CREATING A CROWDFUNDING ECOSYSTEM IN CHILE

MIF
Multilateral Investment Fund
Member of the IDB Group

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Disclaimers

MIF staff and consultants who contributed to this study include Cesar Buenadicha, Carolina Carrasco, María Micaela Cordero, Carolina Landsberger, Evelyn Lopez, Georg Neumann, and Elizabeth Terry. The MIF also thanks Gerardo Puelles of the Ministry of the Economy of Chile for his contributions.

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About the MIF

The Multilateral Investment Fund is a member of the Inter-American Development Bank Group. Funded by 39 donor countries, the MIF is the largest technical assistance provider to the private sector in Latin America and the Caribbean, providing over US$100 million per year to projects reaching more than 4 million small producers, entrepreneurs, and poor and low-income households. The MIF serves as a knowledge broker and as the hub of a network of 1,000 local and international partners that share MIF development goals. It is a provider of grants, loans and equity investments with an average grant size of US$ 1.5 million, and serves as a gateway for knowledge and expertise on private sector solutions for economic development in the region. Through this project, the MIF aims to fulfill its mission to act as a development laboratory for experimenting, pioneering, and taking risks to empower dynamic entrepreneurs and poor and vulnerable populations.

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Abbreviations

API	Application Protocol Interface
B2B	Business-to-business
B2C	Business-to-consumer
BCI	Banco de Crédito e Inversiones
CLP	Chilean peso (unit of currency)
Corfo	Corporación de Fomento de la Producción de Chile
EBITDA	Earnings before interest, taxes, depreciation, and amortization
IPO	Initial public offering
P2P	Peer-to-peer crowdfunding
PE	Private equity
SME	Small and medium enterprises
SVS	Superintendencia de Valores y Seguros (Chilean Securities Regulator)
UF	Unidad de Fomento (Chilean unit of account)
VC	Venture capital

EXECUTIVE SUMMARY

Crowdfunding offers Chile the opportunity to stimulate investment in innovative startups and small and medium enterprises (SMEs), encourage entrepreneurship, create jobs, and spur growth in the Chilean economy. In other countries around the world, crowdfunding has demonstrated the ability to deliver capital more efficiently to a larger number of businesses and entrepreneurs than has been possible in the past. Chile is well positioned to learn from the examples and mistakes of these countries to rapidly develop policy interventions, programs, and regulations for crowdfunding in ways that will both provide access to capital while ensuring prudent investor protections. This new funding mechanism will directly address key financing challenges that undermine SME development in Chile. These include 1) increasing access to seed and early-stage capital in private markets to enable current funders to move upstream into funding more growth opportunities; 2) the "high-friction," time-consuming processes that are usually associated with early stage investing; and 3) difficulty entrepreneurs and investors face in finding each other and creating productive, standards-based dialogue.

This report was commissioned by the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank (IDB) Group, as part of an effort to promote the sustainable evolution of a financial ecosystem surrounding Chilean MSMEs. The report provides a detailed assessment of the challenges and opportunities of the emerging crowdfunding market in Chile. In addition, it evaluates the potential for crowdfunding to channel funding from this novel source to innovative local businesses and entrepreneurs. Based on this assessment, the report formulated recommendations aimed at supporting the sustainable development of a crowdfunding ecosystem in Chile.

The study was carried out under the supervision of César Buenadicha of the MIF's Access to Markets and Skills unit and prepared by Crowdfund Capital Advisors, a research and advisory firm specializing in securities-based crowdfunding.

Jason Best, Sherwood Neiss, and Habib Jamal of Crowdfund Capital Advisors wrote the main text of this report. Crowdfund Capital Advisors conducted first-hand survey research in Santiago, Chile with local crowdfunding platforms, businesses, and public and private institutions. Special thanks go to Gerardo Puelles, Analyst for the Ministry of Economy of Chile, for his invaluable support in coordinating interviews and providing substantive feedback on the report itself.

Building a Crowdfunding Ecosystem in Chile

The report assesses the potential for crowdfunding in Chile by focusing on the factors that are crucial in building a successful crowdfunding ecosystem, including cultural, social, technological, and regulatory aspects. In addition, the report examines the benefits and types of crowdfunding, and the current status of crowdfunding in Chile in comparison to other countries. Drawing upon desk research and interviews with key stakeholders in Chile, including entrepreneurs, investors, lawyers, regulators, incubators, academics, social media experts, and government officials, the report proposes a regulatory framework for crowdfunding in Chile. Specific recommendations are proposed to establish securities-based crowdfunding, to build regulatory capacity, and to raise investor awareness through education and training.

The Chilean economy has great potential for entrepreneurial and SME growth and already has many of the required elements for a crowdfunding ecosystem in place. Its economy has grown strongly in recent decades, although it has not been immune from the global economic slowdown. This, however, has boosted the number of budding entrepreneurs in Chile who, unlike their US counterparts, typically have more private sector experience behind them.

The first crowdfunding platform in Chile was founded in 2011. Currently, there are five crowdfunding platforms active in Chile: two debt crowdfunding platforms (Cumplo and Becual), one equity crowdfunding platform (Broota), and two rewards-based platforms (Dale Impulso and Fondeadora). These platforms have completed funding for nearly 1500 projects totaling over US$ 55 million. The size of fundraising varies by platform – from tens of thousands to tens of millions of dollars.

While the industry is off to a strong start, building a solid regulatory framework for crowdfunding in Chile, for both equity and debt crowdfunding, will greatly expand the opportunity for both traditional startups and SMEs to access the capital they need to start and grow. By modernizing some financial regulations and leveraging its experience in building a startup ecosystem, Chile has the opportunity to use this new financial innovation not only to leapfrog other countries in the region, but also to act as a beacon for the region. Elected officials and regulators have the opportunity to work with the leaders of crowdfunding platforms and the entrepreneurial ecosystem to form policy and regulation in a collaborative way. Executives from debt and equity crowdfunding platforms and other investment firms have affirmed their focus on investor protection and transparency while providing access to capital for their customers.

The crowdfunding opportunity for developing countries today is analogous to the mobile communications revolution we have witnessed over the past decade. In the past, the developmental constraints of investment required to develop penetration in fixed-line telephone systems left populations in a number of countries without access to modern communication. Mobile cellular technology has enabled many of those same populations to leapfrog those fixed-line systems, creating greater penetration than would be feasible under the previously-existing technology. In a similar way, financial technology, and specifically crowdfunding, can connect unbanked and underbanked individuals and businesses to the next generation of financial institutions to provide capital, jobs, and innovation.

Findings and Recommendations

Based on the study's findings and analysis, the report concludes with a set of specific recommendations intended to support the development of a crowdfunding ecosystem in Chile. These recommendations focus on securities-based crowdfunding, capacity building for regulators, and raising investor awareness through education and training. Some of the report's key findings and recommendations include:

- Current private capital market actors in Chile are experiencing challenges in deploying capital at the seed/early stage, leaving a void for growth capital. Crowdfunding policy and technology may allow these actors to reduce risk, focus on ideas that have proven market acceptance, and help promote a major Chilean company success story that could include a global exit.

- Government-backed programs, like Start-Up Chile, have already seen some success and have received widespread media approval, but the lack of follow-on capital is forcing many of these companies to leave Chile to find funds to scale their businesses. Crowdfunding may address this funding void by encouraging Chileans to co-invest with local business angels and venture capital investors.

- With almost a decade of global experience in all four forms of crowdfunding (perks, pre-order, debt, and equity) to draw upon, Chile can learn from crowdfunding successes and failures to develop policy and create a regulatory framework that is unique to its circumstances, and more likely to succeed.

- When comparing Chile to other economies that have robust crowdfunding ecosystems in place, Chile has 86 percent of all the variables (in social, cultural, technological, and regulatory terms) necessary for crowdfunding to succeed.

- Chile's biggest challenges to succeeding with crowdfunding include a lack of risk tolerance in investing, a lack of trust between individuals, and the lack of an active early-stage investment mindset. Crowdfunding provides capital in a more transparent, time-efficient, and direct way than has ever been available before. It may address some of these issues by allowing Chileans to explore investing in SMEs in a limited, regulated, lower-risk way.

- The Chilean government, through co-investment programs sponsored by Corfo and government-backed lending programs via the banks, has created a strong foundation for crowdfunding to be included in alternative financing mechanisms. These stakeholders can be champions for crowdfunding in Chile.

- Like many other countries, Chile has an SME funding void that government programs, banks, angels, and venture capital have been unable to fill. Crowdfunding is showing promise in filling this void.

- Chilean finance and technology pioneers are already exploring securities crowdfunding, even though its legality has been questioned. These platforms are highly motivated to create a transparent, efficient, and collaborative industry that works with the Chilean government to support the creation of a regulatory approach to foster a successful crowdfunding marketplace.

- Thus, crowdfunding policy for Chile should address issues that currently inhibit early-stage funding and craft a regulated framework that seeks to provide investor protection, capital for SMEs, and transparency for regulators, in order to foster the proliferation of crowdfunding platforms.

- Finally, a Chilean crowdfunding association should be incorporated to both serve as a self-regulatory body to provide oversight to the industry and act as the unified voice of the industry. Further, as a Latin American Crowdfunding Association is formed, the Chilean Association should play an active role in it.

Implementing a crowdfunding policy will not only provide a regulatory framework under which all forms of crowdfunding may operate, but also offers the opportunity for Chile to address issues like financial inclusion, enabling a greater proportion of the population to create wealth via investments and entrepreneurship.

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INTRODUCTION

The Crowdfunding Revolution

In less than a decade, crowdfunding has made significant impacts on capital formation and job creation in a number of countries. It is best described as an online form of fundraising for either existing or promising new businesses from a diverse group of small and large contributors, investors, or lenders. It combines the connectivity of Internet technology, the transparency of the digital footprint, the efficiency of real-time data, and the multifaceted interests of the crowd to direct capital to those that need it most. It gained traction during the global financial crisis in 2008-12, and in 2014 was expected to be a US$ 10 billion industry.

Until now, it has been most successful in the United States, the United Kingdom, and Australia, but there may be an even greater opportunity for countries like Chile that have demonstrated the ability to take innovative steps to quickly build an entrepreneurial ecosystem. With its relatively low costs but very sophisticated work force as well as other pricing differentials, Chile offers the opportunity for international investors to invest and leverage. The benefits of such an opportunity extend not only from initial funding of startups, but also in fostering continued competitive operations with the potential to export goods, services, and ideas. Crowdfunding is merely the next step in Chile's disciplined approach to building infrastructure, industries, and entrepreneurial and investor capacity.

The growth of social networks has proven to both engage communities and enable them to share ideas and opinions at a moment's notice. In the late 2000s, crowdfunding platforms like Kickstarter realized the potential of layering the social network onto a technology platform for financing great ideas. By March 2015, Kickstarter had funded a cumulative total of over 80,000 entrepreneurs, innovators, and creative individuals with well over US$ 1.5 billion in capital. Crowdfunding platforms have proven that great ideas can attract funding from both inside and outside of traditional, major money centers (for example, Silicon Valley, New York, Boston).

Peer-to-peer (P2P) and peer-to-business (P2B) debt crowdfunding has also seen tremendous growth as banks have both cut back on their small and medium enterprise (SME) lending and increased underwriting requirements for this type of client. Rather than replacing the role that banks play, debt crowdfunding platforms are beginning to work in tandem with traditional lenders while still offering lower interest rates. There are now numerous examples of partnerships that banks and banking associations are forming with P2P and P2B lenders.[1] While crowdfunding was initially met with concern and resistance, it is now being accepted in many countries that wish to benefit from the innovation in capital formation and economic development. The next stage of crowdfunding – equity and forms of debt – is accelerating globally. Chile is well positioned to take advantage

1 Matt Scuffham (2014), "Santander UK to refer small businesses to peer-to-peer lender," Reuters, 18 June, http://uk.reuters.com/article/2014/06/18/uk-britain-lending-santander-peertopeer-idUKKBN0ET1IT20140618; "Prosper Marketplace Announces Partnership With Western Independent Bankers" CrowdfundBeat, http://crowdfundbeat.com/2015/02/23/prosper-marketplace-announces-partnership-with-western-independent-bankers/.

of this growth and develop policy to support a vibrant crowdfunding ecosystem, ensuring it is aligned with Start-Up Chile and other Corporación de Fomento de la Producción de Chile (Corfo) initiatives.

However, it is critical that policy makers understand that enabling legislation should provide regulators with explicit, prescriptive direction regarding the legislative intent of enacting crowdfunding, and create a light-touch regulatory framework on a clear schedule for enactment. Although it may have a different financial system and regulatory framework, the United Kingdom offers a valuable example for Chile of both effective and efficient oversight and transparency. Such an approach to regulation will help to achieve a focused regulatory review process and minimize the administration and costs that have been observed in some other countries, such as the United States.

Chile is Well Positioned for Crowdfunding

The Chilean economy has great potential for entrepreneurial and SME growth. It is poised to develop rapidly through modernizing its regulatory framework and building new best practices for SMEs and startups that are seeking funding. In order to achieve this growth, innovative entrepreneurs, government officials, legislators, and regulators must each play their parts. Following other country examples, leaders in Chile have the ability to seize the opportunity created by current macroeconomic forces and make positive changes in the way Chileans do business.

Chile has witnessed phenomenal growth in recent decades; the World Bank has recently graduated its status to a High Income country based on Gross National Income. This makes Chile, along with Uruguay, the only non-Caribbean countries with this status in the region. Nevertheless, Chile is not immune from global economic forces, and the slowdown in developing economies, whose exports are based on raw materials, has had an impact, particularly on its mining sector. This, however, has also stimulated the number of budding entrepreneurs in Chile.

Unlike their "net generation" counterparts in the United States, the typical entrepreneur in Chile has more experience in the private sector and, according to the GEM research, over 40 percent of Chilean entrepreneurs are women.[2] Understanding this demographic and the unique Chilean culture are important considerations when formulating government policy to further enable Chile's entrepreneurial class. Fortunately, Start-Up Chile has been a leader in attracting global entrepreneurs to come to Chile and work in a supportive environ-

2 http://www.oecd.org/social/income-distribution-database.htm.

ment to start and grow their businesses. Wayra and other accelerators have also contributed significantly to growing a vibrant ecosystem.

Like their North American counterparts, however, new entrepreneurs in Chile face challenges in growing in an established economy that favors conservative investments and traditional industries. All too often, companies that are supported by Start-Up Chile, or other accelerators and incubators, are unable to secure follow-on funding to develop their businesses. This is where crowdfunding can be utilized to connect willing lenders/investors/contributors with business opportunities and to create those opportunities that may deliver attractive rates of return for investors and at interest rates that are potentially favorable to SMEs.

Although Chile ranks above countries such as Belgium and Luxembourg in the World Bank's Doing Business index analyzing business regulations around the world, it ranks less competitively on specific, relevant indicators, such as ease of bankruptcy (an insolvency indicator) and access to credit. Chile's low ranking in access to credit may result from the limited amount of information available to assess the risk of potential borrowers. Chile has developed a credit system for those who perform poorly, but there is a lack of information about those who perform well. Nevertheless, in comparison to much of Latin America, the Chilean financial system is well developed, and overall, access to credit for large organizations does not appear to be a significant problem.

According to the Gini index, a measurement of countries' levels of inequality, Chile has the greatest inequity of any OECD country,[3] which highlights the need to promote financial inclusion. One of the key findings from this study is that Chile should widen access to banking in a systematic and transparent way. In order to do so, Chile should consider how to address the cost of funding for SMEs, particularly for micro and small businesses. For instance, some factoring companies charge high interest rates for providing working capital to SMEs; crowd-based lending could help to lower the overall cost of capital by increasing borrowing options for SMEs. Market forces have concentrated the majority of banking services in four large banks.[4] Chile might address the issue of competition in the SME loan market by enabling crowd-based lenders to expand their current offerings to provide loans to businesses that are currently not accepted by the banks.

Chile continues to be a leader in Latin America in actively fostering an entrepreneurial ecosystem and has enjoyed significant positive media coverage with Start-Up Chile and other related programs. However, according to interviews conducted during this project, Chilean entrepreneurs have yet to experience a "home run" – an entrepreneurial company with a large and successful exit after multicountry expansion. In contrast, although Argentina has a struggling entrepreneurial ecosystem, it has a risk-taking culture and has produced 10 successful entrepreneurs by this definition, according to interviews for this research. Being an entrepreneur is increasingly seen as "cool," and Chile already has several initiatives that are successfully supporting entrepreneurial activities and benefiting the economy. Companies that go through Start-Up Chile's program, for instance, are hiring 1.7 people on average, a positive boost for job creation. If these companies were able to take the next step in their development, they could have an even greater impact on employment.

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3 Global Entrepreneurship Monitor (2014), 2014 Global Report, http://www.gemconsortium.org/docs/download/3616.

4 Bernardita Piedrabuena (2013), Competencia en el mercado bancario del crédito en Chile, Inter-American Development Bank, http://www.iadb.org/wmsfiles/products/publications/documents/38176877.pdf.

While all traditional forms of financing (business angel, venture capital, private equity, bank, public grants, and so on) currently exist in Chile, recent attention has focused on funding early stage development. The government and Corfo have been critically important in seeding many new companies. Additionally, the Chilean Securities Regulator (SVS) has created specific regulation for SMEs to facilitate capital formation, although utilization so far has been low.

A common theme that emerged in several interviews conducted for this study was that, while the availability of early or seed stage capital is strong, it is much more difficult to secure follow-on financing in the US$ 150,000-800,000 range. This is the "Valley of Death" for Chilean startups. Securities-based crowdfunding may provide tools to address this challenge, as well as to tackle the issue of providing funding for traditional SMEs while supporting financial inclusion.

As in other OECD countries, advances in technology and the Internet have become commonplace in the lives of Chileans. The sharing economy is growing and proving that trust can be developed online, which is further leading to public confidence in online markets. Examples of this can be seen with companies such as Leve, which can be thought of as the Uber for Santiago, and Arrentas, the Zipcar equivalent, as well as coworking spaces that are popular and growing. However, compared to its OECD counterparts, the high-tech industry is underrepresented in Chile, which offers a great opportunity for crowdfunding to help change that.

By studying how the crowd is interacting online, one can begin to understand how novel forms of online capital formation can be applied to startup and SME growth. Examples from across the world demonstrate the effectiveness and sustainability of this bottom-up and peer-to-peer approach: it leverages social networks, digital technologies, and crowdfunding ecosystems to spur economic activity and democratize access to capital.

The results of this study indicate that there is a significant opportunity for innovative government policy and regulation and collaboration with private industry to foster the growth of the SME and entrepreneurship sectors through novel but proven financial vehicles while providing robust investor protection. In adopting an enlightened crowdfunding strategy, Chile can further demonstrate its leadership in driving SMEs and entrepreneurship, as well as creating valuable new jobs.

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BENEFITS AND TYPES OF CROWDFUNDING

Crowdfunding has emerged globally over the past seven years, with major platforms, such as Indiegogo and Kickstarter (which launched in 2008 and 2009, respectively), raising billions of dollars for hundreds of thousands of entrepreneurs. As a model of fundraising, it has evolved quickly from an unregulated form of donating or sponsoring projects popular with artists and basement entrepreneurs to include regulated securities transactions for firms seeking growth capital.

Benefits of Crowdfunding

Crowdfunding has demonstrated a number of benefits that include:

Increased access to capital: Crowdfunding can increase the supply of capital sources to underserved markets or segments.

Efficiency: Crowdfunding can provide new and faster access to investment opportunities for traditional investors in either a closed environment (an angel group) or an open environment (public crowdfunding). Crowdfunding can deliver capital to companies in days or weeks rather than months or years. Virtually all P2B lending campaigns close in less than 21 days and equity campaigns close in less than 90 days. While these investments are often smaller than what traditional investors supply, in both cases it is a much faster process than is typical with investment from traditional sources.

Investor/entrepreneur transparency: "Crowd-vetting" and "crowd-diligence" can assure the legitimacy of companies and entrepreneurs as they seek to raise follow-on capital. Transparency and accountability are greatly increased with crowdfunding. All users of these platforms must begin by entering their Chilean national ID number. The ability for all these transactions to take place online, with the terms of the offerings in a database, provides great knowledge and oversight opportunities for the platforms, the industry at large, and for regulators.

Transparency for the regulator: One of the most significant beneficiaries of crowdfunding is the regulator, because for the first time, regulators can have timely, periodic (for instance, quarterly) and unfettered access to data on activities in private capital markets. This increased transparency and timeliness may provide opportunities to improve regulatory oversight. Also, by creating regulation that is "data intensive and prescriptively light," regulators can create rules that are less burdensome to industry, while still providing robust investor protection through the use of near real-time data feeds from debt and equity crowdfunding platforms.

Crowdfunding is a significant, evolutionary step in moving the ancient practice of lending and investing online. Crowdfunding can create new capacity in the existing financial system, allowing for lower cost of credit and better access to financial services for those who might previously have been unbankable.

However, the benefits of crowdfunding go beyond financial efficiency and transparency. These additional benefits include:

Increased visibility and credibility among investing audiences: By centralizing access to data on available investment opportunities, crowdfunding facilitates the flow of information to potential investors more rapidly than has ever been possible before. Traditional models require companies to hold dozens or hundreds of meetings to seek capital, which is both labor and capital intensive, and highly inefficient. Crowdfunding portals allow potential investors to investigate numerous offerings online at one time and to quickly determine if the investment opportunity fits their portfolio strategy, risk appetite, or interests. More importantly, in the United States, investors now monitor donation-based crowdfunding platforms to identify innovative companies and products. A new class of analyst[5] is emerging to dissect crowdfund investment opportunities to provide better analytics to help investors decide if a business is worthy of funding. All of this leads to transparency, visibility, and credibility in the industry.

Market testing and demand measurement: Crowdfunding typically allows firms to validate their products or services without the expense of manufacturing, product launch, or starting operations. If funding goals are met, these firms have access to the capital needed to launch their initial product. From an investor's perspective, this de-risks the investment to a certain extent, since the market has already demonstrated demand for the product. Some large US-based angel groups, such as Heartland Angels (Chicago) and Global Angel Investors Network (Georgia), are creating their own crowdfunding portals with the expectation that firms seeking capital must prove market acceptance through a successful crowdfunding campaign. If successful, these angel investors will then supply additional funds.

Access to early-stage support networks: By offering a crowdfunding campaign, companies engage a highly motivated group of customers that act both as product evangelists and as a rich and detailed feedback source. By expanding into crowdfunding, companies also accrue an early-stage support network of investors with a vested interest in their success, and may have skills that entrepreneurs can benefit from in addition to the capital. Anecdotal data suggest that these early investors will make introductions for the firms, working in many ways as advisors and product evangelists – activities that will substantially help support the firms through the challenges of early growth.

Markets and partnerships: Entrepreneurs will also receive early feedback on the viability of their intended markets and marketing. The extensive feedback from customers and investors can lead to a revision of their planned business model, allowing firms to change their focus to new markets as necessary, or to seek out strategic partnerships with new suppliers or vendors. The open exchange of information about product ideas, business concepts, and intended markets dramatically increases market efficiencies.

5 For instance, Crowdnetic aggregates, analyzes, and reports data and trends via Thomson Reuters and CNBC (http://www.crowdnetic.com).

Research has also highlighted several other advantages of crowdfunding. For instance, it has the potential to connect diaspora communities to engage in more than remittance payments to help support dynamic, high-impact entrepreneurs and companies. Because of increased visibility and networking, crowdfunding offers startups access to skilled individuals for employment, and allows larger businesses to identify early stage innovation for investment or deal flow.

Types of Crowdfunding

Today, there are several crowdfunding models that allow different levels of financial engagement and collaboration with and from businesses and both nonprofit and for-profit projects. These include donation and rewards crowdfunding, "pre-sale" crowdfunding models, and debt and equity crowdfund investing.

Donation and Rewards Crowdfunding

Donation crowdfunding is the oldest and easiest form of crowdfunding to understand. In many ways it is identical to the donation drives that charities and nonprofits have long used to raise funds using special events like charity marathons and telethons. However, with the rise of the Internet and social networks, this process of fundraising is moving from offline office pools and telethons to online funding platforms. In a typical donation crowdfunding effort, an individual or group solicits donations for a project that a person wants to launch, such as a creative endeavor, a community project, or a new product. Donation crowdfunding could be used by schools seeking to purchase supplies, friends seeking to raise funds for an injured family member, or even nonprofits seeking to host a regional peace conference in the Middle East among Christian, Jewish, and Muslim college students. In donation crowdfunding, the crowd donates money to support a project with no expectation of a financial return.

Donation crowdfunding has quickly evolved to a rewards crowdfunding model in which project backers or donors receive rewards or incentives tied to their level of contribution. Some of these rewards are tangible objects – a T-shirt, an item of merchandise, a signed copy of a script for a play, and so on. Some of the rewards allow and encourage the donor to participate in the production, attend a rehearsal, or receive a credit or citation. Gamification and game mechanics are usually an important part of rewards crowdfunding: making a reward "scarce" increases the desire for backers to grab that reward before it is gone. However, the goal with this type of crowdfunding is to both reward donors for their participation and encourage their involvement in the project. There is a moral obligation to provide the promised reward, but no contractual obligations are created.

Rewards crowdfunding is highly flexible and allows the campaign originator to create a series of rewards that appeal to different donor demographics and income levels. Since campaigns are organic, the sponsor can add new rewards, change messaging, or change a video during the campaign, practices that are usually illegal in equity transactions, as explained below. By creating unique rewards, an organization can align the rewards with its mission and create unique products or experiences to appeal to targeted donor groups while reinforcing its brand messaging. Donation and rewards crowdfunding also avoid the steep compliance costs and legal risks associated with equity-based crowdfunding. Because it is mainly unregulated globally, this form of crowdfunding is also the easiest to promote in terms of social inclusivity, in that it allows anyone to pitch an idea or pre-sell a product to their community and raise funds without unnecessarily creating legal or compliance issues.

"Pre-Sale" Crowdfunding Models

A variation of rewards crowdfunding is a model in which an organization or entrepreneur offers a product for sale before its manufacture through a pre-sale crowdfunding campaign. The entrepreneur tests the market – "If I build it, will you buy it?" – without committing the upfront marketing, production, and distribution costs required to fully commercialize a new product. Some of the most successful pre-sale projects used campaigns to solicit not only capital but also feedback from contributors, which was incorporated into the product design and marketing. Some recent campaigns, like the Pebble Time smartwatch, raised millions of dollars, essentially funding the process of taking a prototype into production.[6] Entrepreneurs that run successful pre-sale campaigns gain a stronger hand while negotiating with investors, while investors can lower their risks by making investments in products that have been validated by customers.

Debt and Equity Crowdfund Investing

Debt and equity crowdfund investing are distinct from donation/rewards/pre-sale models in that entities are legally allowed to issue shares, bonds, or debt instruments, while participants have the opportunity to profit from their investments rather than simply provide financial support for the project, organization, or firm seeking funding.

Debt/Mini-bond Crowdfunding

Where do small manufacturers or entrepreneurs turn for debt finance after they have exhausted microenterprise lending facilities? In most cases, banks and other institutions will not lend to a microenterprise (if at all) until they have a multi-year track record of positive earnings – in other words, after the need for growth capital is over. Even for traditional, successful SMEs finding access to working capital or expansion capital is a significant challenge. Debt crowdfunding is emerging as a mechanism for small enterprises to receive debt capital for growth, inventory, or cash reserves and could evolve as an important part of the funding cycle for innovation in emerging markets.

6 https://www.kickstarter.com/projects/597507018/pebble-e-paper-watch-for-iphone-and-android.

In debt-based crowdfunding, individuals loan money to either other individuals (P2P) or to small businesses (P2B). The debt platforms screen the applicants, underwrite the loans, assign interest rates (usually based on an auction bidding of interest rates between willing lenders), and then create an auction market where investors are able to see available loans and supply parts of the total loan amount to the projects or businesses. P2P platforms fund everything from debt consolidation, to home improvement, to leases, to real estate, and even college tuition.

These platforms are growing rapidly across the world and have achieved billions of dollars in transactions. For example, in 2013 LendingClub originated over US$ 1 billion in unsecured loans from consumers. Normally, unsecured loans come at a higher default rate, but at the 2014 Lendit Conference in San Francisco it was shown that the default rates on these loans were no greater than traditional loans and they have a higher yield. The successful initial public offerings (IPOs) of LendingClub and OnDeck further demonstrate the acceptance of these financing platforms.

Companies and individuals that use debt-based crowdfunding report that the screening and underwriting process is faster than traditional loan underwriting. This may be particularly beneficial to firms that otherwise would have to turn to expensive receivables discounting for the fastest approval when seeking capital. In countries like Chile, where many SMEs need to finance their working capital on credit in order to stay in business and a late payment is a reason for bankruptcy, this could be the difference between life and death.

In the USA, credit information is used to produce FICO credit scoring, which is used for evaluation and risk assessment when providing unsecured loans.[7] This assures that good borrowers get funded, and ensures the quality of the assets that are in turn bundled and sold as securities to institutional investors as low-risk securities. New online platforms are leveraging all available information on potential borrowers in order to assess their creditworthiness.

Large institutional groups also participate in these markets by purchasing loan portfolios or by taking portions of a large number of loans (the structure of each arrangement is negotiated between the financial institution, professional advisors, and investors). One of the biggest challenges in the debt crowdfunding market is that the demand for loans now exceeds the supply of investors. There is optimism that this will be resolved as the market evolves and matures and as investor awareness of debt-based crowdfunding grows and institutional involvement also increases.

Debt crowdfunding will appeal mainly to businesses that have customers and cash flow. It may also benefit retail businesses seeking short-term loans. The benefit of seeking this type of capital via crowdfunding may be lower yields and greater customer engagement ("I'm doing my part to help my community business"). Platforms in the space are focused on underwriting because they understand this market is growing rapidly, but if the underwriting is poor, the quality and yields will suffer. According to Charles Moldow of Foundation Capital, this could become a US$ 1 trillion global market within 10

7 http://www.fico.com/en/.

years,[8] an enormous figure that would still only represent 1 percent of the US$ 100 trillion global debt market.[9]

In Chile, it may be preferable to create a product that acts like debt but is actually structured more like a bond. This could resolve the issue faced by other countries in which debt crowdfunding platforms hold funds or make loans that fall within banking regulations that prohibit any company, other than a bank, to have custody of client funds. This is discussed in greater detail later in this report.

Equity Crowdfunding

With the collapse of global markets in 2008 and the tightening of bank lending and early stage finance, crowdfund investing has emerged as a robust alternative to other forms of traditional finance for start-ups and SMEs. This model involves the sale of a securities instrument (stock) in a company through a regulated, online platform. Whether financing an individual company, or financing a larger mediating organization, crowdfund investing can raise millions of dollars rapidly from a distributed base of investors. Unlike donation or rewards crowdfunding, the purchaser of the security will expect some kind of financial gain from the transaction.

As a result of the significant funds flowing into campaigns with great ideas, and the success of rewards and pre-sale crowdfunding, entrepreneurs and governments alike are recognizing the potential for finding investors through their networks of relationships to raise capital and align long-term interests by selling equity in a venture. For early stage ventures, equity crowdfunding is the equivalent of moving the "friends and family" round of financing online and including not just friends and family, but also "followers and fans." It can also be a substitute or complement to angel investing.

As an alternative, some groups prefer to give away equity or take out loans rather than dilute ownership by taking on investors. It can be a complement to angel investing when the angel investors require the company to demonstrate market acceptance by showing success in crowdfunding. Angel networks, venture capital (VC) firms, private equity firms, and hedge funds are all experimenting with crowdfunding. Some angel networks, like AngelList, have created their own platforms – which blurs the boundaries between these forms of early investing. For entrepreneurs and small enterprises, crowdfunding platforms lower the barriers required for them to offer equity shares in their companies, thereby enhancing their access to capital. Bringing the process of raising funds online increases the pool of investors, encourages the use of common platforms and standardized disclosures, speeds the funding lifecycle, and creates shared repositories of information that can be accessed at any time by investors or entrepreneurs.

Equity-based crowdfunding also has an important role to play in supporting entrepreneurship and employment creation in developing countries. Data collected by Crowdfund Capital Advisors show that crowdfunding by microenterprises leads to rapid increases in revenue and creates employment, on

8 http://www.lendit.co/assets/presentations/Charles-Moldow-Foundation-Capital-LendIt-2014.pdf.

9 http://www.bloomberg.com/news/articles/2014-03-09/global-debt-exceeds-100-trillion-as-governments-binge-bis-says.

average by 2.2 new employees the year following a successful campaign.[10] Early data also show that women and men are equally effective at meeting their goals on crowdfunding projects.[11] This suggests that crowdfunding by and for women can be a key mechanism for channeling funds to women-run/owned enterprises, especially in areas of the world where women may be locked out of capital markets because of traditional business practices.

Organizations that foster entrepreneurship or focus on economic opportunity should be aware that these new models may attract investors from outside their country or region, offering a chance to recruit those investors to promote the opportunity and help recruit further new investors. Such social financing was either not possible or even illegal until recent regulatory changes opened the door to equity-based crowdfunding in many countries around the world.

10 Crowdfund Capital Advisors (2014), How Does Crowdfunding Impact Job Creation, Company Revenue & Professional Investor Interest, http://crowdfundcapitaladvisors.com/news/press-releases/174-crowdfund-signals.html.

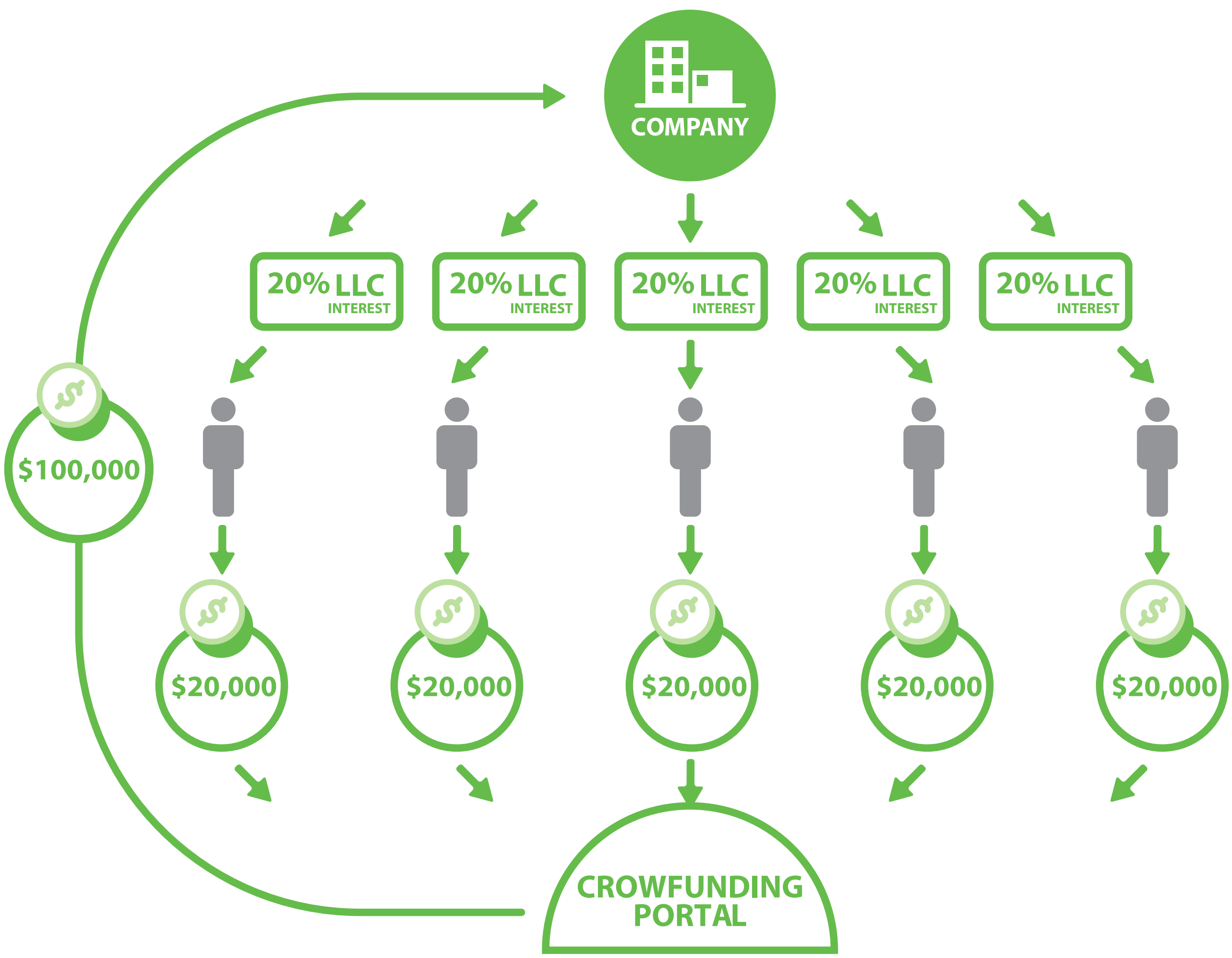
11 Dan Marom, Alicia Robb and Orly Sade (2013), "Gender Dynamics in Crowdfunding: Evidence on Entrepreneurs, Investors, and Deals from Kickstarter," paper presented at Berkeley Academic Symposium on Crowdfunding Research, October 16.

The Flow of Capital in Equity and Debt Crowdfunding

The ways in which capital flows in equity and debt crowdfinancing models vary somewhat and are illustrated below:

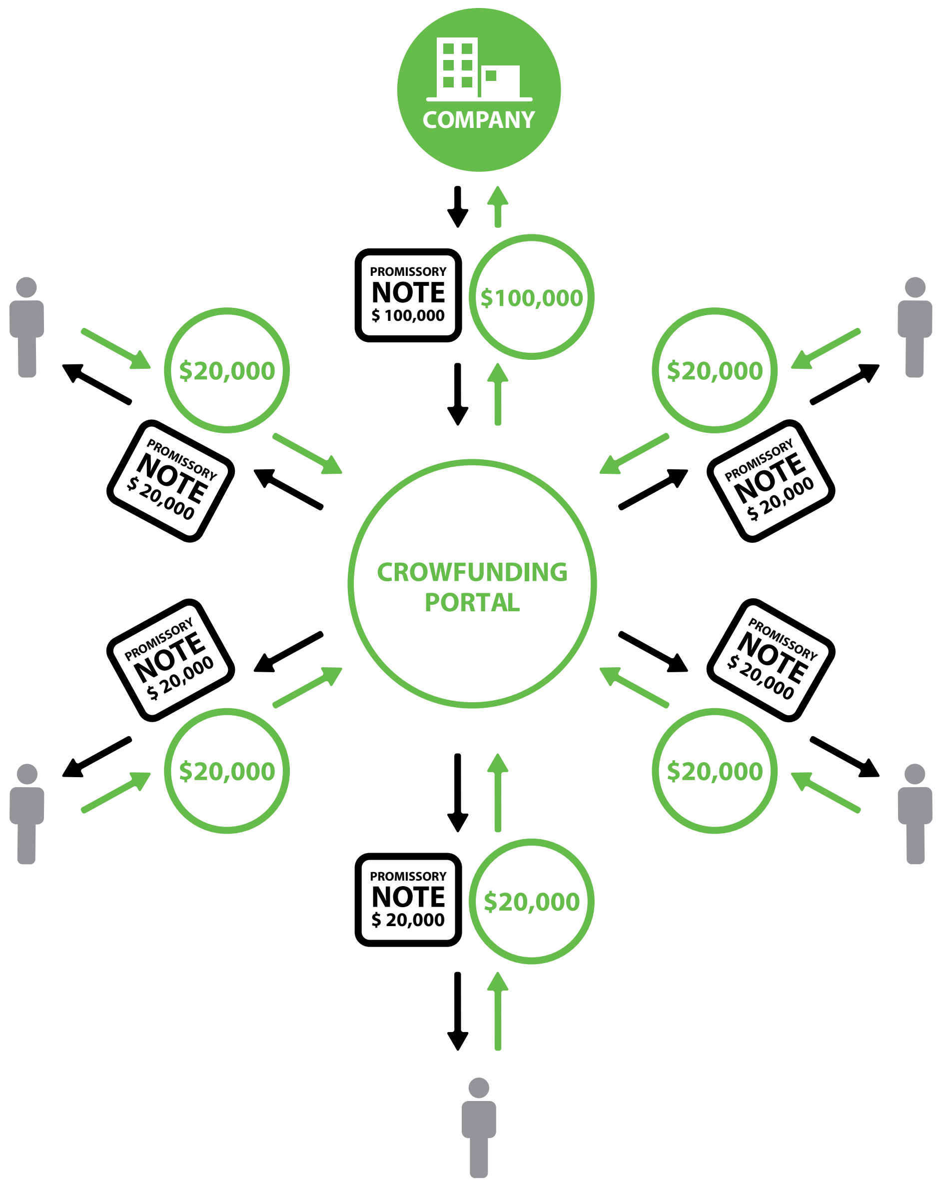
Equity scenario

A company lists its offering (the amount it is seeking to raise and the percentage of equity offered) on a registered crowdfunding portal after it meets all requirements (issuer verification and background check, document diligence check, use of proceeds, and so on). The crowd makes varying financial commitments to invest (notice sent to crowdfunding portal) and money is transferred to an escrow agent. When 100 percent of the funding target is reached, money is transferred from the escrow agent to the company. The company issues shares to investors for their portions of the equity purchased. Upon exit, shareholders receive their equity percentage of the value of the company.



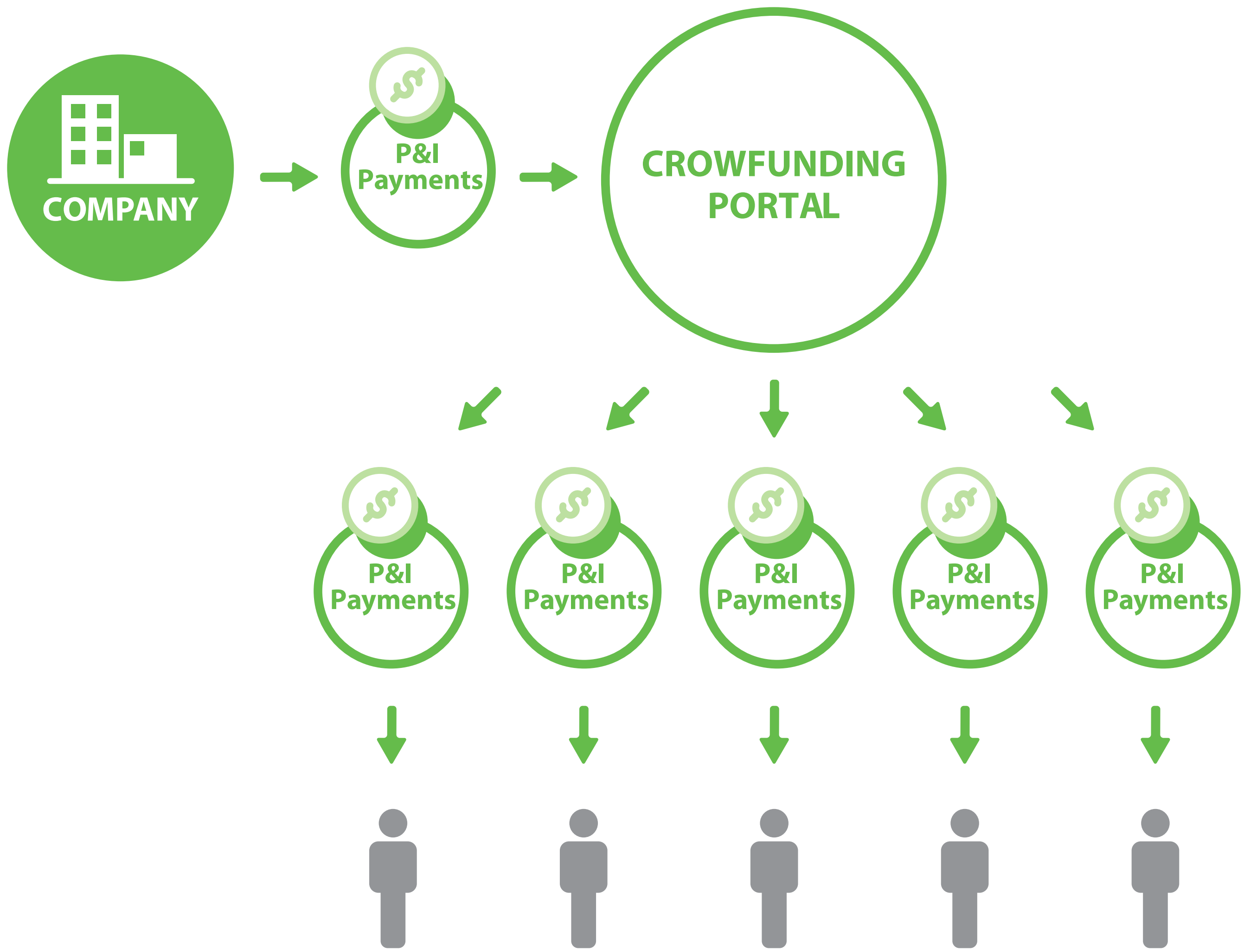
Debt/bond scenario

A company lists its offering, the amount it is seeking to raise, and the interest rate offered on a registered crowdfunding portal. After it meets all requirements, issuer verification and background check, document diligence check, use of proceeds, and so on, the crowd makes varying financial commitments to invest (notice sent to crowdfunding portal) and money is transferred to an escrow agent. When 100 percent of the funding target is reached, money is transferred from the escrow agent to the company. The company issues notes to investors for their portions of the loan serviced.



Debt/bond repayment scenario

A company makes regular principal and interest payments to the escrow agent. When funds are received the portal receives notice. The portal instructs the escrow agent to distribute the principal and interest payments to loan providers.



Where Crowdfunding Fits in the Capital Stack

Crowdfunding addresses a significant gap in the private capital markets in Chile today. While Chile has some of the most innovative programs for providing access to capital in Latin America, for many businesses it remains a significant challenge to raise capital to start or grow. For government programs, it may occasionally be challenging, despite their best efforts, to deliver capital to SMEs. Structurally, another issue is that some SMEs and startups cannot meet the underwriting criteria of large financial institutions. Even if they are able to, these national or regional financial institutions often have difficulty, despite their best efforts, to deliver capital efficiently to individual businesses. This is not a performance challenge on the part of institutions but, in most cases is a scale challenge, in that distributing or investing hundreds of millions of dollars in US$ 100,000-sized investments presents significant logistical obstacles. In the Chilean context, these loans or investments are usually smaller. According to Corfo's FOGAIN Credit Guarantee data from the Chilean Ministry of Economy, the average loan amount under this facility is ~US$ 31,000 per company. This is for firms with revenues as high as UF 100,000.[12] Internet and mobile technology can now address this need in a more efficient and effective way. Crowdfunding addresses the funding gap between "friends and family finance" and "professional investors," or more often, between "friends and family finance" and nothing. This funding gap need can be seen in the following graphic.

12 The Unidad de Fomento (UF) is a financial unit of account used in Chile. It adjusts according to inflation.

Hybridization of Funding Vehicles

In the past, in many cases a strict distinction was applied to different types of investors (angels, venture capital, private equity, and so on). As crowdfunding becomes common practice globally, it is becoming apparent that the Internet and crowdfunding are creating innovative new ways for different investor types to collaborate and invest more efficiently. This is creating hybrid forms of finance. Examples include:

- Equity crowdfunding provides a way for prospective angel investors to invest in private companies with lower amounts than in a typical angel group. This can provide a place to experiment and learn about private company investments and stimulate more interest in angel investing.

- Angel groups are sending some of the firms they are considering for investment to crowdfunding platforms to demonstrate product-market fit, and/or the ability to raise some friends and family capital.

- Angel groups are now using crowdfunding platform technology privately to streamline diligence, document processing, entrepreneur presentations, deal rooms, check processing, and long-term engagement with entrepreneurs. One of the challenges of angel investing generally is the friction in the transaction due to the independent actions of individual angels. By utilizing crowdfunding technology, these groups can continue to operate in a private, secure, and closed environment, while benefiting from technology to reduce transaction friction.[13]

13 http://dealbook.nytimes.com/2014/09/18/crowdfunding-site-seedinvest-strikes-deal-to-widen-its-reach/.

Global Trends in the Adoption of Crowdfunding

United Kingdom

At the time of writing, the most sophisticated crowdfunding ecosystem exists in the United Kingdom. The main reason for this is that, rather than over-regulate the industry at the outset, policymakers and regulators agreed to let the market evolve first. As platforms gained traction and volume, the United Kingdom's crowdfunding industry approached the regulators with a plan to regulate it in a way that was data intensive and prescriptively light touch. This meant that accountability was dependent on the transparency of the offering stored in a digital footprint. With ready access to all the information and data about offerings (both debt and equity), the regulators in the United Kingdom, as well as the market participants (investors and issuers), had the confidence to allow the market to evolve.

As a result, 2014 saw the biggest year for crowdfunding in the United Kingdom, with £37 million donated via donation and perks-based crowdfunding platforms (up 42 percent from 2013), £111 million invested via equity-based crowdfunding platforms (up 300 percent from 2013), and £1.75 billion loaned via debt-based (both peer-to-peer and peer-to-business) crowdfunding platforms (up 78 percent since 2013).[14] Some of the leading platforms in the United Kingdom are Funding Circle (P2B), Lending Club (P2P), and CrowdCube (equity).

United States

While the United Kingdom has the most developed crowdfunding ecosystem, the United States leads the world in both the size and scale of donation and perks-based crowdfunding, with leading platforms Kickstarter and Indiegogo. In 2014, Kickstarter alone had 3.3 million people globally pledge more than half a billion dollars. The funds brought over 22,250 projects to life. In the debt-based space, Prosper and Lending Club made huge strides in the P2P market, lending over US$ 5 billion in unsecured loans,[15] and P2B lending started to gain traction with platforms like Funding Circle USA, Kabbage, and OnDeck.

Equity crowdfunding saw its first real year of activity with the successful launch of accredited investor crowdfunding, otherwise known as 506(c) in October 2013. According to United States Securities and

14 Robert Wardrop, Bryan Zhang, Raghavendra Rau and Mia Gray (2015), Moving Mainstream: The European Alternative Finance Benchmarking Report, http://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2015-uk-alternative-finance-benchmarking-report.pdf.

15 Heather Somerville (2014), "Lending Club Loans Exceed $5 Billion", Silicon Beat, July 8, http://www.siliconbeat.com/2014/07/08/lending-club-loans-exceed-5-billion/; Bob Pisani (2014), "P2P Lending Stocks Offer Rewards and Risks", CNBC, 10 December, http://www.cnbc.com/id/102256563#.

Exchange Commission (SEC) filings, over US$ 378 million was transacted in the first 12 months of accredited investor crowdfunding. Reporting on the results of the first year equity crowdfunding platform, OfferBoard said:

The advent of the 506(c) publically advertised private placement has gradually begun to have several significant effects on the overall private placement market. The number of accredited investors investing in private placements has increased, as has the number of offerings, yet the overall volume of capital raised is mostly unchanged compared to historic averages. The ratio of accredited to unaccredited investors has slightly declined. The use of intermediaries remains in line with historic averages. At this stage, Title II of the JOBS ACT has not significantly disrupted the markets or revolutionized capital raising in the U.S., yet it has increased access for both investors and emerging growth companies.[16]

While equity crowdfunding for unaccredited investors was signed into law by President Obama in 2012, the SEC has been slow to issue the final rules. In the meantime, there has been criticism of the SEC for over-regulation, bureaucracy, and compliance costs built into the existing rules. The full impact of SME use of crowdfunding to seek capital from anyone (subject to income or net worth rules) has yet to be felt.

Brief Overview of Crowdfunding in Selected Countries

Italy

After the United States, Italy was the next country to go live with equity crowdfunding, but its framework is heavily regulated and narrow in its applicability; for instance, only technology companies qualify for crowdfunding, companies must be of a certain age, there must be a PhD on the management team, as well as other requirements. As a result, crowdfunding has yet to take off and, so far, only one company has raised money under the current exemption. At the end of 2014, the government reexamined and relaxed some of these restrictions, but not enough to ignite investors and entrepreneurs to the use of this new financial tool.

Malaysia

In late 2015, Malaysia will be the first country in Asia and the first developing economy to go live with equity crowdfunding. Regulators used a systematic approach to engage all stakeholders while crafting its policy and holding events with global experts to share best practices and lessons learned. Malaysia did not restrict the types of businesses that could leverage crowdfunding and has been careful not to overburden successful companies with compliance costs.

16 http://www.offerboard.com/whitepaper.asp.

Mexico

Mexico is an example of a Latin American country that has conducted research on crowdfunding, and is now beginning to turn to the question of regulation and education with the assistance of Anahuac University, the Inter-American Development Bank, and Crowdfund Capital Advisors. It is embarking on a two-year program to incubate, educate, evolve, and scale crowdfunding in Mexico.

Israel

While unaccredited crowdfunding is still in a regulatory creation cycle in Israel, accredited crowdfunding has already taken off. OurCrowd, the leading equity crowdfunding platform in Israel, has taken a hybrid approach to crowdfunding. Its model is very much like a venture capital firm: it performs due diligence, and lead invests in deals. However, it syndicates these deals out to diaspora investors via its crowdfunding platform. It has had much success, and has raised the most of any equity crowdfunding platform globally (US$ 100 million) for their portfolio companies. It has formed strategic partnerships with Fortune 500 companies, such as GE, and has seen the first crowdfund IPO for Rewalk, an exoskeleton company.

New Zealand

New Zealand competes for capital and talent with its neighbor, Australia. While Australia was the first country to lead with equity crowdfunding, progress has stalled, in part because its crowdfunding rules are based on laws that were not written expressly for crowdfunding. One example of where these rules are not adequate is the restriction on the number of investors (currently limited to less than 50). New Zealand learned from the eight years of crowdfunding experience in Australia, added perspective from the crowdfunding frameworks in the United States, adopted the "light-touch" approach from the United Kingdom, and created a systematic approach appropriate for its investors and entrepreneurs. With this experience, New Zealand's regulators created a framework for securities-based crowdfunding that is both light touch in its approach to regulation while ensuring compliance and robust investor protection via technology and disclosure requirements. Since passing in August 2014, one equity and one debt platform have launched in New Zealand, with more in development. In the first 6 months of operation, they have raised a combined total of over US$ 25 million via crowdfunding from a country of just 4.4 million people.

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THE CROWDFUNDING ECOSYSTEM IN CHILE

How Does Chile Compare?

Crowdfund Capital Advisors surveyed individuals from government and development organizations as well as entrepreneurs, investors, and other capital market actors to discover their views on how to approach the implementation of a crowdfund investing framework in Chile.[17] Questions addressed regulatory issues, attitudes towards entrepreneurship and risk taking, social and cultural factors, and the ability to cultivate a broad-based investment community. Having answers to all these questions does not necessarily guarantee success, but it can help to identify issues that need to be addressed in a successful implementation of crowdfunding; for instance, the need for new social or economic structures and practices to support risk taking and entrepreneurship or to promote individual investors.

Comparing Chile to other economies that have robust crowdfunding ecosystems already in place (that is, with crowdfunding platforms processing more than US$ 1 billion per year in transactions), Chile has 86 percent of all the variables necessary for crowdfunding to succeed. This is a very positive finding. In particular, Chile has almost all the technology and regulatory variables necessary to move forward with a crowdfunding framework. The biggest barriers (at 80 percent of the global average) are the cultural variables necessary for crowdfunding to succeed. Since crowdfunding relies on strong social networks and trust, this could mean that even with the right framework in place, adoption of crowdfunding in Chile could be slow. However, capital seems to be in place (84 percent said it is available) to allow this market to evolve should the right policy be enacted.

For crowdfunding to succeed, a strong, socially connected ecosystem is needed, as well as a funding gap. Crowdfunding resides online and leverages the social network. Chile has a high utilization of social networks (8.6/10) and a higher utilization than other economies that have a robust crowdfunding ecosystem (8.3/10). Regarding the funding gap, the survey data show this may exist, as early stage venture funds are not perceived as being active in Chile (3.1/10), signaling that financing for startups (6.9/10) and small businesses (5.0/10) comes from friends and family as opposed to governments and banks.

Chile has growth opportunities in risk tolerance in investing (4.9/10), trust between individuals (3.8/10), and an active early stage investment mentality (3.2/10). This could hinder crowdfunding or, instead, when implemented, crowdfunding could be a catalyst to help improve these variables. Be-

17 CCA surveyed 17 Chilean individuals representing key stakeholder groups that would be impacted in a crowdfunding ecosystem: entrepreneurs, incubators, accelerators, angel investors, venture capital, banking regulators, securities regulators, policymakers, government officials, social media experts and academics. Findings from this survey were compared with a broader set of global data compiled by CCA. Results were tallied as averages (i.e. 17 responses on a scale of 1 to 10; the sum of those responses divided by 17 equals the Chilean average) and compared with the full dataset. A more complete dataset of Chilean respondents would have been preferable but, nevertheless, the results do signal specific findings with a degree of confidence.

cause crowdfunding helps promote entrepreneurship and innovation in an online, transparent setting among strong social networks, if Chile can promote some winning ideas that have the backing of the crowd, create a media story around it, and foster follow-on financing, it is likely that this will increase the amount of risk capital Chileans allocate for crowdfunding, increase trust among players, and encourage more early stage investments.

Engaging Funders and Stakeholders

With an active and growing startup culture, strong Web technology utilization, openness to cultural shifts, and government institutions aligned with creating a supportive legislative environment, Chile can lead Latin America in creating a strong and vibrant crowdfunding ecosystem for itself, and potentially become a hub for crowdfunding innovation in the region. Crowdfunding also offers the opportunity to both accelerate key and emerging sectors of the economy as well as provide traditionally marginalized groups with access to alternative sources of funding. For this to occur, key stakeholders must be engaged and understand how crowdfunding can benefit them.

It is not possible to crowdfund without a crowd, nor can a business grow without capital. Hence it is important to also understand where traditional capital resides in the Chilean ecosystem, the role it has played, the challenges it has had, and the opportunities to integrate it with crowdfunding.

Government Funding and Corfo

The Corporación de Fomento de la Producción de Chile, Corfo, offers the following programs through its Division of Financing and Investment:

- FOGAIN, Investment and Growth credit guarantee scheme,
- Support for Mutual Guarantee Societies,
- Funding for nonbank intermediaries, and
- Credit lines for venture capital fund managers.

The Investment and Growth Credit Guarantee Scheme (FOGAIN) is a guarantee fund managed by Corfo that addresses the gap in availability of collateral required by SMEs. FOGAIN is an open window where registered financial institutions can claim repayment on defaulted short-term and long-term loans for

SMEs. During 2014, there were 68,531 operations of guarantee. Micro and small businesses accounted for over 82 percent of the total of FOGAIN credit guarantee operations.

Mutual Guarantee Societies (IGRs), created in 2009 by law 20,179, are private institutions that help SMEs access finance by addressing the lack of collateral required by financial institutions on loan applications. The role of Mutual Guarantee Societies is to screen and assess the risk of a potential borrower. Upon approval, the societies provide SMEs with certificates that can be pledged as collateral to a financial institution in order to secure a loan application. If the enterprise defaults on its debt, the guarantee can be paid out with resources from the fund, which helps to reduce the default risk perceived by creditors.

As the IGR program has evolved, Corfo has placed a higher importance on counter-guarantees (assets pledged as collateral by SMEs) to reduce the default risk and in order to increase the divisibility and mobility of the collateral that SMEs can pledge. Under the latest credit line (IGR IV), Corfo guarantees the repayment of the certificates issued by IGRs with its own fund, and provides a credit facility line to ensure liquidity.

Support for nonbank intermediaries: Corfo provides credit lines to nonbank financial intermediaries. This program currently provides funding to microfinance institutions and credit unions (Cooperativas de Ahorro y Crédito).If securities-based crowdfunding were to become fully legalized in Chile, it could be imagined that it may be appropriate for Corfo to consider including crowdfunding within this type of facility. This would appear to be aligned with the program's goal to bring competition to the credit market by providing funding to alternative lenders.

Other Government Support Programs for SMEs

Sercotec

Servicio de Cooperación Técnica (Sercotec) is a public service organization, part of the Ministry of Economy, that focuses on supporting microenterprise. It provides microenterprises with grants, support services to bolster their management and internal capacities, and training in different matters such as marketing and management. Sercotec supports the development of microenterprises with little or no traction in more traditional industries and relatively small scale. Two other programs it offers include:

- Entrepreneurship seed capital (e.g. grants of up to CLP 3.5 million) for entrepreneurs with business ideas. This facility requires 20 percent co-financing from the entrepreneur, but does not require a successful "track record" from the entrepreneur).[18]
- "Abeja," another innovative program that provides seed capital to entrepreneurial women looking to implement business plans.

18 http://4w.sercotec.cl/Productos/CapitalSemilla_Regi%C3%B3nMetropolitana.aspx

In addition, Sercotec is responsible for implementing the recently created Centros de Desarrollo de Negocios, whose design is modeled on the successful experience of the Small Business Development Centers in the United States. Some of the businesses this program supports might choose to utilize reward/presale based crowdfunding (small-scale projects or products), or even get funds from P2B platforms as part of their fundraising strategy.

As part of an integrated crowdfunding strategy, Sercotec may also choose to offer its clients online training on presale and reward-based crowdfunding. They might also provide follow-on funding to businesses that successfully run crowdfunding campaigns on recognized platforms (for instance, Dale Impulso). This would enable those businesses that prove traction with clients and the crowd to gain additional capital from organizations like Sercotec, which may increase their attractiveness to other professional investors. The amounts that can be raised via Dale Impulso are within the range of support that businesses can receive from Sercotec (~CLP 1 million or higher)

Plan C

In 2011 ProChile, the Chilean export promotion agency, started a pilot program called Plan C,[19] in which businesses were helped to run campaigns on international reward/presale-based crowdfunding platforms, such as Indiegogo and Kickstarter. Under Plan C, ProChile supported entrepreneurs in:

- Selecting the right platforms for their campaigns (for instance, some US-based platforms required a US address or bank account);
- Producing videos to promote their products;
- Designing a marketing strategy; and
- Promoting their products on social networks and through overseas ProChile offices around the world.

ProChile also looked to reduce shipping costs by offering discounts on shipping fees through partnership with cargo air transportation companies.

According to ProChile, of the nine businesses that participated in the pilot program, three ran successful campaigns (one of the entrepreneurs that reached its funding goal on Kickstarter offered products made of Alpaca wool from Northern Chile). ProChile is currently redesigning Plan C, aiming to incorporate it within a larger initiative called "Digital Platforms (Plataformas Digitales)" that will include, along with international reward-based platforms, other networking platforms offered by the SBDC Network of the Americas and Inter-American Development Bank, and e-commerce marketplaces, such as eBay and Alibaba. ProChile is also working in partnership with the Chilean Post Office (Correos de Chile) to facilitate export procedures and reduce the cost for delivering the products under a program called "Exporta Fácil."

19 http://www.prochile.gob.cl/planc/.

Incubators and Accelerators

As previously mentioned, a growing number of individuals are trying their hands at entrepreneurship and many are seeking support from public and private incubators and accelerators around the country. Most of these operate in the same way, by accepting promising business ideas, incubating them, providing limited funding, and helping them graduate beyond the incubation phase.

Incubators and accelerators (public or private) may choose to use crowdfunding in several ways that can help address their challenges, including:

- **Admission to the program:** Entrepreneurs may be required to raise a small amount of money from individuals to demonstrate that they have a community of support behind them, and that they are able to raise some modest seed capital. One of the most important jobs of an entrepreneur is to raise money. Finding out if they can do this from the beginning can be a helpful criterion for admitting them to an incubator or accelerator.

- **Proof of concept funding:** Entrepreneurs are often seeded at incubators or accelerators to assist them in building a proof of concept. These funds could be matched by the crowd, or the crowd could be leveraged to raise funds to help take the proof of concept to market for a test run.

- **Exit from the program/transition between programs:** As is common in many countries, in Chile it has proven difficult for entrepreneurs to jump directly from these supportive environments directly to angel or VC investors. Crowdfunding could provide sustaining funds for companies as they exit accelerators or incubators. It could also be a way for companies to gain the attention of new Corfo facilities or funds targeted at helping entrepreneurs in the transition period.

Start-Up Chile

Start-Up Chile is an example of a state-backed accelerator program (funded by Corfo) designed to spur the development of a startup ecosystem in Chile. Since its launch in 2010, it has seeded about 250 projects per year and graduated over 1,000 startups from its accelerator program, with 45-50 percent of companies still operating. It offers a platform for education and learning that includes US$ 40,000 in equity-free financing if entrepreneurs temporarily move to Santiago. Several vertical sectors have emerged within Start-Up Chile: sensors, Internet of Things, and chemical process innovation with big companies. Start-Up Chile seeks to triple the number of companies involved to 700 per year.

While receiving excellent press and having several of its companies go on to receive millions of dollars in follow-on funding, the program has faced its fair share of challenges. First, building a startup ecosystem takes time. Second, there is a dearth of local investors, resulting in many of its graduates succumbing to a premature death. Third, funds to scale businesses have been hard to find domestically and funding has instead often been found outside of Chile, thereby limiting impact on the Chilean economy.[20]

To deal with the scaling issue, Start-Up Chile has devised a solution by funding startups itself through a follow-on fund called Start-Up Chile SCALE. Through SCALE, Start-Up Chile will offer CLP 60 million (about US $100,000) in new financing to three graduates per batch of 30 upon completion of a three-month program. Just like the accelerator, the SCALE funding is equity free. The money will be given through a cofinanced grant, in which the US $100,000 will account for 70 percent of the total funding and the recipients of the grant must raise the remaining 30 percent themselves.[21]

Crowdfunding could be an effective and efficient way for startups to raise that 30 percent, by providing a scalable mechanism for raising money from customers, partners, friends, and family, as well as more traditional investors from Chile and from other countries. It may also provide an opportunity to expand the program from just the top three startups per batch, depending on the availability of crowdfunding in Chile. Suggested strategies for this are discussed later in this report.

Wayra

Wayra, hosted by Telefonica, is an example of a private seed capital accelerator. Wayra is given US$ 500,000 each year by Telefonica with the goal of identifying and investing US$ 50,000 (in seed capital) in promising startups, scaling them, and distributing new products or services to Telefonica's 300 million customers worldwide. The startups must have a fit with Telefonica (for example, in smartphones, B2B, B2C, Terra Networks Internet portal, and so on). Wayra has the discretion to invest more than US$ 50,000.

Companies that are accepted receive an additional US$ 25,000 in services (office space, mentoring, and so on). Unlike other funds, Wayra's investment in a company is held in escrow and distributed to the company based on reaching quarterly milestones. The investment is in the form of a convertible note that grants Wayra between 7 and 10 percent equity in the company. If a startup does not attract an investment within two years, Wayra is entitled to 10 percent of the business. If it does get outside investment, then Wayra receives its percentage of the current valuation. Valuation is based on growth in sales of real startup or external financing.

Wayra operates in seven countries in Latin America as well as Spain, the United Kingdom, Ireland, the Czech Republic, Germany, and China. In the three years that it has been operating in Chile, Wayra has invested in 26 companies. As the only private accelerator (all the others have money from Corfo), it is not restricted from investing in a company that already has Corfo capital. Accelerators, like Wayra for example, could follow a path similar to OurCrowd in Israel. They could combine crowdfunding with their current investments to allow the crowd to join in deals that are of interest to Wayra. This could help Wayra know if there is market engagement in the companies they are funding.

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20 Christine McGee, "Start-Up Chile Launches Follow-On Fund To Boost Local Growth" TechCrunch, 19 January, http://techcrunch.com/2015/01/19/start-up-chile-launches-follow-on-fund-to-boost-local-growth/.

21 McGee, op cit.

Angel Investors

Angel investors are high-net-worth individuals who allocate a small portion of their net worth to start-ups. They usually come from backgrounds of starting or growing their own businesses, and use not just their capital to help grow a business but their knowledge and experience as well. They usually syndicate deals among themselves to invest in attractive opportunities.

Chile Global Angels, founded in 2009, is the leading angel group in Chile and a leading group in Latin America. There are currently about 35 angels in the network and four institutional partners for which deals are syndicated (one of which is Wayra). In order to become a member one needs to apply, meet minimum financial requirements (annual salary or savings), and be presented to the board for approval. Institutional members pay a US $4,000 annual fee and individuals pay US $1,000. The group has an internal investment policy and is self-governed by a professional team of investors. Over the past few years, the average investment has been US $100,000. Investors decide their investment size, although there is a minimum of US $20,000.

A few of the larger angels are backed by family offices and make investments of US $50,000- 100,000. Currently, Chile Global Angels has a portfolio of 18 companies and a successful exit: Solar Chile, which was purchased by First Solar. It conducts the diligence and then offers attractive deals to members of the group. Given the efforts in driving entrepreneurship in the country, there may be an excess supply of deals for the angels' appetite, some of which may be well served by offering opportunities to a wider audience via crowdfunding. Syndication with the crowd could be constructed in a similar fashion as has been demonstrated on AngelList.

Angel and VC investors around the world increasingly see the benefits of rewards, equity, and debt crowdfunding, and are directing some of their investment targets to utilize one or more forms of crowdfunding as part of their larger funding strategy. It provides a way for these investors to see proof of product/market fit, early traction, and the fact that an entrepreneur has a group of individuals behind them in their quest for success.

A successful crowdfunding campaign can provide positive signaling to follow-on investors like angels. Angel investors typically make high-risk investments in not-yet-proven technology or in entrepreneurs who have track records but lack the resources to develop their business ideas on their own. Angels look for ways to reduce their risks wherever possible and crowdfunding may be a screening and risk mitigation tool for them. Entrepreneurs who can use crowdfunding to demonstrate product/market fit, product pre-sale, and the ability to raise capital from an engaged community (friends, family, fans, customers) offer some proof of execution, which may be an indicator to consider in assessing the riskiness of the investment.

A second and quite different way that angel groups and individual angel investors can utilize crowdfunding technology is for their own deal flow and deal execution. This technology platform can be used privately so that only registered members of the angel group can view and invest in deals. This kind of technology can deliver significant benefits to groups and investors seeking to increase deal flow, reduce deal friction, and speed funding.

An example of how this is being done today in the United States is a partnership between the equity crowdfunding site Seed Invest, a leading US-based crowdfunding platform for early stage technology companies, and Gust, the largest investor network in the world with over 45,000 investors that come from angel groups, networks, and VC groups, and over 200,000 entrepreneurs who have sought funding via this network. Previously Gust had no deal execution capability and needed new technology infrastructure. Through this partnership, it gained both, and Seed Invest became the essential technology backend for this global investor organization. This is still a new partnership (begun in Q4 2014) so results are not yet available. That said, the potential for deals to not only be shared, but executed globally, is highly significant.

Venture Capital

Venture capital (VC) is a form of private equity investment, usually in early stage companies. It has become pivotal in promoting innovation, often carried out by new firms, in science and technology, as well as in promoting innovative business practices and bringing new products to market. In many leading economies, VC has become a major source of funding for new technology-based firms in recent years and thus a major contributor to radical innovation.

Venture capital in Chile started as a collaboration with the government in the 1970s, but did not begin to scale until the late 2000s.

Since then, Chile's government and entrepreneurial community have made great strides in beginning to bring in VC, but there is still significant room for improvement in increasing the number of VC firms, diversifying the pool of limited partners for VC firms, increasing the dollar value available for investment, and introducing more diversity in firms, including firms of different sizes and investment focus.

According to a 2013-2014 report by ACAFI, The Chilean Association of Investment Funds, there are currently about 30 VC funds and 11 private equity funds in Chile.[22] Five of these are substantial players. These five manage on average a portfolio of about US $30 million, and the funds seem to be mainly segmented in life sciences, information technology, and early stage ventures. Because of the size of the Chilean market, many of the limited partners in the funds are invested in the same funds in Chile. While there are benefits to a small community, such as increased trust, Chile requires more venture capitalists in order to lower the systemic risk if one or more prominent VC funds were to have financial difficulties or shift focus. Funds make average investments of US $2 million. Historically, returns come from a few of these venture funds, but the number of investors willing to go in on low- or zero-EBITDA companies is small. In addition, many of these companies cannot receive follow-on investment because they are too small, or fail to reach scale because there is an uncompetitive advantage trending toward investing in larger businesses.

22 http://www.acafi.cl/5_estudios_c_informes.html

This research has indicated a strong need for funding in Chile in the range between US$ 100,000 and US$ 800,000. Experience in the United States and United Kingdom shows that while this range of funding is possible via crowdfunding platforms, it will take time for the market to mature for this level of funding to be possible. While this may be at the upper end of what crowdfunding can achieve in the near term, significant potential lies in creating "hybrid funding models" that may include VC/angel/crowd/Corfo combining in different ways to help create the right mix of investments and structures.

Aurus, Fen and Magma Partners

Aurus, founded in 2008, is a VC fund that has received long-term credit lines from Corfo, under its venture capital programs that promote investment on early stage companies. Recently, Aurus announced it has launched a fund, Aurus Ventures III, focusing on copper related technologies with capital (US$ 50-80 million) from Corfo, the Inter-American Development Bank, CAF, CODELCO (the Chilean state-owned mining company), and Mitsui.[23]

Corfo's program that supports VC funds is based on the Small Business Innovation Research (SBIR) program by Corfo and leverages matching venture capital funds of US$ 3 to every US$ 1 from investors, up to a cap of US$ 9 million. The capital was provided in the form of non-dilutive, non-recourse 10 year loans. Currently they manage two funds of US$ 32 million each, focused on technology and life sciences. They have made 11 technology investments and nine investments in life sciences.

Other VC funds include Fen and Magma Partners. Magma Partners also operates as an accelerator. Since it opened in April 2014, it has funded two companies with US$ 2 million in total. Unlike traditional established VC funds in the United States that have raised additional funds, the older VC funds tend to invest less than the new ones. Unfortunately, this means that their capital, as well as their knowledge and relationships, are not available to help grow promising enterprises.

Private Equity

For the larger, more sophisticated SMEs that need increasingly bigger investments (> US$ 200 million) private equity (PE) is an alternative. In Chile, money is loaned to PE firms and they invest it in SMEs. Disclosure requirements include a business plan and more in-depth diligence. Investment decisions are made by administrators based on their own investment plans, which vary from one firm to another. However, PE funds and administrators are few in Chile and the sector is underdeveloped. Private equity is focused on supporting and helping in the management of the company with large sums of money and expertise. Private equity remains an option for SMEs that have scaled and need the resources of a private equity firm.

23 http://www.corfo.cl/sala-de-prensa/noticias/2015/abril-2015/corfo-y-aurus-lanzan-nuevo-fondo-de-innovacion-en-la-mineria-del-cobre-aurus-ventures-iii

Banks

Banks are by far the largest financiers in Chile and focus a great deal of effort on large companies, that is, those with annual revenue greater than UF 100,000 or US$ 4 million or to a lesser extent those large/medium sized businesses with strong multi-year success records and substantial collateral to use for the loan. While some banks have been working with SMEs over the past decade, it does not make financial sense for many banks because startups do not have sales revenues to qualify for loans, they often need to be backed by an accelerator or VC fund, and the transaction costs are high making it difficult for them to scale down on loan size. In addition, most private banks do not serve innovative projects or enterprises (those with annual sales lower than UF 2,400). Microenterprises are characterized by a high dynamic – the majority that enter the market usually disappear in the short run[24] – and for the most part good quality financial information for risk assessment is lacking. Hence, this segment of firms is perceived as risky and does not seem attractive to many private banks. This market is led in both number of operations and value by the state-owned bank, Banco Estado. A 2014 report shows that Banco Estado is playing a more active role in the acceptance of Corfo credit guarantees schemes because of the slowdown in the lending to SMEs by private banks.[25]

As for small and medium sized firms, Santander and Banco Chile have entered this market to look for profitable clients, but they only represent a small percentage of investment volume and they do not have the capacity to serve the entire market. Many of these institutions require companies to be in business for at least one year (usually much longer) and have sales turnover of at least US$ 100,000 per year, and their underwriting models are based on past cash flows and play a key role in assessing this segment of the market. The default rate for these types of loans average seven percent; however, 70 percent of such loans are backed by government credit guarantee scheme programs. There are examples of large/medium sized businesses being served by these products, however, the demand outstrips the market's ability to fund these loans with current products.

Crowdfunding can provide an opportunity to reduce the cost of credit for SMEs and entrepreneurs. Currently, SMEs face high interest rates on their loans in comparison to large companies. According to the OECD,[26] the spread between large and small companies in Chile is about 8.5 percent; in other OECD economies it is no higher than 3 percent. In addition, SMEs face difficulties in obtaining long-term financing at reasonable rates. Microenterprises pay a high cost for their access to financing (with rates that can reach as high as 30 percent). This is why SMEs and entrepreneurs turn to personal loans, credit cards, or factoring to obtaining short-term financing to fund working capital. According to the Product Exchange, which trades in discounted receivables, the rates of financing for SMEs by factoring firms in Chile might reach a monthly rate of 1.5 percent.

24 More information on this can be found in "la Dinámica Empresarial en Chile 1999-2006" by José Miguel Benavente.

25 Corfo Credit Guarantee Scheme Report of December 2014, http://www.corfo.cl/biblioteca/informes/informe-de-garantias-corfo/2014/diciembre-2014.

26 OECD (2014), Financing for SMEs and Entrepreneurship 2014: an OECD Scoreboard, http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/financing-smes-and-entrepreneurs-2014_fin_sme_ent-2014-en#page1

As a government-owned bank, Banco Estado tends to focus on providing products to a wider variety of businesses, which may also deliver lower margins to the bank. It provides loans to microenterprises that have an annual turnover of up to UF 2,400 (about US$ 100,000). The cost of serving these segments is high (due to diligence and ongoing monitoring costs).Even considering higher potential margins, commercial banks are usually not engaged in this segment of the market. According to Banco Estado, there are 1.5 million microenterprises in Chile, and Banco Estado is the primary bank for this market segment. To calculate loan suitability, banks use cash flow rather than projections and provide loans of up to UF 2,400 per microenterprise.[27] In the case of microenterprises, Banco Estado gives greater weight to the character of the potential borrower to repay the loan. In this market, it is not possible to assess credit risk based on reliable financial information, so the screening and evaluation of the risk are more expensive than for a traditional commercial loan because of the need to visit on site and have a closer relationship with the client.

Banco Estado also lends to small firms with annual sales ranging from UF 2,400-25,000 (about US$ 100,000-1 million), and for medium-sized businesses with a turnover of up to UF 100,000 (about US$ 4 million). The current government administration has imposed loan goals for SMEs and has increased the capital of the bank accordingly (US$ 450 million) in order to make the bank more competitive in the SME segment. Nonetheless, private banks have a larger share of the small and medium-sized commercial loan portfolio.

Another program that helps SMEs secure their loans is the SME Credit Guarantee Scheme Fund (FOGAPE) that is run by Banco Estado and is based on a bidding process in which banks and financial institutions compete for guarantee rights based on the credit risk coverage rate that they demand for their loans. The lower the coverage of the guarantee demanded by the financial institution, the greater the incentive for banks to screen and assess the risk of potential borrowers.

Given the lending caps and limited deals, crowdfunding may present a strategic partnership opportunity for Banco Estado. The bank could form a bi-directional referral network with rewards, and equity and debt-based crowdfunding platforms. For businesses that fall outside of their lending requirements, they could refer deals to the appropriate type of crowdfunding platform so that these microentrepreneurs can raise capital from their communities and customers or pre-sell inventory to address working capital needs. As operations grow, they can return to primary banking relationships as appropriate. The track record of the business with crowdfunding will serve as a reference point for loan repayment with the bank.

A key question is whether established banks and other financial institutions will see crowdfunding as a threat or a business development opportunity. Experience has demonstrated that engaging financial institutions early in the conversation to explain what crowdfunding is, how it operates, and how it can be utilized as a strategic business development opportunity usually creates understanding, lowers potential concerns, and can create partnership opportunities with crowdfunded companies. There are several ways that banks and SMEs can work to partner on crowdfunding:

27 https://www.df.cl/noticias/empresas/innovacion-y-sustentabilidad/cumplo-planea-llevar-plataforma-de-creditos-acolombia-y-peru/2015-02-13/184732.html.

- Banks could add "prior success with crowdfunding" to demonstrate social proof of product/market fit as a benchmark for lending;

- Banks could provide the first tranche of funding but then require that the business pre-sell or gain lenders/investors from its communities; or

- Banks could provide diligence (for a fee) to help vet deals for crowdfunders. This would be a way for banks to support their clients, with no additional capital, while gaining fee-based revenue.

Crowdfunding Platforms in Chile

Donation/Pre-order

Because donations or product pre-orders are mainly unregulated, donation and pre-order crowdfunding platforms have been the first to develop in countries around the world, including in Chile.

Dale Impulso

Dale Impulso is a pre-sale crowdfunding platform launched in October 2014 by BCI Bank as part of its "entrepreneur inclusion" efforts. There has been tremendous interest in its platform and as of April 2015, it has received more than 750 campaign requests. Currently it has 28 projects listed on its site. Since launching in the autumn of 2014, it has received more than US$ 45,000 in pledges for its projects. Six projects have been financed.

Idea.me

Idea.me is one of Latin America's leading donation crowdfunding platforms. It has surpassed US$ 1 million in pledges received and has operations in Mexico, Argentina, and Brazil. As crowdfunding is still new to Latin America, it has a strong education component to teach the basics of crowdfunding and fundraising in general. According to an Idea.me official, it used to have an office in Chile but closed it because of issues with the Chilean legal system, accounting for rewards and the Stamp Tax. So while rewards are unregulated in most of the rest of the world, policy in Chile forced this contender out of the market and may prevent donation-based crowdfunding from really taking hold.

Fondeadora.cl

Fondeadora is a Mexican donation-based platform that launched in Chile in October 2014. It has a focus on music, art and culture, design, mobile apps, open source software, technology, and other personal technologies. One of the features that separates it from other platforms is its relationship with corporations that allows it to test-market products of interest. Since launching it has funded over 34 projects with US$ 201,981 in pledges.

Debt-based Crowdfunding

Within the Chilean context, considerable effort has gone into leveraging debt to promote entrepreneurship by scaling down the requirements for SMEs. One company has ventured into the crowdfunding space and already gained valuable lessons.

Cumplo

Cumplo is a startup founded by Nicolas Shea and Jean Boudeguer, the founder and co-founder of Start-Up Chile, which connects private lenders to individuals and small business borrowers. Cumplo had lent US$ 2,300 through its platform before regulators served it with court papers stating it was violating Chile's banking law, which stipulates that only licensed banks may accept deposits. The firm explained that it believed it was not breaking the rules, since it did not take deposits per se; it only connected borrowers and lenders. The regulator then passed its case to criminal investigators, who have been probing its operations. Cumplo does not hold any funds and merely acts as a platform for those individuals and entities to meet. While the legality of Cumplo's model in Chile is still undecided, the company has served as a proof of concept in many ways. Currently it is focused on making loans to SMEs that are 100 percent backed by government guarantees.

Cumplo is also engaged in factoring activity, allowing investors to invest in credits backed by accounts receivable. Estimates suggest that Cumplo has processed over US$ 55 million in loans over the past three years. In the past 12 months Cumplo has had loan transactions of around US$ 38 million with net internal rate of return (IRR) for investors of 11.5 percent. These loans are at lower interest rates than the banks and do not have the same onerous fees and general conditions.

Cumplo charges average rates of 20.31 percent for consumer loans, 13.82 percent for business invoice loans, and 13.20 percent for business working capital. The result of these lower rates and use of a P2B model is that the default rate for Cumplo is less than one percent for business loans, compared to a default rate of approximately 7 percent in the overall Chilean banking sector, according to one of the interviews for this research. Cumplo has over 1,800 investors and 40,000 users, and averages 13 investors per loan. It has completed over 1400 transactions. In October 2014 alone it completed 87 transactions for a total of US$ 3.5 million in loans. Of that amount, US$ 2.5 million was in short-term loans based on invoices, and US$ 1 million was in government-backed loans for SMEs. All this data signal that they are serving an important role in the market, which might explain why Cumplo was awarded a seed capital grant by Corfo to help support its growth. Cumplo has the goal of increasing by its monthly number of operations sixfold, and plans to expand to Colombia and Peru.[28]

Regulators have an excellent opportunity to create a stable and transparent environment in which innovative financial institutions like Cumplo bring valuable financing options to SMEs. One lesson from Cumplo's experience would be the potential to use escrow agencies to facilitate these lending transactions. As Cumplo argued in its response to regulators, it is not a depository institution because it does not hold any funds. This structure has evidently failed to relieve it of its regulatory burden, and there are several ways in which this has limited its operations.

Becual

Becual was founded in August, 2014 by Herbert Schulz and Mario Ortiz, both former executives of Forex Chile. Becual was conceived as a P2B platform. Default rates for SME lending were better than P2P lending because businesses were less inclined to default on their loans since they frequently required good sources of short-term capital in their ongoing businesses. In discussing his firm's strategy with SMEs, co-founder Herbert Schulz stated:

We realized, first, that SMEs had trouble with financing because they had to pay higher interest on their loans, and, secondly, that there were people who invested their money and received low interest on their savings. So, we set out to find how technology could help solve these problems. That's how we got to crowdfunding.

Becual receives multiple requests from SMEs that need financing, evaluates them, and selects only those of higher quality. Then investors review returns and the conditions of such requests, and if they are interested in investing, finance the credit of these companies. The company pays monthly fees to investors, which include both principal and interest. This results in investors earning more on their investments and businesses ultimately paying less for their loans.

According to Diario Financiero, Becual will be accelerated by Fundacion Chile under the program "Lanzate" that promotes high-growth, innovative businesses with CLP 60 million from the Corfo program "Flexible Allocation Seed Capital" (or Subsidio Semilla de Asignacion Flexible, SAAF-I). Becual has the goal of financing CLP 10 billion in new projects during 2015 and also has plans to expand into to Peru in 2016. Becual reports having 1,000 investors and has provided financing to 18 projects with a total amount of CLP 260 million invested in those companies. Becual also reports having CLP 2.56 billion in pending financing requests from 52 projects currently being screened, as of the writing of the article.

28 https://www.df.cl/noticias/empresas/innovacion-y-sustentabilidad/cumplo-planea-llevar-plataforma-de-creditos-a-colombia-y-peru/2015-02-13/184732.html.

Equity-Based Crowdfunding

Equity crowdfunding is the next step for both Chile and most other countries globally. The challenge is crafting policy that leverages technology to raise funds but gives both regulators and investors confidence in the market through the appropriate management of operational risk, systemic risk, and fraud risk. New tools have already been created to assist all parties in creating an effective and transparent market.

Broota

Broota was founded by José Antonio Berrios and Alejandro Perez in 2013. It was the first equity crowdfunding platform in Chile and South America and aims to be the AngelList for Latin America. The goal of Broota is to strengthen investment in venture capital in Chile to promote entrepreneurship and global competitiveness throughout Latin America. It also provides syndication services via its Brootafolio service. Seed financing for Broota was provided by Start-Up Chile. As of May 2015, there were over 400 filtered projects in its pipeline. However, according to the founder, it has been challenging to find projects that meet investors' investment needs. Since launch it has funded more than six enterprises with over US$ 1,053,346. The minimum investment is US$ 200 with no maximum, and companies may have up to 500 investors. Broota was also awarded seed capital from Corfo.

Other Ecosystem Players

Fundación Chile

Fundación Chile (FC) is an example of a public-private partnership (PPP), founded in 1976 to promote innovation in Chile. Funded by the Chilean Government and BHP Billiton-Minera Escondida, Fundación is a "do tank" (a think tank that focuses on taking action and developing projects) with the stated goal to convert Chile into a pole of innovation and entrepreneurship.[29]

Fundación Chile has four areas of expertise:

- Energy and mining
- Sustainability and food
- Biotechnology, and
- Education and human capital.

29 http://www.fundacionchile.com/about-us-en.

It has created an entrepreneurship platform that consists of an accelerator, angel investors, and corporate relationships. It runs open innovation programs for private industry players like Nokia by taking assets that are being developed and matching them with technical knowledge to grow.

Fundación Chile started acting as a VC firm in 1982 by incubating ideas, matching them with management teams, and spinning them off. In 1982, its average investment was US$ 2.8 million and it has invested over US$ 100 million in 65 companies with an exit rate of over 25 percent These exits included Salmones Anartica, Axonaxis, and SIF, among others.

Today, FC's model has changed to include a startup accelerator where the average investment per company is about US$100,000. There are 26 companies active in the accelerator portfolio. FC's accelerator (and its co-investor, Corfo's SSAF program) just had its first exit, in which Aventones (a carpool service) was acquired by BlaBla Car, a larger ride-sharing service.

Socialab

Socialab is a platform for social innovation. There are significant lessons to be learned from its early struggles. Initially, Socialab took on a greater number of entrepreneurs than it was able to easily mentor through its processes. Interviewees commented that it was important to decide how to measure success at the outset. Ultimately it used qualitative and heuristic measurements such as newspaper coverage and the creation of university courses in an area, rather than focusing on data. This can be problematic because although it appears to be successful, it cannot be sure how to attribute success or failure without the data to support it. However as crowdfunding evolves in Chile, Socialab can be a great partner for increasing awareness.

Future Opportunities

In order for the ecosystem to grow, new services will be required to increase transparency and trust as well as deliver data and information to both investors and entrepreneurs. An example might be for services that enable venture capital firms or angel groups to see information about their portfolio of companies in a standardized way across platforms. Services like this could also provide ratings for entrepreneurs and helps make investing decisions easier.

4

THE FACTORS NECESSARY TO DEVELOPING A CROWDFUNDING ECOSYSTEM

There are four factors necessary for crowdfunding to evolve – cultural, social, technological, and regulatory.

Cultural

Building a startup ecosystem requires a vibrant startup culture built on trust, risk taking, entrepreneurship and collaboration. Crowdfunding needs these same cultural elements in order to succeed.

Trust

Chile has done well in fostering a startup ecosystem with Start-Up Chile. However, according to OECD reports,[30] Chile has the lowest trust of any country in the OECD. Many Chilenos have significant issues trusting other Chilean nationals, as well as formal government and banking institutions. Nevertheless, it is believed that many younger generation Chilenos are not as focused on issues from the region's political history, but rather on emerging economic opportunities and the potential for growth and change.

Despite age differences, in general individuals have low levels of trust in institutions as well as in other individuals. Anecdotal evidence supports this: several interviewees said that they trusted foreigners more than other Chilenos. The importance of trust in a culture to enabling the success of entrepreneurship and crowdfunding cannot be overstated. Both require individuals to believe in other individuals, to do what they say they are going to do and, given their best efforts, to achieve results. For crowdfunding to succeed in Chile, it should focus on those areas where trust has already been established (for instance, Start-Up Chile, incubators, angels/VC), leverage the relationships and deal flow there, and then expand as a credible market evolves. This can help build additional trust in the core of the culture as well. Curating and promoting success stories in different industries and geographies will be important to continue the work already underway in the area.

Attitudes Toward Entrepreneurship

Chilenos are more receptive to the idea of entrepreneurship than are people in many other nations, but they are still concerned about the consequences of failure. While in some countries there is a stigma against starting your own business and a strong preference towards a stable job in a large corporation, in Chile, a quarter of the adult population says it wants to be an entrepreneur. In the collective mythos of Chilean culture, the hero entrepreneur defeats the bureaucratic big business. Based on a number of

30 (Of OECD Countries) Nordic countries have the highest levels of trust and Mexico, Turkey and Chile the lowest, see data at: http://www.oecd-ilibrary.org/sites/soc_glance-2011-en/08/01/index.html;jsessionid=320noedfmq6g2.x-oecd-live-02?itemId=/content/chapter/soc_glance-2011-26-en&_csp_=7d6a863ad60f09c08a8e2c78701e4faf.

conversations with stakeholders, this idea seems to resonate with cultural beliefs about trust. Chilenos include local entrepreneurs in their circles of trust along with their colleagues, friends, and neighbors, while they place large businesses outside their circles of trust, along with banks and government. This is an aspect of Chilean culture that is worthy of additional research to determine the roots of these attitudes and to form recommendations for how to transcend them.

Tolerance of Risk and Failure

Chileans' employment preferences have consistently favored traditional industry and large concentrated banks. Our interviews indicate that Chile has a culture that is disdainful of failure. This also links to the trust issue described above. Investments may be perceived as more risky than they are objectively. Chilenos demand a compelling narrative to invest rather than trusting projections. One interviewee expressed this by saying that he would not invest in a great idea but would invest in a great person. Similar sentiments were expressed by other interviewees, which suggest that storytelling using well-known figures could mitigate low risk tolerance to some degree.

Building Trust Through Consumo Colaborativo

The sharing economy is growing, and with it, trust in startups. Driving through downtown Santiago you will see a multitude of Chilean versions of Zipcar-like car-sharing systems (for example, ViajaConmigo, Carpooling.cl, Yeba.me, and A Dedo). Their colorful livery and logos signal to ordinary Chileans that the stigma of renting and not owning a vehicle is disappearing. Chileans, who have a well-established car culture and are as likely to indulge in conspicuous consumption as their American and Brazilian counterparts, have taken to ridesharing and car-sharing services, as well as other sharing services, with an unexpected gusto. They even have a Spanish term for it – consumo colaborativo, or collaborative consumption, is one of the ways those affected by the economic downturn have been able to cope. But it is more than a coping and cost-saving model. The emergence of these services is a visible sign of Chilean youths' adaptability and readiness to embrace technological and economic innovation, even if cultural stigmas exist.

This fast-paced adoption of consumo colaborativo services is not limited to ride-sharing. In the area of office space this concept is also booming. Co-working spaces' popularity and demand have been growing rapidly. A few years ago these kinds of spaces did not exist, but in the past year 10 new co-working spaces have sprung up.

Social

As discussed earlier, although there have always been entrepreneurs in Chile, the latest crop is more motivated than ever, not just to make money for themselves and their families, but to reduce poverty and modernize Chile's financial and business ecosystem. The rise of social entrepreneurship and the development of benefit companies (a type of for-profit corporate entity that includes positive impact on society and the environment in addition to profit as its legally defined goals) is an important developmental step for Chile. It signals a growing focus on development of technology that can expand financial inclusion. These new entrepreneurs are developing new technologies that can help Chile reach its economic goals. Opportunities may exist for entrepreneurs to partner with financial veterans and vision capital to expand Chile's startup economy.

Technological

Chile has a high degree of Internet penetration, with 89 percent coverage. Social media utilization is high, with about 10 million Chilean Facebook accounts. The country has 7 million Twitter users, a number boosted by its use during the 2010 earthquake, when it was the major source of real-time information along with radio.[31] Most Chileans are comfortable using email and e-commerce sites like Amazon.com, and coupon sites are popular. There is a high degree of mobile penetration and utilization, although there is room for improvement in fully utilizing available resources (for example, there is low use of services like Google Scholar). Interviews and data indicate that where IT solves common and practical problems (e-banking, coupon sites, ratings of services) adoption happens quickly. In some areas there has been double-digit annual growth in usage.

Chile is well positioned to be a technology hub of Latin America. According to Vivek Wadhwa, an entrepreneur-turned-academic, Chile could "morph into the new land of opportunity for immigrants in general and export-centric tech entrepreneurs."[32] Chile has the most advanced telecommunications infrastructure in Latin America. Modern infrastructure and plans to overhaul legacy systems have been improving the country's technological capabilities in other areas. Chile has the highest personal computer

31 Note that about 30 percent of Twitter users have not used their accounts in the past two years and only 20 percent are heavy users.

32 Christine McGee, "Start-Up Chile Launches Follow-On Fund To Boost Local Growth" TechCrunch, 19 January, http://techcrunch.com/2015/01/19/start-up-chile-launches-follow-on-fund-to-boost-local-growth/.

and Internet usage rates in the region. Owing to Chile's early deregulation and the robust development of its telecommunications sector during the 1990s, as well as recent advances in e-government, every Chilean company can use the Internet to pay national insurance contributions for its employees, review current accounts, and apply for bank loans. Businesses can pay taxes and process permits, participate in public auctions, and exchange business information, payments, and technical specifications with customers and suppliers. They can subcontract projects, interact with databases, and take part in electronic marketplaces both in Chile and abroad.

Chile's large-scale and fast adoption of technology is not the result of mere chance but, rather, the result of concentrated government effort. Ten years ago, statistics showed that only 18 percent of SMEs in Chile used administrative software, while most of the remainder used computer terminals merely as word processors, along with some Excel software. Most companies were not using IT efficiently to manage their business. This was corroborated by a 2002 World Bank Report that assessed Chile's technological adoption and its influence on the economy, which stated that, "the main competitive weakness of the Chilean economy is the country's relative lack of ability to innovate and adopt technological change."[33] A report by the Center for Study of the Digital Economy of the Santiago Chamber of Commerce (CCS) from 2004 showed that, although 69 percent of Chilean companies were connected to the Internet, digital technology covered mainly just the fundamentals.[34] Only 25 percent of Chilean companies had their own website; only 11 percent used the web as a platform for sales; and only 16 percent used it to buy online and to connect with suppliers. Chilean government officials responded to this by adopting a policy known as the "Digital Agenda." The stated goal of this policy was to convert Chile into a digital country by 2010.

More recent government data indicate that the Digital Agenda has largely been a success. Internet usage in Chile between 2007 and 2012 grew 63.8 percent, taking the population of Chileans using the Internet to 56.1 percent. This is fifteen percentage points above the average for Latin America.[35] Chile is beginning to be Latin America´s IT industry hub.[36] Many companies from all over the world, from large multinational corporations to SMEs, are choosing Chile as the base to create new development services centers. The key reason for this is the fact that Chile provides the best opportunity to obtain "high quality-competitive prices" for the IT nearshoring industry.[37] The success of the Chilean government's Digital Agenda in improving its regional standing in the adoption of technology is an example of how similar programs may be able to help Chile expand its entrepreneurial and private funding sectors. Coupling this with crowdfunding could not only promote social and financial inclusion in these businesses, but also continue the already positive growth in this sector.

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33 Joaquin Vial and Peter K. Cornelius, eds., (2002), The Latin American Competitiveness Report 2001-2001. New York and Oxford: Oxford University Press.

34 http://knowledge.wharton.upenn.edu/article/information-technology-in-chile-still-awaiting-takeoff/

35 Euromonitor International Ltd. (2013). Passport: Technology, Communications and Media. London: Euromonitor International Ltd.

36 McGee, op cit; 2014 Wine Tech Reception Presented by the Chilean & American Chamber of Commerce.

37 2014 Wine Tech Reception Presented by the Chilean & American Chamber of Commerce.

Regulatory

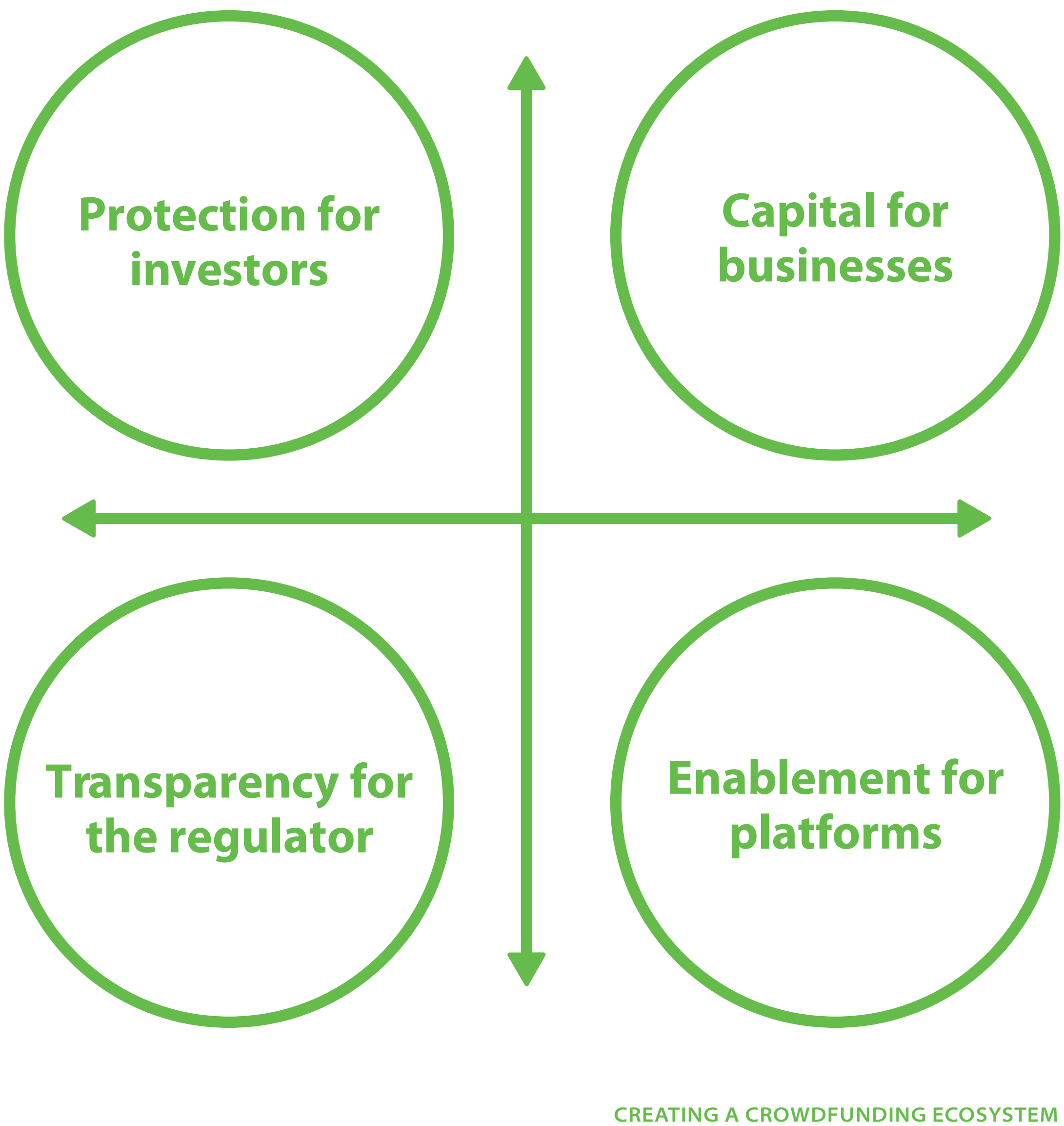
Stable financial and capital markets are necessary for crowdfunding to evolve. Chile has one of the most stable economies in Latin America. This stability has largely resulted from the focus on its core competencies (for example, mining) and large businesses that support those industries. This, however, has created regulatory needs for SMEs. While Chile has worked to improve the regulatory environment for SMEs, particularly over the past decade, it is now more obvious where the missing links are, notably finding capital to scale businesses and promote successful financial exits. It is possible that crowdfunding can help fill gaps in seed and early stage capital, thus allowing retail investors to be able to co-invest with traditional financiers (angels/VC) at the early and mid-stage. In order to meet these significant market needs, regulatory and cultural changes must be made that would allow for crowdfunding to take its place in the private capital markets in an orderly manner. These include:

- Allowing public solicitation for securities on regulated crowdfunding platforms.
- Allowing the use of social media, email, and reasonable electronic means for the notification of investment opportunities that can be reviewed in full on regulated crowdfunding platforms.
- Making it easier for platforms to operate by allowing escrow agents to act in conjunction with crowdfunding platforms.
- Creating policy that encourages cross-border investments so entrepreneurs do not leave Chile for follow-on financing.
- Policy that educates Chileans on the risks and opportunities of investing in SMEs and startups.
- Appropriate disclosure rules that are scaled to fit the needs and capabilities of the size of the company and the size of the capital that needs to be raised.
- Appropriate limits on the amount of money per year that a retail investor can invest in debt and equity crowdfunding issues.
- Moderate tax incentives for individuals who choose to invest a limited amount of capital in crowdfunding. Incentives could include the opportunity for either tax credits or deductions on losses or profit.
- Regulation that promotes financial inclusion, technology enablement, and incentives for crowdfunding mobile transactions.
- Corporate governance best practices to benefit an emerging crowdfunding ecosystem in Chile.

A Framework to Promote Crowdfunding

In this section we present a balanced framework necessary for a crowdfunding ecosystem to fully evolve. This framework considers the audiences that are impacted and how to address their needs. It does so by addressing changes that might be necessary for securities regulation, the legal framework, and even tax codes. The framework identifies the key questions that need to be asked and the issues that may need to be addressed through regulatory frameworks.

The CCA Balanced Stakeholder Framework™ creates a way to build a vibrant crowdfunding ecosystem in a country. For this to occur, the framework must address the needs of the four audiences described below. Initially it may appear that these stakeholders are unaligned. However, while they may push in different directions, each of these stakeholders needs all of the others to come together in order to create a highly functional crowdfunding ecosystem:



1. Protection for Investors

The requirements for investor protection are paramount. Without the protection that is provided by disclosure, financial markets fail. Investors can receive protection via fulsome disclosure provided by issuers. Additionally, ongoing educational programs must be enacted to educate both sophisticated and unsophisticated investors regarding the risks and opportunities of investing in SMEs and startups. Also, crowdfunding may provide an opportunity to update the definition of a "sophisticated investor" now that more individuals have better access to financial data.

2. Capital for SMEs and Entrepreneurs

Securities-based crowdfunding regulation should enable the creation of financial vehicles or issues that provide both SMEs and entrepreneurial startups with access to seed capital, working capital, and expansion capital. These regulations must provide enough structure to companies that seek capital, while also being lightweight enough so that the process is not so onerous that businesses are discouraged because the cost and time requirements make it unviable for them. If regulations are too restrictive, then the very targets of this legislation will never be able to benefit from it.

3. Transparency for Regulators

Regulators must have access to secure, standardized, timely, and periodic data from all crowdfunding platforms so they can provide oversight and enforcement of the rules. Crowdfunding should provide the regulator with more transparent and recent data than it gets today from the traditional private capital markets. What is important here is that the oversight is "data intensive and prescriptively light." This means that by using technology for frequent monitoring of the system, there is an opportunity to react much more quickly if there are concerns regarding an issuer, investor, or transaction.

4. Enabling Crowdfunding Platforms

Finally, the crowdfunding platforms themselves must have the opportunity to build a profitable, growing, long-term business. This means that the regulatory burdens must be such that there is proper and appropriate oversight, while providing enough room for platforms to grow. Again, the question is how can we utilize technology in new ways, to be "data intensive and prescriptively (and cost) light?" If crowdfunding platforms are overburdened with high costs and time-intensive compliance requirements, then they will fail, and then the entire initiative to create new access to capital for SMEs and startups will also fail. Approach to Building Recommendations

5

A PROPOSED REGULATORY FRAMEWORK FOR CROWDFUNDING IN CHILE

Approach to Building Recommendations

In the short period of time that crowdfunding has existed globally, regulatory frameworks have evolved rapidly as best practices have emerged. The key lessons that have been learned from experience in the United States, the United Kingdom, Italy, France, New Zealand, and elsewhere include:

1. The need for government ministries, regulators, and stakeholders to understand how an integrated approach to crowdfunding policy and implementation can help in overcoming the challenges that a fragmented approach, where one stakeholder pushes for their needs over others, may pose.

2. The value of learning from the crowdfunding policy mistakes made in other parts of the world to avoid hindering future opportunities (for instance, expensive audit requirements in the United States; too narrow a regulatory funnel in Italy; initially too low a limit on funding that could be raised in France).

3. The importance for the crowdfunding industry to form an association to speak with a unified voice. A Chilean crowdfunding association could be part of a Latin American Crowdfunding Association. Such an association should be allowed to act as a self-regulating organization to oversee and monitor the industry and to engage in ongoing dialogue with the SVS. Allowing the industry to evolve from individuals who have a vested interest in its success will help build a credible industry.

4. The importance of creating a Latin American data standard to support indices and other hemisphere-wide metrics to support the industry and protect investors. This data standard would be created by the Latin American crowdfunding association and would create a minimum required data set – one that standardizes the key data points and that can be easily adopted by both existing and new crowdfunding platforms

5. The advantages in the Chilean crowdfunding association making a proposal for a framework for a legal entity for equity and debt-based crowdfunding platforms. It is clear that crowdfunding platforms, while sharing some functions with brokers and dealers, function in different ways. A crowdfunding association could make proposals to create a stable industry that the SVS could regulate effectively while staying flexible enough to enable crowdfunding platforms and service providers to become financially successful.

Ultimately, crowdfunding must be viewed as a new collaborative part of the private capital market that seeks to address the funding gap that exists today. It does not seek to eliminate other parts of the market, but to address unmet financing needs.

Securities-Based Crowdfunding Framework Recommendations

The following recommendations take into account global best practices in crowdfunding, variables that are unique to Chile, and the CCA Balanced Stakeholder Framework™ (see above).

Policy

1. An entirely new type of security should be created that should be exempt from existing regulations, based on the size of the issue or because of the utilization of the Web for the sale and ongoing oversight of the investment. Crowdfunding requires a rule that is specific to the crowdfunding process for use in raising capital by SMEs and startups. SVS Rules (Normas de Carácter General, NCG) numbers 336 and 345 were created for raising capital in the past, but neither fully takes into account the use of the Internet as a vehicle to raise capital publicly. New rules should be specifically created to regulate online crowdfunding and amend the securities law to create an exemption for crowdfunding that clearly distinguishes between a public offering and a crowdfunding offering. For example, crowdfunding should be exempt from complying with SVS Rule 108, which requires more disclosure from SMEs than from large issuers. This new rule for crowdfunding is to govern the public sale of securities via registered crowdfunding platforms and also allows for public solicitation via social media, the Web, and email. Crowdfunding should not be related to any other type of public offering so that it can have appropriate oversight given the additional transparency and the online nature of the offerings.

2. Crowdfunding should not be restricted to a particular industry or sector (for example, technology) as it has applications for many markets. For instance, real estate has been a fast moving part of the industry globally; because the loans are backed by hard assets investors feel confident in crowdfunding them. Chilean regulation should enable crowdfunding to be conducted in virtually any legitimate industry, including but not restricted to: technology, retail, commercial real estate issuers and project sponsors, mining, biotechnology, creative industries, hospitality, agriculture, and so on.

3. Rules should address policy risks, operational risks, capital requirements, capital flows (domestic and international), and escrow services.

4. Given the number of crowdfunding investors, the law that requires a two-thirds majority of the whole ownership to sell relevant assets or go public should be amended to allow for a simple majority decision so as to not discourage investors.

Regulation

1. Debt and equity crowdfunding should be placed under the domain of the SVS but rules should be created that align with the intent of banking regulations. This should be particularly true where crowdfunding platforms are using third-party escrow, not handling investor money and hence not holding deposits. In such cases, platforms should not be held to the same stress test or minimum capital requirements, because they are not lending their own money, but just acting as an intermediary.

2. Partnerships between banks and debt crowdfunding platforms should be promoted to encourage financial inclusion. This would demonstrate that Chile is being proactive on policy to promote financial inclusion, similar to Peru, Costa Rica, Mexico, and Ecuador.

3. A standard offering document should be created for debt offerings, hosted by the platforms and electronically submitted to the SVS and the Central Bank to provide transparency and accountability in the system. Open access should be provided to this data (without any personal identifying data) to allow for data analysis and reporting.

4. For platforms that wish to escrow funds, a framework should be created for the brokerage of money that includes operational policy, how to make deals possible (sample contracts), the process for managing information, and how platforms will be regulated. Capital requirements should be scaled, depending on how active a role the crowdfunding platform plays.

5. A central database should be leveraged to control how much any individual can put into crowdfund investments. Once the system is proven, these limits could be relaxed.

6. As tax policy continues to evolve, it should be reviewed to consider how incentives for crowdfunding may be included. Tax policy should encourage investors to take limited risk and write off losses in the case of insolvency. Where crowdfunding comes in to address funding voids in markets that have additional regulation (such as mining), crowdfund offerings should be exempt from triggering such additional rules, provided that the issuer does not leverage a crowdfund offering for the sole purpose of avoiding such additional regulation.

7. SVS should be granted the specific legal power to differentiate between small companies and bigger companies for disclosure rules. This will allow for annual reporting, and consolidation of annual reports that are appropriate to the size of the company.

8. SVS and other regulators in the Pacific Alliance, as well as in the entire Latin American region, should convene a working session to receive a briefing on current global data, trends, and best practices in all forms of crowdfunding. This forum would also provide an opportunity for countries to begin important conversations regarding their crowdfunding markets, regulations, and data standards. As this is a fast-evolving market, these conferences should be held on a regular basis. It is noteworthy that many Chile-based crowdfunding platforms within the Pacific Alliance have plans to expand into countries within the Alliance. At the same time, platforms from other

countries in the Alliance have started operations in Chile (e.g. Fondeadora from Mexico).There are opportunities for countries in the Alliance to make progress on the regulatory framework and support programs for crowdfunding platforms. A larger market would further stimulate competition, capital formation, best practices, and crowdfunding knowledge within the countries of the Pacific Alliance.

Industry

A Chilean Crowdfunding Association should be established to serve as both a self-regulatory body to provide oversight to the industry as well as act as the voice of the industry in relation to the SVS. Modest seed capital for the association could come from the national government (Corfo, for example, is one possible source) and regional economic development organizations:

1. The Chilean Crowdfunding Association should create a common data-reporting scheme to enable full and timely transparency for the SVS and any other necessary authorities. This scheme would enable a common, national standard API (Application Protocol Interface) to be created. The API would connect all crowdfunding platforms to the SVS so that their deal data can be automatically transmitted to the SVS, enabling effective oversight.

2. The Crowdfunding Association should create a lightweight and effective membership process so that as a crowdfunding platform applies to the SVS to do business, it must also apply to be a member of the Crowdfunding Association at the same time. This process should validate the legal existence of the platform and the fitness of the top executive officers, and promote minimum standards and best practices in platform development.

3. The Crowdfunding Association should develop an accreditation process in conjunction with the SVS that includes global best practices in platform practices and security.

4. The Crowdfunding Association and the SVS should keep a live list (including hyperlinks) of approved/licensed platforms on each of their websites for the public's use to confirm that a platform is legitimate.

5. The Crowdfunding Association should actively work with other participants in the private capital markets (angels, VC funds, Start-Up Chile, accelerators, incubators, universities, governmental entrepreneurship agencies, and so on) to help develop private markets in Chile.

6. The Crowdfunding Association should create a framework for a legal entity that has the characteristics of a broker or dealer, but with different capital requirements and to enable "Broker/Dealer Light."

Platforms

1. All crowdfunding platforms should be licensed and regulated by the SVS. Legislation should stipulate required timelines to review applications for platforms so that appropriate regulatory oversight is balanced with market needs. From the date of the application, the SVS should be required by the legislation to complete its review process in less than 90 days.

2. Public solicitation is a core principal of crowdfunding. It must be permitted for companies that seek to raise capital via crowdfunding. These crowdfunding offerings should include the following requirements:

   a. Limits Issuers are permitted to raise up to US$ 500,000-1,000,000. (This range is provided only as an example and should be discussed with platforms, and other industry participants should agree on an appropriate target given the factors that are unique to the Chilean market. In making this decision, one must balance the need to have a funding facility that is "big enough" so that companies find it useful and "not too big" that it creates concerns from regulators regarding the potential for fraud. It is important to note that regardless of the amount in its first iteration, this limit should be reviewed/adjusted as the market evolves over time.

   b. Solicitation may occur on television, radio, public events, Internet websites, mobile apps, and/or social media services.

   c. The solicitation must alert the public that a company is raising a specified amount of capital, and all of the details and disclosures of the offering should be posted on a dedicated crowdfunding website. This ensures that all prospective investors receive the same information regarding the offering.

   d. Platforms must provide a mechanism for investors, entrepreneurs, and issuers to engage in chats, discussions, and question and answer sessions, or make comments.

   e. Every issue must explain the risks of investing in small businesses and startups as well as the specific risks of investing in that individual issue.

3. Crowdfunding platforms should not hold any funds at any time unless they are registered brokers or dealers. The platforms should only provide a regulated, trusted online marketplace for lenders and borrowers to meet and conduct business. Depositing money with independent, third-party escrow agents will protect investor funds if a platform goes out of business. In cases where there is an escrow agent, crowdfunding platforms should have a much lower or no capital requirement than brokers or dealers that hold and could potentially lose funds.

4. All individuals seeking to engage in any form of crowdfunding must create a user ID and password on the crowdfunding platforms where they decide to invest. The individual's user ID should be the Chilean ID number that is the standard number that is used in all transactions today. This enables all users on the system (both principals within the issuing company as well as investors)

to be positively identified. Such information should be shared with a central database, hosted by the Chilean Crowdfunding Association.

15. The SVS should consider purchasing a top level domain (for instance, "www.platform.ccf," for "dot Chilean Crowdfunding") that only the SVS could license to crowdfunding platforms to prevent fake or unlicensed crowdfunding platforms from operating.

Issuers

1. Companies should be authorized to raise up to US$ 500,000-1,000,000 per year via crowdfunding platforms. This could be in the form of equity or debt-based securities. Companies must raise 100 percent of their funding target by the declared closing date or the money is returned to the investors:

a. Equity securities should initially be issued only as common stock with no complex structures. This is the easiest type of security for investors to understand. To avoid owners of common stock suffering dilution in follow-on rounds of financing, common stockholders should be offered: i) the right to redeem their securities at the follow-on offering price to allow them to exit; ii) the right to buy more shares of common stock at the follow-on offering price to prevent dilution and show commitment; or iii) to stay an investor and accept that they will experience dilution but still have a potential exit later.

a. Simple debt instruments should also be authorized.

c. Given the complexities of banking regulations, simplified bond instruments (sometimes referred to in this report as "mini-bonds") should be authorized as a way for traditional SMEs to utilize crowdfunding. An example of this structure is being currently used by Crowdcube in the UK.[38]

d. To prevent "pumping and dumping" of securities, crowdfunding issues should be held for a minimum of 12 months by the original buyer of the security (with exceptions for the death of the original buyer).

e. Companies should be allowed to use legal entities in the existing Chilean legislation as special purpose vehicles (to pool larger numbers of small investors, limit liability, and narrow risk without the burden of becoming subject to disclosure rules that apply for much larger, publicly listed companies).

f. The law should ensure that the settlement of the instruments is irrevocable to address concerns of speed and market continuity so that transactions are not being reversed, causing market uncertainty, which would cause the market to be unused.

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38 http://blog.crowdcube.com/2014/06/10/lend-established-brands-mini-bonds-new-way-invest/.

2. Legislation should create a new lightweight disclosure form for companies seeking to raise capital via the Web that is electronically submitted to both the platform and the SVS. The firm should include a minimal and standard set of information that needs to be provided, including a standard set of variables. This will allow for data analytic companies to enter the market and provide investors with reports that compare offerings and reveal trends. Sample disclosure templates should be promoted that represent best practices.

3. VC funds, angel groups, brokers and dealers, or other "sophisticated investors" should be permitted to invest funds via crowdfunding. They should also be allowed to create funds dedicated, in part or in whole, to making investments in companies that use crowdfunding to raise capital.

4. Issuers should submit annual data filings to the crowdfunding platform, which should transmit the data electronically to the SVS and investors automatically. Issuers are strongly recommended to submit quarterly data to investors regarding beginning and ending balances for cash, sales, earning, customers, and jobs.

5. Sophisticated/accredited investors should be allowed to lead syndicates of other (accredited or unaccredited) investors. To form a syndicate, leaders must invest at least 10 percent of their own capital in the syndicate. Leaders must also invest on the same terms as the other investors in that syndicate. The syndicate leader must disclose any and all prior or current relationships with the issuer. Syndicates should be an optional structure, not a required one.

6. Corfo could create "crowdfunding co-investment vehicles" to provide an efficient and effective way for the government to support SMEs. These co-investment vehicles or programs can provide a way to deliver capital to SMEs and startups that have been validated by the crowd. Businesses that prove they have a customer for their products and/or a community of support behind them could then receive a percentage of their raise from such a co-investment vehicle. This program could be designed to be 100 percent online and eliminate most of the paperwork required by Corfo for small grants, loans, or investments. This would be possible because most of the information previously required by Corfo would have already been collected by the crowdfunding platform.

7. Consideration should be given to the creation of separate tax-free individual savings accounts for those who want to lend money to encourage lenders to enter the marketplace, loan money, and not be taxed on the interest. The UK government has provided different beneficial tax treatment for investors who invest in crowdfunding issues.[39] These 2 programs, the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), provide either tax deductibility or tax credits on investments in SMEs and tax rate reductions or tax exemptions on gains for making investments in SMEs. These programs have provided strong stimulus for SME investment.

39 http://www.crowdfundinsider.com/2013/06/16641-how-the-uk-uses-tax-relief-to-boost-entrepreneurs/

Investor Protection and Participation

1. Robust investor education is the best investor protection. A significant national educational effort should be launched to provide a basic understanding of crowdfunding, to all citizens but especially to potential entrepreneurs and investors.

2. Accredited or sophisticated investors should be allowed to invest in crowdfunding issues as they choose, without regard to income or net worth limits. According to Patricio Cortes (Pronostica) there are about 10,000 high-net-worth Chileans who each possess over US$ 1 million of capital to invest.[40] Certification of such status should come in the form of self-disclosure. The definition of "accredited or sophisticated investor" should be expanded to enable those with financial sophistication or understanding to be able to invest in private offerings through crowdfunding. A suitability test could be devised to ensure that investors possess a basic understanding of risk, portfolio diversification, and the importance of due diligence.

3. Unaccredited investors with income of more than the equivalent of US$ 25,000 should be allowed to invest up to 10 percent of their annual income or net worth into crowdfunded ventures. Given Chilean circumstances, and in order to protect unaccredited investors, it is prudent to limit individuals with low incomes from investing more than they can afford. For instance, those who earn less than US$ 25,000 a year could be restricted from investing more than the equivalent of US$ 500 a year in crowdfund offerings. While this would dramatically reduce the size of the pool of investors and the amount of capital, it would protect those most at risk. If investors are required to enter their national ID number, technology could validate investors and ensure they do not exceed their limit.

4. Investors should be allowed to revoke their offers at any time up to the closing of the funding goal without penalty. Doing so would allow the crowd time to do necessary diligence and investors the opportunity to change their minds based on those findings.

5. Before an investor can invest, robust disclosures must be provided to them about the risks and opportunities of investing in crowdfunding. A possible example of these disclosures could be a crowdfunding version of the safety video on airplanes. This could be a required step before individuals are able to complete an investment transaction. This step could be time- and date-stamped for easy compliance measurement.

6. Crowdfunding issues should be exempt from any maximum shareholder rules that might trigger public registration and the cost and compliance that comes with it.

7. Losses from crowdfunded investments should be 100 percent deductible from the investor's taxes in the same tax year as the loss was declared (that is, in the financial year the company failed). This recommendation is intended to allow a tax deduction, not a tax credit. This would both stimulate interest in the crowdfunding space and soften the blow of any loss owing to the failure of an investment in an SME or startup.

40 http://diario.latercera.com/2015/04/06/01/contenido/negocios/10-187010-9-el-bajo-impacto-de-la-ley-unica-de-fondos-en-la-regulacion-de-los-grandes.shtml

Recommendations for Capacity-Building for Regulators

A regulatory workshop should be held with experts in crowdfunding regulation, for example, regulatory agencies from the United Kingdom. This would enable productive dialogue about crowdfunding with regulatory colleagues from the most sophisticated crowdfunding market in the world. This would also provide an opportunity for regulators to build relationships with colleagues from other countries. Other workshops could be held with examples of global platforms that are already transacting business in all the forms of crowdfunding, so that participants can learn how information flows, decisions are made, and capital is transferred. Examples should also include other "white space" participants, for instance, background check businesses, money processing, crowdfunding data analytic companies, investor relations/communication tools, accounting software, and legal templates. In all of these dialogues with regulatory bodies, it is important to address the legitimate and appropriate concerns that regulators have about the emergence of any new type of security or market.

Recommendations for Investor Awareness, Education, and Training

Developing a robust crowdfunding ecosystem is a lofty goal that cannot be achieved overnight. As such, a staged approach is recommended that does not try to accomplish everything at once, but iteratively, with a holistic perspective in mind. It requires engaging many current stakeholders in the SME ecosystem with a focus on promoting winning industries via crowdfunding policies (for instance, natural resources, mining, agriculture, fishing, and tourism). A summary of key recommendations for investors and entrepreneurs is given below.

Investors

With the right policy in place that gives investors the confidence in the market, it is important to educate them about what crowdfunding is, how it works, what their role is, what the risks are and how to properly (and safely) diversify into this asset class. Key recommendations are given below:

- The Chilean Crowdfunding Association could choose to create (or partner with a firm that has already created) an online education series for investors that includes comprehension quizzes and provides a certification of completion.

- The Chilean Crowdfunding Association could also choose to create a two-day workshop for investors that initially trains trainers to then deliver content on evaluating crowdfunding opportunities at subsequent workshops around the country. A detailed outline of topics that should be covered is included in Appendix B.

Entrepreneurs

For many crowdfund entrepreneurs, raising money online could be a first-time initiative for them. If this is the case, it is important that they have all the training necessary to prepare them for building a crowdfunding campaign, completing the required disclosures that investors will need to make an informed decision, determining how much money is needed, and deciding on the type of security to offer and the valuation.

Training programs could be delivered via professional third parties (for instance, Corfo, Sercotec, ProChile or accelerators and incubators), online, or via other direct educational options with coaching/mentoring via current SME outreach and development programs.

Similar to the training for investors, a key recommendation is to create a two-day workshop for investors that initially trains trainers to then deliver content on planning a crowdfunding campaign at subsequent workshops around the country. These workshops could be part of a broader capacity-building project. This project's goal would be to build crowdfunding capacity within Chile. It would begin by bringing in outside experts to conduct initial training across the country. While doing so they can identify potential crowdfunding champions who can be part of a one-year capacity building program to take over from the outside experts and build a network of expertise in Chile in all forms of crowdfunding. An outline of proposed topics that could be covered is included in Appendix B.

The government should also create a public relations campaign for general awareness on how entrepreneurs can learn more about crowdfunding.

6

CONCLUSION

With the rapid expansion of crowd-based finance around the world, the time is right for Chile to engage in this new technological form of fundraising. Crowdfunding is now channeling billions of dollars into enterprising and innovative ventures, startups, and small enterprises, and global data signal that countries leading the way in crowdfunding are benefiting from job creation, economic inclusivity, and economic opportunity. Chilean platforms like Dale Impulso, Broota, and Cumplo already demonstrate the benefits of crowdfunding, but realizing its full potential will require greater governmental support.

Implementing a crowdfunding policy in Chile will not only provide a regulatory framework under which all forms of crowdfunding may operate, but may also help address issues such as financial inclusion and enable a greater proportion of the population to create wealth via investments and entrepreneurship. It should also build smarter companies, increase access to capital, improve efficiency in the private capital markets, and increase transparency in these markets for investors and regulators by bringing the opaque process of fundraising online and creating a digital footprint of all movements.

Crowdfunding may allow Chile to highlight some of its most promising startups and SMEs, not only within its borders but also on a global stage, as crowdfunding is proven to validate markets and test demand internationally. However, it will require a new policy that addresses bottlenecks in the current securities and banking regulations.

A comparison of Chile with other countries shows that the most important factors required for crowdfunding to succeed – Internet access, social network engagement, and technology – are broadly present. While lagging in a culture of trust, Chile has the potential to excel at crowdfunding given the rapid adoption of local socially based companies, such as Leve and Arrentas. These companies help foster trust among individuals that do not have a pre-existing relationship through the use of a rating mechanism that measures a person's reputation online. This digital footprint is shown to force transparency in the buying and selling of goods and services and is now being applied globally to the trading of securities and loans.

The recent success of Start-Up Chile indicates that this is an opportune moment to provide local Chileans, Chileans living abroad, and investors keen to invest in Chile with a mechanism to do so. However, it must address difficulties with raising an initial round of capital from professional investors (commonly referred to as Series A funding, which seeks to prove the existence of a market), which is the main funding void in the local context, and consider how crowdfunding can help address this issue and move capital where it is needed.

In order for Chile to see the true potential for crowdfunding, it will be important to ensure that all stakeholders are fully engaged in the policy making process. These stakeholders include not only entrepreneurs and funding platforms, but also government officials, regulators, incubators and accelerators, universities, and investors. Chile should be strongly commended for the efforts it has taken to date to enable SMEs financially. It should continue to engage the appropriate governmental, investment organizations, educational entities, and corporations in the promotion of crowdfunding and foster the creation of a Chilean Crowdfunding Association to give the industry an identity and a single voice.

Chile can learn from the early lessons of countries including Australia, New Zealand, Malaysia, the United Kingdom, and the United States to create a balanced regulatory regime that is appropriate for Chile's culture, business environment, and economic growth targets. Given the new data analytic tools that are already available and being developed for this new market, leaders in Chile should design a regulatory framework that leverages the data and information these systems can provide. This light-touch approach will enable the growth of a successful industry. Policy to enable crowdfunding platforms, however, is only the first step in an important process to educate entrepreneurs and investors about the risks and rewards of crowdfunding. Thus, a comprehensive program of awareness raising, education, and training should form a key part of government policy. Finally, Chile has an opportunity to play a leadership role and help other countries in the region as they consider appropriate ways to structure this new form of finance in their own countries.

APPENDIX

A

Workshop Topics for Investors and Entrepreneurs

Structured training workshops can be an important part of creating a successful crowdfunding ecosystem. These workshops should be delivered both to entrepreneurs regarding how to use best practices to create successful campaigns, as well as to investors regarding the risks and opportunities of investing in crowdfunded companies. Outlined below are topics that should be covered in training for investors and entrepreneurs.

Investors (0.5-1day seminar):

- Evaluating crowdfunding opportunities, including knowing your overall investment goals, balancing risk and rewards, and diversifying your portfolio.
- Conducting due diligence, including pinpointing your connection to the entrepreneur or small business owner, watching the pitch video, reading the pitch information on the company page, and reviewing financial information.
- Applying some common-sense tactics, including making sure investors really understand the business or project by asking a simple question: would you buy it? Discussing the opportunity with people you trust. Reading the crowd's feedback online. Avoiding impulse buys and how to detect fraud by trusting that the crowd can spot signs of trouble and reporting your suspicions to the funding portal.
- Determining how much you are allowed to invest. Consider how much you actually want to invest. Being prepared to lose it all. Committing to the investment by pledging your amount on the funding portal. Transferring funds when the financial goal is met. Sticking with the investment for at least one year.
- Knowing your rights as an investor and anticipating rewards for your investment.
- Playing the right role as an investor by sharing what (and who) you know. Tapping into your professional experience. Connecting people who can benefit each other. Serving on a board of advisors.

- Evaluating the quality of what is being produced by getting a taste of the product or service early in the process and offering constructive feedback.

- Becoming an ambassador for the company by conducting grassroots marketing and encouraging other investors to follow your lead.

- How to participate without becoming a nuisance, and how to take action if you believe the company is breaking the law.

  How to exit a crowdfund investment, including respecting your commitment for one year. Considering whether you want to commit for multiple years. Knowing your options if you want or need to sell. How to work in a secondary market or hold out hope for an IPO, merger, or acquisition.

Entrepreneurs (2-day seminar):

- What is crowdfunding and how does one plan a crowdfunding campaign? Defining your goals and financing needs. Conducting market research. Getting specific about the problem(s) you can solve. Identifying your target market. Understand what phase your business is in. Calculating how much money you will need and how it will be used. Predicting how long that will last. Being realistic about your funding sources and which type (debt, equity) is right for you. Calculating your company's valuation and imagining your exit strategy.

- Focusing on building your crowd and your team. Estimating how many investors you will need. Setting the minimum investment. Finding experienced investors in your crowd. Respecting what your investors need from you: personal background and experience, clear vision, passion, creativity and motivation, communication, honesty, and financial transparency. Building out your team.

- How to pick the right platform and stay legal during the fundraising period.

- How to create your campaign and communicate with your backers, and what to do if you either hit or miss your funding target.

- How to run your business with your investors in mind. How to leverage their knowledge, experience, and relationships to grow your business. What investors want in terms of communication, and knowing your options if your plans go astray.

- How to stay compliant once you've raised funds. What legal, tax, or other reporting do you need to do?

APPENDIX B

List of Contributing Organizations

The following institutions provided valuable input into the creation of this report.

- Academics in the field of entrepreneurship
- Aurus Venture Capital Fund
- Banco Estado
- Becual
- Broota
- Carey Cia Law Firm
- Central Bank
- Chile Global Angels/Fundación Chile
- Corfo Entrepreneurship Division
- Corfo Financing Division
- Cumplo
- Dale Impulso
- Financing Committee for SMEs and Entrepreneurship
- Ministry of the Economy
- Ministry of the Treasury
- Nazca Ventures Venture Capital Fund
- Senate
- Social network and Internet experts
- Start-Up Chile
- Superintendency of Banks and Financial Institutions
- Superintendency of Securities and Insurance
- University of Chile Economics Department
- Wayra Incubator

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