the risks involved in investing in SMEs; Lack the will or the resources to perform an in-depth analysis of individual issuers, hence they rely on independent risk ratings and market driven price discovery; Have the financial resources to build a well-diversified portfolio of SME securities.	Lack the ability to understand or assess the risks connected to investing in SMEs; Often lack the financial resources needed to build a well-diversified portfolio of SME securities.
Suitable investment targets	All kinds of security accorded as consistent with specific investment policies, including equities, senior bonds, high yield bonds, equity-linked bonds, commercial paper; Direct lending instruments such as loans, including services offered by P2P lending E-platforms	Direct investments in securities such as equities, senior bonds and commercial paper; "Portfolio type" investments such as specialized investment funds; Direct lending instruments such as loans, including services offered by P2P lending E-platforms	"Portfolio type" investments such as specialized investment funds or P2P-diversified lending – direct investing in individual securities is not suitable for these investors

Fig. 7.5 The growth cycle

professionals have evaluated the security, priced it at a visible level and underwritten it for a certain visible amount. To a potential investor, all this becomes relevant pre-trade "soft" information that the E-platform is more than willing to provide to its customer as a distinctive key feature. For an emerging E-platform, this is a possible way to start the positive cycle of liquidity, by building up volumes and calling for more liquidity.

The leader/follower situation tends to apply to many forms of investment-based crowdfunding E-platforms and seems to address a chronic issue deriving from the necessary level of trust needed by investors in their decision-making path. E-platforms compete in providing more and more information and analysis on possible targets; however, investments SMEs and start-up companies require a higher level of

insight and understanding. This is often due to general concerns regarding transparency and integrity, but is also related to the fact that SMEs and start-up companies' business models often tend to be unique and, hence, incomparable.

7.10.1 Fundraisers

E-platforms target the following kind of fundraisers:

- Consumers interested in borrowing money at lower rates, as well as those with poor credit ratings or a bad credit history –banks would not consider these eligible clients.
- Small businesses, including small merchants. In this case, borrowers can rely on a developing market of E-platforms providing ad hoc credit-scoring engines, specific loan structures and invoice financing.
- Start-up companies are the quintessential type fundraiser that relies on equity-crowdfunding platforms. This segment is perhaps the least regulated and platforms tend to specialize in each of the typical start-up companies' growth stages. The more advanced the development stage requiring equity financing, the bigger the size of investments tickets, the more structured and possibly regulated the function of the platform.
- SMEs can raise equity funding via specialized pre-Initial Public Offering platforms. Debt products range from self-liquidating short-term solutions – such as invoice financing to securitized financial products such as commercial paper, mini-bonds, or even convertible bonds. The majority of E-platforms typically specialize by product. Product focus is, indeed, the key to a successful acceleration. However, given that, the value of an active investor franchise, marketing and technology, and competition might push players to offer more products on the same platforms. In this perspective, E-platforms insisting on the same client base of the same geographical market will be very likely to consider sharing certain functions, or even merging in order to further the achievement of critical mass. This will be particularly likely in smaller geographical markets.

7.10.2 Financial Instruments

In addition to the standard lending products offered by P2P E-platforms, the FinTech market has allowed a strong development of other funding solutions. For example, in invoice financing, start-up equity fundraising or mini-bonds, the community of possible investors has been attracted by risk/return profiles that were once either a restricted hunting ground for banks or simply did not exist.

FinTech growth was triggered due to new crowds of investors, enabled by the web-based offering. More importantly, they have perceived a relative value opportunity in accessing new asset classes with new funding solutions. Access has enabled the opportunity.

7.11 Why E-Platforms?

Considering the emerging SME-driven flow of investments, long-term investors such as insurance companies and retirement funds will play a key role in enabling the structural growth of the real economy. As highlighted by the EU CMU scenario, this will become a continental priority. In this context, investment-based E-platforms seem to address the challenges that investing in SMEs has witnessed so far. In particular, the possible breakthroughs introduced by these models are:

- The opportunity for investors to meet SME fundraisers in a cost-effective context that is transparent and prudent. E-platforms appear to be in a better position to deliver this benefit than traditional investment banks, which lack the focus and organization to serve this market segment efficiently.
- The syndicate model experienced with venture capital equity investments and highlighted by the example of AngelList can be extended to SME bonds and equity fundraising.
- The fact that E-platforms are independent players, typically acting as brokers, mitigates possible conflicts of interest.