

# THE RISE OF FUTURE FINANCE

## The UK Alternative Finance Benchmarking Report

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December 2013

## ACKNOWLEDGMENTS

This benchmarking report would not have been possible without the generous help and support of all participating alternative finance intermediaries. We are very grateful for the contribution of all members of the UK Crowdfunding Association (UKCFA) and the Peer-to-Peer Finance Association (P2PFA). We deeply appreciate the endorsement by the Co-Chairs of the All-Party Parliamentary Group on Crowdfunding and Non-Banking Finance, Barry Sheerman MP and Dr Julian Huppert MP. We would like to express our special thanks to Dr Mia Gray, Professor Lee Fleming, Julia Groves, Dr David Bholat, Kieran Gravey, Rory Graham and Daniel McGlynn. Diagrams in the report and related infographics are produced by CowdyLab, a multipurpose digital platform that specialises in crowdfunding data analytics and visualisation. We thank its co-founders Horacio Morales-Blum and Rodrigo Frias-Rivas for their excellent technical assistance. We are also very thankful for the institutional support of Nesta, University of Cambridge and University of California, Berkeley.

## ABOUT THE AUTHORS

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**Bryan Zhang** is a PhD Researcher in Crowdfunding and Alternative Finance at the University of Cambridge. Bryan is an academic contributor to the 2013 Crowdfunding Industry Report.

## RESEARCH ENDORSEMENTS

*“Alternative finance is playing an increasingly important role in helping businesses access the finance they need to grow and contribute to the economy. I therefore welcome this research undertaken by UC Berkeley, Nesta and the University of Cambridge to benchmark the current size of the alternative finance sector and track its growth.”*

**Dr Vince Cable MP**

Secretary of State for Business, Innovation and Skills

*“It is very promising to see such a high calibre partnership between Berkeley-Nesta-Cambridge to support the collection and dissemination of real information about one of the most exciting and dynamic parts of the financial services sector. I give my full support to this outstanding initiative which will certainly serve to build momentum and improve the overall credibility and understanding of alternative finance industries.”*

**Barry Sheerman MP**

Co-Chair, APPG on Crowdfunding and Non-Banking Finance

*“Congratulations to Berkeley-Nesta-Cambridge for conducting the UK Alternative Finance Benchmarking Survey. In these days of pitiful mainstream saving rates, it is crucial savers are able to put their money to work funding productive business. I am delighted the project has revealed the astonishing growth of this sector.”*

**Steve Baker MP**

Chair, APPG on Economics, Money and Banking

*“Alternative finance is a really exciting and dynamic sector, and has the potential to grow much further, enabling many things to happen that just could not happen before. But we do need to know how large a sector it actually is, and this survey will be incredibly valuable for that purpose.”*

**Dr Julian Huppert MP**

Co-Chair, APPG on Crowdfunding and Non-Banking Finance

# EXECUTIVE SUMMARY

Alternative finance activities such as crowdfunding, peer-to-peer lending and invoice trading have emerged as a significant funding mechanism and source of capital in the UK in recent years. Meeting the capital needs of both individuals and businesses, facilitating fundraising activities for civic projects and social causes, alternative finance intermediaries have become online marketplaces where individuals, rather than institutions, work collaboratively to form capital. As the alternative finance market continues to grow in the UK and the government looks to regulate the area, this benchmarking report offers a timely snapshot of this fledgling and dynamic sector in order to understand its size, growth and the fluid development of respective segments. In turn, this report aims to inform regulators, brief policymakers, update industrial leaders and educate the wider public about this growing and important industry.

This benchmarking research is a joint project between Nesta, the University of Cambridge and the University of California, Berkeley. It represents the first intensive, comprehensive and empirical country-level study of an alternative finance market anywhere in the world. Primary data gathering was facilitated by a questionnaire-based survey, which was able to capture more than 95 per cent of all UK-based alternative finance activities such as crowdfunding, peer-to-peer lending and invoice trading. Data on more than 50 alternative finance intermediaries was obtained, including from almost all members of the United Kingdom Crowdfunding Association (UKCFA) and the Peer-to-Peer Finance Association (P2PFA).

## Market size

This benchmarking survey reveals that **the UK alternative finance market grew by 91 per cent from £492 million in 2012 to £939 million in 2013**. Accumulatively, the overall market had an average growth rate of 75.1 per cent over the last three years and contributed £1.74 billion of personal, business and charitable financing to the UK economy. While the peer-to-peer charitable fundraising and donation-based crowdfunding still represents the largest segment with £310 million in 2013, the vitality and diversity of the alternative market is on full display. This includes peer-to-peer lending, which takes in nearly £287 million in 2013, peer-to-business lending achieving a notable £193 million, invoice trading platforms funding £97 million, equity crowdfunding registering £28 million, and reward-based crowdfunding recording a further £20.5 million.

## Market growth

Perhaps even more impressive than their already considerable transaction volumes, their accumulative and **year-on-year growth rates are high**. Equity-based crowdfunding grew 618 per cent from 2012 to 2013, peer-to-business lending grew 211 per cent in the same period, while peer-to-peer grew 126 per cent, reward-based crowdfunding grew 387 per cent, invoice trading grew 167 per cent and debt-based securities grew 170 per cent.

## SME finance and future projection

Collectively, **the UK alternative finance market provided £463 million worth of early-stage, growth and working capital to over 5,000 start-ups and SMEs in the UK during the period 2011-13, of which £332 million was accumulated in 2013 alone**. Based on the average growth rates of between 2011 and 2013, **we can cautiously predict that the UK alternative finance market will grow to £1.6 billion in 2014 and provide £840 million worth of business finance for start-ups and SMEs**.

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# INTRODUCTION: RESEARCH RATIONALE, OBJECTIVES AND METHODOLOGY

The UK alternative finance market has witnessed unprecedented development, unparalleled innovation and unmatched growth in the years since the global financial crisis. As commercial banks restrict business lending and venture capital industries scale back on investment, a new brand of innovative, decentralised and disruptive online financial intermediaries are burgeoning in the UK. From equity-based crowdfunding to peer-to-peer lending, from invoice trading to reward-based crowdfunding, these alternative finance providers are supplying credit to SMEs, providing early-stage investments to start-ups, stimulating regional economies and funding worthwhile causes. The UK Government has actively encouraged the growth of the alternative finance sector by direct capital investment through the Business Finance Partnership, and the Financial Conduct Authority (the FCA) is currently publicly consulting on forthcoming regulation in the area.

However, little information is presently available regarding the overall size of the alternative finance market or the growth of the crowdfunding, peer-to-peer and invoice trading transaction volumes in the UK. While there has been some industry reporting by for-profit organisations on crowdfunding, no independent, reliable and academic research exists to benchmark the UK alternative finance market. It is imperative, particularly at this early stage of the market development, to gather comprehensive information to brief policymakers, inform regulators and update industry associations and other key stakeholders in alternative finance. It is in this context that UC Berkeley, which has the world's first dedicated research programme for entrepreneurial and social finance, has collaborated with Nesta and Cambridge University to collect and analyse aggregate-level data for the UK alternative finance market and produce this benchmarking report.

## Research strategy and source of data

To ensure the consistency, rigour and validity of this benchmarking exercise, this research collected aggregate-level market data directly from alternative finance intermediaries via a secure web-based questionnaire. Leveraging existing research relationships and industry contacts, the benchmarking survey aimed to capture over 95 per cent of all online alternative financing activities in the UK from crowdfunding, peer-to-peer lending to invoice trading. As a country-specific study, we specifically focused on alternative finance intermediaries that are facilitating funding for UK individuals and businesses. Therefore, our survey sample consists of both UK intermediaries and some of the international platforms that have significant activity in the UK. The primary data submitted by individual intermediaries were then analysed and aggregated to provide in-depth analysis in order to produce a comprehensive report. In the very few cases where primary data were not obtainable through survey, secondary data such as public information, annual reports and press releases were utilised to provide the best estimations.

As this benchmarking research is aimed at collecting aggregate-level market data, all individual alternative finance intermediaries were anonymised and all identifying information was stripped from the analytical process. Therefore, no individual or particular survey participants are identified in this final report. The questionnaire-based survey itself was securely hosted on a dedicated account accessible only to the core research team. Commercial exploitation of the data is strictly prohibited.

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## Research Schedule and Survey Participants

The joint Berkeley–Nesta–Cambridge UK Alternative Finance Benchmarking Survey opened on 25 November and closed on 5 December 2013. Information was obtained on more than 50 alternative finance intermediaries, including from almost all members of the United Kingdom Crowdfunding Association (UKCFA) and every member of the Peer-to-Peer Finance Association (P2PFA). Judging by the quality and breadth of the data collected, the research team is confident that more than 95 per cent of all online alternative finance activities in the UK were captured through the benchmarking exercise.

## Data cleaning and data analysis

All primary data were exported into an Excel spreadsheet and all intermediary identifying and/or confidential information was stripped from the cleaned data set. Based on the preferences registered by participating intermediaries, a working taxonomy for different segments and models of the alternative finance market was constructed. As a result, donation-based crowdfunding and/or peer-to-peer fundraising are now one category. Peer-to-peer lending and peer-to-business lending are now two separate models to reflect their distinctive lending functions and mechanisms. Invoice trading is classified as a stand-alone model, whilst microfinance and community shares are merged together. The other models of alternative finance are identified as reward-based crowdfunding, revenue/profit sharing crowdfunding, equity-based crowdfunding and debt-based securities, which all have their characteristic mechanisms, dynamics, as well as risk profiles. Hybridised crowdfunding activities, which leverage more than one type of alternative finance model (e.g. reward and equity), were broken down and added separately to the above-mentioned categories.

From the aggregated data of each alternative finance model, the accumulative transaction volumes as well as average yearly growth rates were derived for the last three years. The 2013 figures were predicted by each participating intermediary based on the trading statistics to date, captured during the survey window (25 November–5 December) and the expected volumes for the remainder of the year. The total alternative finance for Small and Medium Enterprises (SMEs) in the UK was obtained by aggregating the empirical data from peer-to-business lending, equity-based crowdfunding, invoice trading, debt-based securities and estimated data (through manual and theoretical sampling) on reward-based crowdfunding. The total number of SMEs that raised alternative finance was derived by the same method, except that figures from reward crowdfunding platforms were excluded to give a conservative, but perhaps statistically more reliable estimation.

The data for the number of total ventures (including all fundraising ventures for personal finance, business finance, social causes and project-based campaigns) and for the number of active investors (including donors, backers or lenders) are gathered directly from the survey entries provided by participating intermediaries. Therefore, these figures are likely to be overestimated and inevitably involve double counting. However, as a snapshot of the UK alternative finance industry, these statistics are still valuable in highlighting the depth of the market and the breadth of people's participation in this important economic sector.

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# THE SIZE AND GROWTH OF THE UK ALTERNATIVE FINANCE MARKET

In recent years, the UK alternative finance market has more than tripled from £309 million in 2011 to £939 million in 2013. Accumulatively, the alternative finance sector has delivered funding of £1.74 billion to UK individuals and businesses in the last three years. Taking out the donation-based crowdfunding and peer-to-peer fundraising for charitable causes, the UK alternative finance industry still contributed over £955 million worth of personal and business finance to the UK economy from 2011 to 2013.

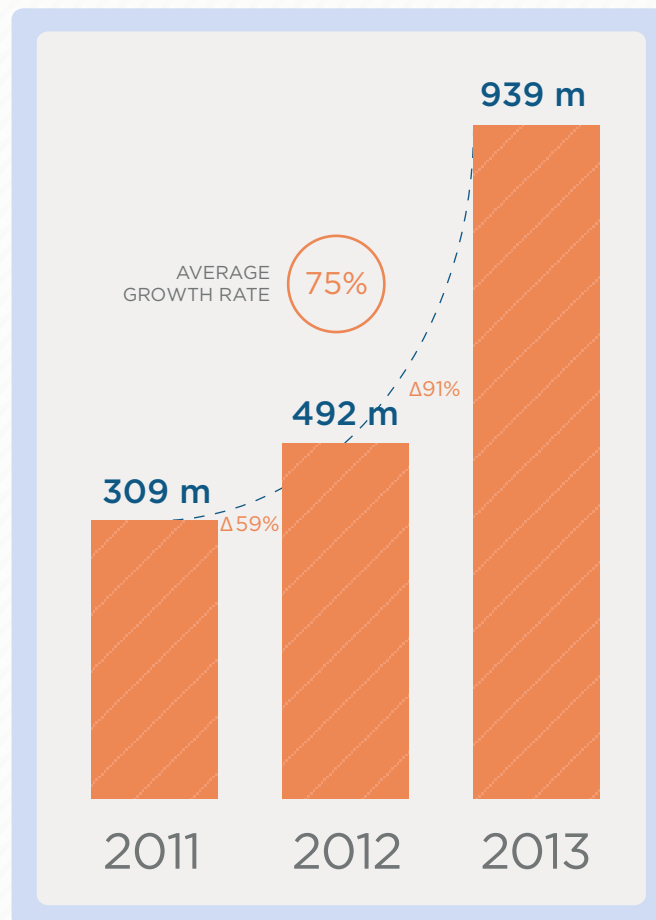
## The Size and Growth of the UK Alternative Finance Market

### TOTAL FINANCE RAISED IN THE PERIOD 2011 - 2013

£1.74  
billion

EXCLUDING DONATION-BASED  
CROWDFUNDING AND P2P  
CHARITABLE FUNDRAISING

£955  
million



In 2013, all sectors of the UK alternative finance market recorded considerable growth and rapid expansion. These market sectors are identified by their alternative finance models, which are summarised and contrasted in the table below. The figures in the right-hand column provide a useful snapshot of the latest market data for these sectors in 2013.

Donation-based crowdfunding/Peer-to-peer online fundraising	No legally binding financial obligation incurred by recipient to donor; no financial or material returns are expected by the donor.	(2013) £310m
Peer-to-peer lending	Debt-based transactions between individuals; mostly are unsecured personal loans.	£287m
Peer-to-business lending	Debt-based transactions between individuals and existing businesses who are mostly SMEs.	£193m
Invoice trading	Firms sell their invoices or receivables to a pool of individual or institutional investors.	£97m
Equity-based crowdfunding	Sale of registered security by mostly early-stage firms to investors.	£28m
Reward-based crowdfunding	Donors have an expectation that recipients will provide a tangible (but non-financial) reward or product in exchange for their contribution.	£20.5m
Debt-based securities	Lenders receive a non-collateralised debt obligation typically paid back over an extended period of time. Similar in structure to purchasing a bond, but with different rights and obligations.	£2.7m
Revenue/Profit sharing crowdfunding	Issuers incur an obligation to repay lenders, but these payments are variable and a function of the revenues or profits of the firm.	£1.5m
Microfinance/Community Shares	Microfinance refers to the lending of small sums to entrepreneurs who are often economically disadvantaged and financially marginalised. There is a debt obligation incurred, but the amounts lent are very small. Community shares refer to the sale of shares in social enterprises serving a community purpose in a particular locality.	£0.8m

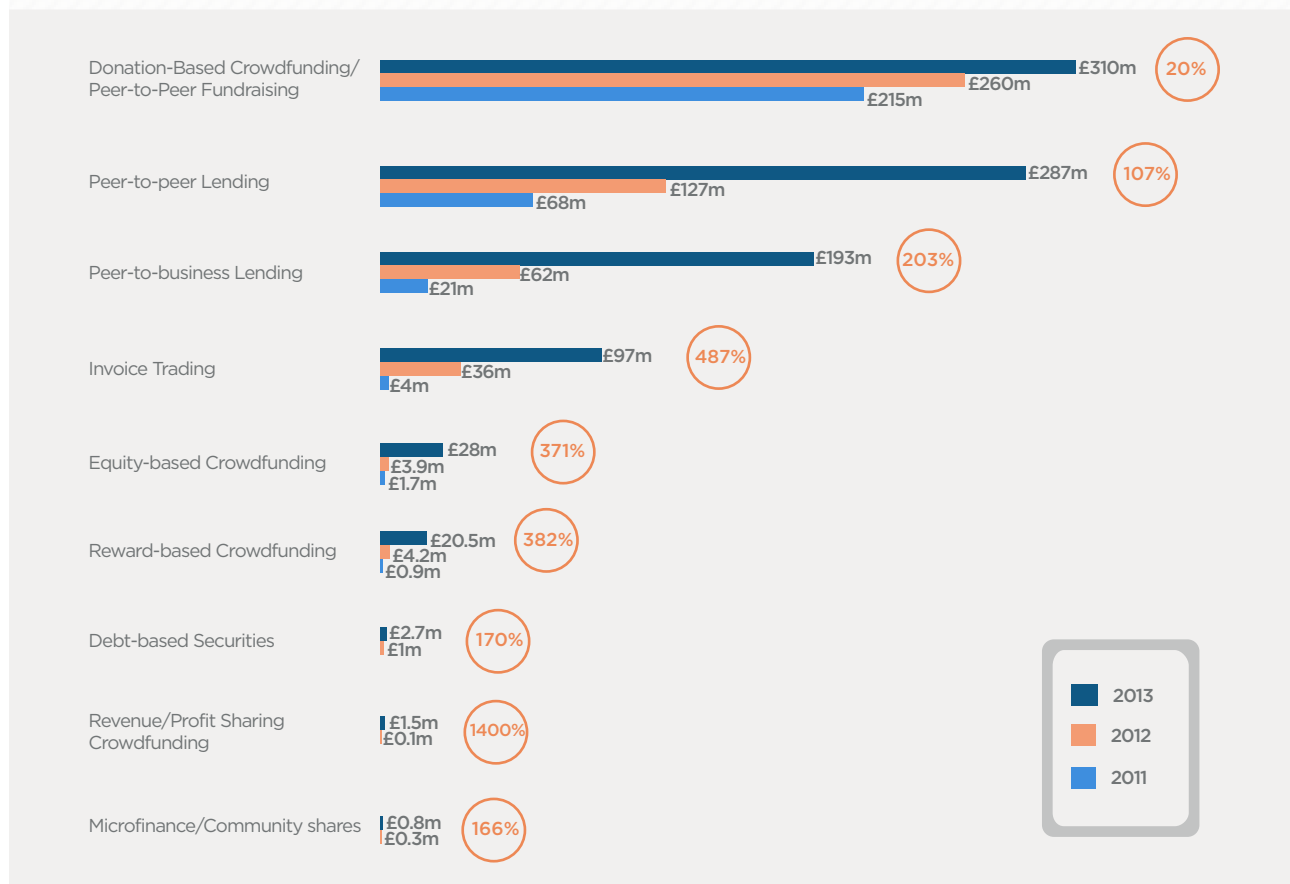


# THE DIVERSITY OF THE UK ALTERNATIVE FINANCE MARKET

As the diagram below illustrates, perhaps the most encouraging indicator of the UK alternative finance market is its strong and diversified growth in a wide array of models across the board during the period 2011-2013.

## The Diversity of the UK Alternative Finance Market

### TRANSACTION VOLUMES AND AVERAGE GROWTH RATES BY MODELS 2011-2013



The **donation sector**, which consists of donation-based crowdfunding and peer-to-peer online fundraising activities, remains the largest sector in the market with £785 million funding raised through it in the last three years. This more established sector has shown a relatively steady growth of about 20 per cent year-on-year in contrast to some of the other more recent models.

For instance, both **peer-to-peer lending** and **peer-to-business lending** models have developed rapidly and funded £482 million and £276 million respectively over the last two years. This sector has significantly outperformed the interest rates available to investors with a relatively low-risk profile. The peer-to-business lending sector is more than doubling each year and the UK is the undisputable world leader of this alternative financing model. The peer-to-business lending intermediaries allow SMEs to receive loans from a pool of online investors in a very short period of time by bypassing the most complicated bank lending processes. For many firms, the speed with which they are able to obtain funding, often in a matter of days, makes this model significantly more attractive than traditional banking.<sup>1</sup> The default rates on peer-to-business loans are also often less than that experienced by commercial banks, demonstrating the ability of a crowd of investors to select and fund quality firms.

**Invoice trading** is another relatively nascent, but no less innovative, alternative finance model that is burgeoning in the UK. Invoice trading intermediaries enable SMEs to sell their invoices or receivables to many individual or institutional investors and, in turn, effectively drive down the cost of funding. This sector has raised £137 million in finance for businesses in the three years from 2011 to 2013 with an annualised growth rate of 487 per cent.

**Equity-based crowdfunding** grew by more than 600 per cent between 2012 and 2013, from just under £4 million in 2012 to slightly over £28 million in 2013. This is consistent with the rise of equity-based activities in Western Europe and elsewhere. World Bank research on crowdfunding shows that, in the past three years, some form of equity crowdfunding has emerged in 27 nations around the world. Given the rapid expansion of crowdfunding markets internationally, particularly in the USA after the recent implementation of Title II of the JOBS Act, it is expected that equity-based crowdfunding will grow significantly over the next few years, depending on the policy decisions and the evolution of the regulatory framework in the UK. Data reported by Paul Niderer, CEO of the Australia Small Scale Offering Board (ASSOB), shows that, over the past seven years of equity crowdfunding in Australia, 83 per cent of funded firms are still in operation, significantly outperforming comparable firms who were financed using traditional means. Whilst the Australian ASSOB market has structural differences from the UK, it is nonetheless encouraging to see high survival rates among firms raising funds through equity crowdfunding.

**Rewards-based crowdfunding** is also showing explosive growth, with a growth rate of more than 370 per cent year-on-year and funding £25.6 million in the last three years. This sector represents a significant area of growth potential as start-ups and SMEs, rather than just individuals, can leverage this model to conduct early marketing testing and pre-sell inventory, thus shortening product development time, demonstrating market validation and acquiring social proof. Many firms that have utilised reward crowdfunding can go on to approach institutional investors or participate in equity crowdfunding markets once they have demonstrated their capability. Profit/revenue sharing crowdfunding totalled £1.6 million from 2011 to 2013 and is potentially a high-growth sector, particularly for gaming development, music, books and other forms of entertainment ventures.

**Debt-based securities**, which is an alternative finance model that offers long-term investment spanning normally 20–25 years, has also recorded an impressive accumulative growth rate of 170 per cent in the last three years, reaching £3.7 million. This investment model is often associated with renewable energy projects that offer a very low-risk-profile and make fixed-term interest payments (plus part of the principal) to investors every year. **Microfinance and community shares** financing by individuals or businesses in the UK is still a relatively niche activity. Looking forward, both have demonstrable growth potential to offer hyperlocal and community-based alternative funding solutions leveraging people's social and geographical affinities.

# THE VITALITY OF THE ALTERNATIVE FINANCE MARKET FOR SMES IN THE UK

There is strong evidence to suggest that the alternative finance sector is already a meaningful and effective source of funding for SMEs in the UK. In 2011, online alternative finance intermediaries provided only £26.7 million worth of finance to UK SMEs. By 2013, from peer-to-business lending to equity-based crowdfunding, from invoice trading to revenue/profit-sharing crowdfunding, the alternative finance market has supplied £332 million to SMEs in the UK – a more than 12-fold increase in just three years. By a rather conservative estimation, without including reward crowdfunding, more than 5,000 SMEs have utilised these alternative financing mechanisms in the UK between 2011 and 2013.

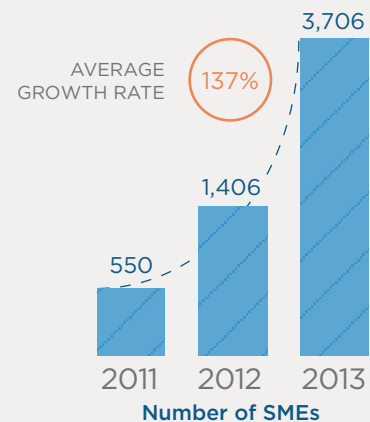
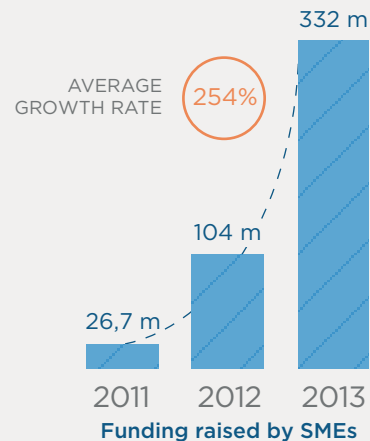
## Alternative Source of Finance for SMEs in the UK

### TOTAL ALTERNATIVE FINANCE FOR SMEs IN THE UK 2011-2013



More than 5,000 SMEs have raised business funding through alternative finance intermediaries between 2011 and 2013.

NOTE: It excludes those raising through reward-based crowdfunding



On the whole, the alternative financing activities for SMEs have been growing at an average rate of 254 per cent per year total finance raised since 2011. The number of firms participating in these markets has also been growing by an average of 139 per cent in the same period. The difference between these growth rates demonstrates that firms have been able to raise more significant sums of money through alternative financing over time.

This significant growth in alternative finance for SMEs reflects broader national and international socio-economic trends. First, the global financial crisis forced many older adults to start companies in order to protect their retirement accounts or supplement their income. This trend of well-connected, well-networked adults starting firms in mid-life or later is a relatively new development. But, these older entrepreneurs often enjoy significant social networks, which they can leverage to finance new ventures via alternative means, an advantage recent college graduates usually lack. Data from the Global Entrepreneurship Monitor illustrates this trend and identifies a significant increase in entrepreneurial activity in the UK since 2009.<sup>2</sup>

Second, in many countries, financial reforms have been instituted which, whilst stabilising banking and reducing risk profiles, also had the effect of limiting access to capital for entrepreneurs – many of whom do not have the collateral or credit scores necessary to secure bank financing. Eurostat data indicates that, in the UK, and across Europe more broadly, rejection rates for SMEs applying for loans increased significantly in the wake of the financial crisis.<sup>3</sup>

Third, there are significant barriers that prevent many entrepreneurs from accessing capital based on gender, race or other non-business factors.<sup>4</sup> Empirical data demonstrates that investors prefer to invest in companies that match their profiles – in terms of race, gender and socio-economic status. For example, in the United States, investors from elite venture capital firms show a strong preference to invest in companies where the founders graduated from a very small set of elite private universities – usually preferring to invest in fellow alumni. The unintended effect of this homophily is that entrepreneurs who do not enjoy access to these networks of investors based on shared characteristics are often locked out of angel investing and venture capital markets. Alternative finance can be successfully utilised by women, minorities and other financially marginalised entrepreneurs, where its funding mechanisms are often more democratic and less biased. In fact, women entrepreneurs are found to be starting firms in significant numbers on alternative finance intermediaries<sup>5</sup> and they are at least as effective as men at being successful in meeting crowdfunding targets.

Fourth, the widespread application of social media and web-based financial transactions has enabled entrepreneurs to seek funding directly and effectively from their online communities and through their social relationships. Data from the Wharton Business School<sup>6</sup> shows that at times, 81 per cent of investors or donors in crowdfunding are connected to the founders of the fundraising firm at the first or second degree of separation. Thus, entrepreneurs can essentially monetise their web of relationships, whether from existing customers or social media connections, to raise money directly for growth SMEs or start-ups. This monetisation of social networks could not have occurred without the ubiquitous presence of social media, coupled with the growing trust in online commerce models. The rapid growth of alternative finance for SMEs in the UK is a function of all of these socio-economic trends and an indicator of evolving forms of entrepreneurship and enterprise in the digital era.

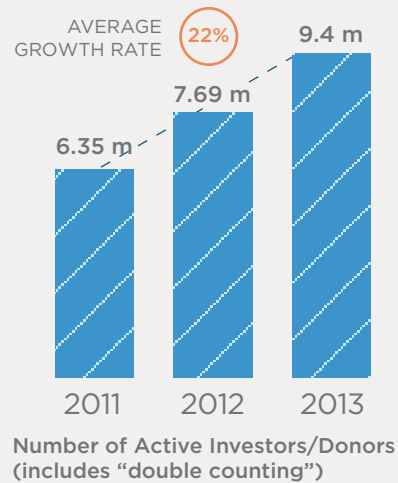
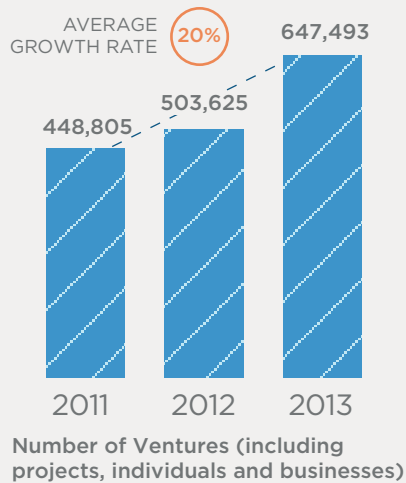
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# THE POWER OF PEOPLE AND THE POTENTIAL OF ALTERNATIVE FINANCE

The socio-economic foundation of alternative finance is built upon financial disintermediation, direct interaction and exchange between individuals without the need for orthodox institutions. Therefore, more than purely financial transaction volumes or growth trends, the breadth and depth of individuals and communities' engagement in this sector is fundamental to the health and sustainability of the alternative finance industry.

## The Power of People and The Potential of Alternative Finance

### THE NUMBER OF VENTURES THAT RAISED ALTERNATIVE FINANCE AND THE NUMBER OF ACTIVE INVESTORS/DONORS ON ALTERNATIVE FINANCE PLATFORMS



Prediction for the Year 2014  
(based on the average growth rate between 2011-13)

TOTAL ALTERNATIVE FINANCE



BUSINESS FINANCE FOR  
START-UPS AND SMEs



## Number of ventures funded

In 2013, over 647,000 projects, individual or business financing campaigns were fully funded through alternative finance intermediaries. In 2011 and 2012, the figures were just over 448,000 and 503,000 respectively, representing a steady, sustainable and sizable increase of 20.4 per cent per year. Although, in actuality, these figures will tend to be smaller due to potential issues of double counting, they still reflect the scale and depth of a vibrant, dynamic and growing alternative finance sector.

## Number of new funders

As with most social networking or social-based mechanisms, there are digital divides based on computer literacy, access to the Internet/Mobile technology, and comfort with web-based financial transactions. Despite these well-documented barriers, the UK alternative finance intermediaries have attracted and sustained more than 9.4 million active donors, backers and investors on their platforms in 2013. The figures for 2011 and 2012 are 6.35 million and 7.69 million respectively, realising a healthy and steady increase of 21.5 per cent per year. Again, these figures will be overestimated in the survey, as many investors, backers and donors will likely be double counted if they contribute funds through more than one alternative finance intermediary in the UK. Nevertheless, the number of people and their level of engagement with alternative finance activities are definitely on the rise in Britain.

According to the benchmarking survey, most of these backers, investors and donors would also have participated in mostly donation and rewards-based crowdfunding and peer-to-peer fundraising activities. However, there is also now a sizable investor community for peer-to-peer, peer-to-business lending, equity-based crowdfunding and other forms of alternative financing activities. Collectively, they represent a major social movement towards an alternative paradigm of funding mechanisms, as well as a significant source of systematic disruption in the evolving financing system.

## Growth looking forward

While one cannot make any specific predictions of growth rates based on the early years of a nascent industry propelled by disruptive technology, evidence from the rise of social media, e-commerce, mobile technology and the rise of innovative entrepreneurship suggests that alternative finance in the UK will likely grow to be a several billion pounds a year market within the next 3-5 years. From the benchmarking data to date and the global growth context, it is almost certain that Britain will continue to experience substantial growth in the number of campaigns, intermediaries, individual borrowers and lenders, and also in the total capital raised to fund businesses through alternative means. Based on the average growth rates between 2011 and 2013, we can cautiously predict that the UK alternative finance market will grow to £1.6 billion next year and provide £840 million worth of business finance for start-ups and SMEs in 2014.

## ENDNOTES

1. [http://www.nesta.org.uk/sites/default/files/banking\\_on\\_each\\_other.pdf](http://www.nesta.org.uk/sites/default/files/banking_on_each_other.pdf)
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5. See, e.g., Marom, D., Robb, A. and Sade, O. (2013) 'Gender Dynamics in Crowdfunding.' <http://www.funginstitute.berkeley.edu/sites/default/files/Gender%20Dynamics%20in%20Crowdfunding.pdf>
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