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The contribution of alternative finance to business growth

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This paper analyses the characteristics and activities of firms that use crowdfunding, using data from the Longitudinal Small Business Survey (LSBS). Our aim is to better understand the role that crowdfunding plays in the business lending market, and potential implications for policymakers. Our key findings are set out below.

Demographics

- Crowdfunded firms are of a similar size and sector make-up compared to other SMEs.
- However, crowdfunded firms are more likely to be structured as companies and less likely to be structured as sole proprietorships, compared to non-crowdfunded firms, and firms in general. The choice of legal structure may be related to the types of finance being sought.
- Crowdfunded firms are slightly less likely “middle-aged” than non-crowdfunded firms. They are slightly more likely to be very young and very old compared to non-crowdfunded firms.
- Crowdfunded firms appear to be less likely to have ethnic minority partners, directors or owners compared to non-crowdfunded firms, although data limitations affect the conclusiveness of this result.

Does crowdfunding fill gaps in the market?

- Crowdfunding is still relatively uncommon compared to other forms of finance. In the LSBS, 1.8% of all firms are using crowdfunding, compared to 42% using bank overdrafts, 40% using credit cards, and 32% using a loan from a bank or building society.
- Crowdfunding appears to be relatively difficult to obtain compared to other sources of finance, based on comparing success rates of applications for different sources of finance.
- It is common for crowdfunded firms to use other sources of finance, particularly overdrafts (61% of crowdfunded firms) and credit cards (51% of crowdfunded firms). Crowdfunded firms are relatively successful in their applications to other sources of finance, with a success rate of 72%, similar to average success rates in applications for finance across all firms.
- Across both crowdfunded and non-crowdfunded firms, finance is most commonly used for working capital and cashflow. Crowdfunded firms are more likely to use finance for research and development and debt consolidation compared to non-crowdfunded firms. However, this should be interpreted with caution, as for firms that use more than one source of finance, we are not able to directly attribute purpose of finance to different sources.

Is crowdfunding associated with business growth?

- Our analysis is based on the first wave of the LSBS. In future waves, it will be possible to examine performance over time. To gain an indication of whether firms that use crowdfunding are high growth or low growth, we examine factors that previous studies have shown to be linked with business growth. These factors are: innovation, exporting, training, growth ambitions and intentions, and having a business plan.
- We find that crowdfunded firms are more likely to have innovated by introducing new or improved goods in the past three years, compared to non-crowdfunded firms. We find a similar pattern for new or improved services (marginally statistically significant).
- We do not find consistent differences across the other factors.

Conclusions and policy implications

- Our analysis suggests that crowdfunded firms tend to be already well-served by the lending market. In this sense, crowdfunding does not appear to be a solution to structural gaps in financing for SMEs, but rather is more likely to compete with more traditional forms of finance, and potentially provide a complementary source of financing for SMEs that are already able to access finance

- Crowdfunding may be friendly towards specific types of investment, such as research and development spending. Other research suggests that other benefits include speed and ease of access.
- Crowdfunding may be less accessible (or at least perceived to be less accessible) for certain groups of businesses compared to mainstream lending, in particular, firms that do not have a traditional company structure, and firms that are ethnic minority-owned. Wider research shows that ethnic minority business owners tend to face other disadvantages that reduce access to finance. From a policymaking perspective, this means that initiatives to increase access to finance will continue to be important even as crowdfunding grows. There may be a case for further investigating ethnic minority access to crowdfunding more specifically, and examining whether differences arise at the application stage (which could be driven by differing levels of awareness) or due to different success rates in obtaining funding.
- The analysis in this paper is based on descriptive analysis of cross-sectional data. However, future waves of the LSBS will offer the valuable opportunity to track firms over time to explore whether crowdfunded-raised finance is, on average, put towards more productive investments, and how variable the returns are. Such information will help guide policymakers to understand how well the market is working in assessing the risk and return on investments, particularly important factor given that crowdfunding platforms are used by retail as well as institutional investors.