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MARKET AND SOCIAL IMPACT OF CROWDLENDING IN SERBIA

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I. Executive Summary

Throughout history, the awareness that the financial market has a demand that traditional suppliers are not ready to meet, at least not in satisfactory way, has always been the basis for the development of crowdlending. As early as the 18th century, in the times of the Irish Loan Fund, it was recognized that certain customer segments could not be addressed with standard products and services and the specific features of the segments must be considered. The lack of willingness among traditional suppliers to adapt to the needs of small clients, despite the significant importance of small businesses for the economy, and society in general, has given rise to new and creative solutions. One of such creative solutions are crowdlending platforms, and this study provides an analysis of the impact that such an innovative service could have on the financial market, national economy and society in Serbia.

In the second chapter, we analyse the role of crowdlending platforms in the financial market as a whole, in the targeted market segment, in relations with traditional financing suppliers and finally the added value these platforms deliver. Firstly, we examine what functions do the platforms fulfil and whether they are, and if so, why, more effective than traditional financing suppliers. Considering that, based on international experience, micro, small and medium-sized enterprises have been identified as the main users of crowdlending platforms, access to finance of this market segment in Serbia has been specifically examined.

Special attention has been paid to the relationship between the crowdlending platforms and traditional finance suppliers in the market, with a further emphasis on the hypothetical case of establishing a platform in Serbia. In three separate sections, we analysed the competitiveness and complementarity of platforms with conventional funding providers, with particular emphasis on the added value of platforms in comparison with competitive services, as well as the potential for cooperation.

Chapter 3 examines the impact platforms can have on the national economy of Serbia, with particular attention to the market failure caused by the information asymmetry. A detailed explanation of the contribution of platforms to raising the level of awareness among players in the financial market and, consequently, mitigating the market failure is provided. Furthermore, the impact on raising the level of gross investments in the national economy, with a special section on foreign investments and the growth of gross domestic product is analysed.

The impact of platforms on the society has been analysed in the last, fourth, chapter. Importance is given to stimulating the entrepreneurial spirit, which is one of the most important effects that the platform can have on the society in Serbia. The contribution to expanding the entrepreneurial spirit resulting from the double effect achieved by platforms is analysed: the expansion of the range of funding opportunities and the promotional effect of fundraising campaigns through platforms. Some of the significant problems that Serbian society faces (unemployment, poverty, brain drain and regional differences in the level of development) and the potential contribution of crowdlending platforms to their resolution are described in the last three sections.

2. Impact of crowdlending on financial markets

2.1 Position of crowdlending on financial markets

Although the idea of crowdlending is not exactly new, the development of an interactive Internet, or the provision of two-way communication, resulted in the emergence and rapid growth of the number and size of platforms for crowd (joint) financing. These internet platforms have largely diminished the asymmetry of information between entities in search of funding, on the one hand, and investors on the other. In addition, many investment projects allows investors to diversify risks, and the possibility of participating with a relatively small amount almost completely invalidates the barrier that represents the size of the amount of individual investment.

From the foregoing it can be seen that the platforms have taken over the transformative function of traditional financial intermediaries, such as banks or stock exchanges. Transformative function of

financial markets, viewed through the frame of traditional financial intermediaries (stock exchanges, banks, etc.), can be broken up into three basic forms of transformation¹:

Risk Transformation - the possibility for investors to adequately manage their own level of risk aversion through the diversification or allocation of money available for investment in several individual projects. In the case of banks, this transformation is reflected in the distribution, e.g. of individual deposits on a multitude of loans issued. Stock exchanges, on the other hand, enabled investors to mitigate their risk by diversifying to many companies of different characteristics.

Informative transformation - informing market participants (e.g. lenders and borrowers or investors and companies listed on the stock exchange) about the existence of the counterparty and their needs for funding, i.e., investing. In addition to informing the market about the existence of other players, the building of expertise for informed decision-making (for example, with banks) or the establishment of regular reporting rules (on stock exchanges) reduce the so-called information asymmetry, i.e., the difference in the level of information and the ability to evaluate the existing information between the contracting parties.

Liquidity transformation - divided further into a **maturity transformation**, which overrides the difference in target maturity between, e.g., a person saving in the bank and the company that takes the loan, and the **size transformation** (large loan amount, small amount of individual deposits).

Crowdlending platforms meet, to a greater or lesser extent, depending on the business model, the transformative function of traditional intermediaries in financial markets. The question that arises is whether the platforms fulfill the above-mentioned functions more efficiently, or more specific, if their existence is justified. If the methods used by the platforms and their innovative business models are generally faster, cheaper and more reliable than traditional solutions?

The answer to these questions is very complex and should be analysed for each individual case, or each individual platform. The reason for this complexity is the focus of each of the platforms on individual specific problems that traditional intermediaries ignore for various reasons. Although the platforms offer technical (e.g. faster loan approval) and business (e.g. the marketing effect of crowdlending campaigns) solutions superior to traditional financial intermediaries, their advantage is mainly reflected in the effective addressing of neglected problems and customer segments, such as, for example, financing of young and innovative companies or enabling a broad mass of individual investors to invest in this kind of company. Focusing the business model to a clearly defined and narrowly limited range of problems puts these innovative companies in a position to specialize in delivering services while remaining profitable.

Therefore, it can be concluded that the role of crowdlending platforms, as well as many other alternative forms of financing, is focused primarily on covering those market segments whose needs are not satisfied by the traditional forms of financing for various reasons. This role of platforms determines their positioning in financial markets in relation to traditional financial intermediaries and leads to the conclusion that the platforms are only to a lesser extent competitive, and much more complimentary to the existing market offer.

2.2 Access to Funding for Entrepreneurs, Micro-, Small- and Medium Enterprises in Serbia

Entrepreneurs, micro-, small- and medium-sized enterprises ("EMSM") in Serbia are increasingly gaining the attention of relevant factors in the financial market (primarily commercial banks), but also many stakeholders interested in economic development in general. The experience of the countries of the European Union and the activities of many national and supranational institutions and organizations (e.g., RAS, EBRD, EIB, EIF, USAID, etc.) greatly emphasize the importance of this segment of the economy and increasingly shift focus from large corporations, mostly international, to entrepreneurship and EMSM.

¹ Bankbetriebslehre – Hans E. Büschgen, Chrisoph J. Börner

Many commercial banks follow this trend and, in cooperation with some of the above mentioned supranational financial institutions, are increasingly turning to this segment of the market. The credit line of the European Investment Bank, the guarantee scheme of the European Investment Fund, KfW's support to the domestic ProCredit Bank, etc. are just some examples of incentives. In addition, development organizations such as USAID or GIZ have also directed many of their activities to the development of entrepreneurship and support to EMSM.

Nevertheless, despite all the above-mentioned initiatives, the approach to financing for EMSM remains the subject of discussion and is subject to quite different assessments. While from representatives of commercial banks one may hear that the market is saturated and that even the supply of loans exceeds the demand for financing, different market researches either deny such claims or throw a different light on the ostensible balance in the financial market. A study prepared for the British Council and the Swedish Institute² identifies the difficulties and costs of access to finance as one of the two key barriers to entrepreneurship in Serbia. The Competitiveness Report of the World Economic Forum, in its analysis for 2018, ranks Serbia in the 95th place out of 140 analysed national economies according to the criterion "Financing of SMEs".³

The European Investment Bank survey of 2017⁴ estimated the Serbian financial market as shallow, especially in terms of diversification of financial services offers. The conclusion of the study is that the prevailing role of bank loans as a source of funding and the impact of commercial banks on financing EMSM has far-reaching effects on the development of this market segment. At the level of the overall market, dependence on bank financing increases the economy's vulnerability to external shocks, which is confirmed by the experience of the last major economic crisis. In addition, at the level of individual companies, relying on traditional bank loans secured by pledge may have a negative effect on the value of the assets of companies, which makes this type of banking service less attractive or even inaccessible to many companies, and the lack of alternatives hinders their development.

The analysis presented in the study clearly indicates a relatively large gap between supply and demand in the micro-company segment, as data for 2017 show that demand for financing is more than twice as high as supply. These data, as well as interviews with decision-makers in this market segment, suggest that access to traditional banking products is generally very limited for micro companies. The business history (minimum 2 years), relatively high expected revenue, low level of debt and high level of capital are just some of the criteria that micro companies in Serbia often do not meet, and most often they turn to informal sources of financing (friends and family) and non-repayable funds (so-called grants) or interest-free loans and guarantee schemes secured by loans from development agencies and similar institutions (so-called subsidized loans). The problem for micro enterprises is the lack of knowledge for defining their own financial needs and making a clear business plan, which additionally hampers access to financing sources.

When it comes to small and medium-sized enterprises, the demand for financing seems to be covered by the offer, primarily thanks to the longer history of business and the property that can be pledged. However, data pointing to market equilibrium can be misleading because the lack of demand does not necessarily mean the lack of financing needs. Many companies know they will not get a bank loan, so they do not address the banks on this occasion and thus create an illusion that the demand is lower than it really is. In addition, in cases where a bank loan does not meet the company's needs, a poor knowledge of alternatives may affect an unexpected demand for financing. The described circumstances in the Serbian financial market point to the existence of the so-called hidden demand.

² Study of challenges that hinder the development of micro, small and medium enterprises in the Republic of Serbia (2018) - Report prepared for the British Council and the Swedish Institute

³ The Global Competitiveness Report 2018 - World Economic Forum

⁴ "Ex-ante study to assess the potential future use of Financial Instruments to deploy IPA resources in support of Small and Medium-sized Enterprises (SMEs) in Serbia" (March 2017) – European Investment Bank

However, the dominant role of banks in the financial market is not solely their merit, but largely due to the weak supply of other funding instruments, but also of relatively poor information companies have about the available options.

A study published in the scientific journal "Ekonomika preduzeća", focused on analysing access to funding sources for young innovative EMSMs, provided an additional insight into the shortage of the current offer of financial services in Serbia.⁵ The electronic survey, as well as a review of the relevant literature and research, pointed to the so-called "bank centrality" and underdevelopment of the Serbian financial market, but also emphasized the incompatibility of traditional sources of financing with innovative companies.

Although general banking loans are the most widely used source of funding in the Serbian financial market, young innovative companies (the so-called "start-ups") are rarely financed in this way. Among the respondents, there is a general opinion that financing through traditional banking products is unattractive due to high interest rates, collateral requirements, low importance of business plans in the evaluation process, insufficient availability of long-term loans, stringent bank loan terms and complicated loan approval procedures. Such perception of the respondents is supported by the fact that only 21.60% of the surveyed young companies have requested a bank product, while the majority relies on internal sources of financing (59.97%).

Because of the high uncertainty of innovative projects, the banks rarely decide to finance them, while the loan approval procedures systematically eliminate young companies. On the other hand, the fact that less than one-third of the respondents (31.82%) decided to finance the investment in equity capital, as a much more suitable way of financing the start-up, also points to the relatively low representation of the so-called risk (venture) capital, which may be due to lower appeal of this type of financing, lack of supply or poor information companies have on that option.

However, authors of the study particularly emphasize the crucial importance funding can have on the development of start-ups. While in companies lacking a clear element of innovation in terms of product, service or business model, a lack of funding has a relatively greater impact on growth opportunities, with young and innovative companies securing funding is often the matter of survival. Limited access to financing and a lack of alternatives directly affect the choice of strategy and investment decisions of the start-up, which can have a very negative impact on the company's development at an early stage in the life cycle. Intensive reliance on internal sources of financing gives some flexibility and freedom to management, but due to the limitations of internal resources does not solve the problem in the long run in the most cases.

All analysed studies agree that in the financial market, primarily in the micro and start-up segment, there is a demand that commercial banks cannot or do not want to satisfy. The collected data also confirms that subsidized loans, support to venture capital funds, guarantee programs, grants, technical support programs and similar incentives greatly help to overcome problems with access to finance at an early stage of the life cycle. Such programs of national and supranational institutions supersede the lack of supply in the financial market, most often through cooperation with commercial banks or investment funds. However, the goal of these programs is not or should not be to take over the role otherwise intended for the private sector, but the incentive to offer the market new, more suitable solutions. Given the still dominant role of traditional banking services in the financial market, it can be concluded that this effect has yet to be achieved.

A positive, relatively new phenomenon is represented by several accelerators and funds, which, although very limited in volume, fully adapted to the needs of start-ups, and in addition to funding companies offer additional services such as mentoring, office space, networks, etc. What distinguishes these sources of funding is based solely on private (non-public) capital, and the most famous representatives of this group are certainly the StartLabs and ICT Venture funds, as well as the recently established Impact Hub accelerator. Delta Holding's Business Incubator is also a novelty, as

⁵ Access to Funding Sources for Young Innovative Enterprises in Serbia (December 2018) – assessment and recommendations for policy makers - Ana S. Trbović, S. Nešić, J. Subotić

well as the acceleration program of the company dm (funded by USAID), and other potential accelerator projects involving major domestic and foreign corporations are also mentioned in the public. The relatively low level of knowledge of such innovative forms of financing greatly complicates access to micro and small enterprises. In addition, the above-mentioned providers are interested in a very specific and narrow circle of companies that promise extremely high growth or fit into strategic goals of corporations sponsoring accelerators and incubators.

Consequently, the problem in the Serbian financial market is not so much in the quantity as in the quality of the supply and that the needs of certain market segments must be addressed with more suitable products and services. In addition, the results of the studies indicate that demand is very difficult to estimate reliably, and that the existing quantitative indicators underestimate or do not detect hidden demand in the financial market. This effect is further exacerbated by insufficient information on financing options, which significantly impedes access to these funding sources.

Although the opinion has been, especially among commercial banks as the largest suppliers on the market, that demand for funding is saturated, research has shown that there is a huge gap between supply and demand in the micro and small companies' segment. The experience so far has led to the assessment that a high level of supply in the market does not necessarily mean easier access to financing, and that a wider range of services and products on the supply side as well as a higher level of information among companies will generate new and reveal the existing hidden demand for financing.

2.3 Crowdfunding platforms – Competitors or complementary to traditional financing?

Although the very idea of crowdfunding originated from the need to provide an alternative to banking services, these two funding sources in practice rarely compete. At first glance, financing through crowdfunding platforms helps the borrower solve the same problem as, for example, a bank loan, but the targeted market segment, financing conditions, type, level and scope of services, as well as the effects of funding vary greatly in these two sources of funding.

Crowdfunding platforms most often address a segment of the market whose financing needs are not met by traditional providers. In the Serbian banking market, companies with a short history of business (under two years), a negative result in the last two years, without assets and guarantees of third parties have a very difficult access to financing. Due to the high level of risk and the lack of resources to evaluate innovative business models, banks refrain from this segment of the market, so it cannot be said that true competition is in question. International experience shows that in case the platforms and banks really compete with their offers, bank loans in most cases contain far more favourable conditions while the speed of loan approval in many platforms is much higher than with banks. Depending on the borrower's priority (speed or rate of interest), the borrower chooses one of the options. However, such cases are the exception rather than the norm.

Market experiences where crowdfunding services through internet platforms are the most developed (USA, UK, France, etc.) show that banks see a partner rather than a competitor in platforms. Crowdfunding not only complements traditional providers by "covering" an unsaturated segment of the market but can make that same segment more attractive and enable them to place their own products and services, both traditional and innovative.

Many banks and funds in more developed markets have recognized the potential offered by cooperation with crowdfunding platforms, as formalized through partnerships of various formats. In the Serbian market, there are no formal obstacles to cooperation of this type, and, as described in the previous section, demand exists for an alternative type of financing for micro and small companies. The question remains whether traditional providers (primarily commercial banks, development organizations, funds, etc.) would be willing to take the advantages of the opportunities offered by crowdfunding platforms?

2.4 Added value of the crowdfunding service in relation to the competition in the Serbian financial market

When introducing a new product or service on the market, all stakeholders raise the question of the

added value this novelty brings. When analysing the hypothetical establishment of a crowdlending platform in the financial market of Serbia, it is necessary to ask the same question.

The added value of the group financing platform on the Serbian financial market could be manifested primarily through the following effects:

Access to financing

The added value of crowdlending platforms is most obvious in enabling access to finance for companies that would otherwise be denied such access. In addition, enabling access does not only imply a simple offer of loans to a neglected market segment, but requires that this offer is implemented in a certain way, adapted to that segment. Considering the characteristics of the target segment (entrepreneurs, micro, small and start-up companies), simplicity, transparency and flexibility play an extremely important role. Simplicity and transparency, from the perspective of the company, mean simplification of the application process for a loan or some other type of financing. Complicated contracts, collection of extensive documentation or negotiation with potential investors in the case of equity investments represent a huge challenge for companies without experience in such processes.

Flexibility implies, on the one hand, the speed of obtaining funding, although this quality is particularly pronounced in some platforms. The German platform Bitbond, e.g., with its credit rating technology offers loan approval within just 24 hours to the borrowers, while the online loan application takes only 30 minutes.

Approval of a loan without collaterals or guarantees i.e., reliance on the feasibility of the attached business plan, is another manifestation of the flexibility of financing through platforms. If a company does not have assets that can be collateralised or assets of insufficient value, access to bank loans is very difficult or impossible.

Preservation of the ownership structure

Banking products are not the only potential source of financing in Serbia, especially when it comes to innovative, young companies with high potential for growth. Risk capital funds, business angels or strategic investors (usually large corporations) can express interest in investing in start-ups through an investment in equity. This kind of financing brings with it money and other benefits, such as expertise, contacts, strategic partnerships, etc.

However, the price paid by the original owner of the company is a waiver of part of the equity capital, to which many of them are not ready at such an early stage, because they believe their company's value is underestimated. In addition, there is a question of losing independence and control over the development of the company. Although financial investors most often take a minority share in ownership, they still have ways to influence the company's processes. Giving over the majority share in ownership leaves the controlling package to the new co-owner and is an even less attractive option.

Financing through crowdlending platforms allows companies to obtain the necessary money outside the banking system, but without renouncing ownership and losing independence.

Testing market interests

Depending on the business model of the crowdlending platform, in addition to securing financing, companies can have additional benefits. If money is collected through campaigns that last for a certain period (from one to two months), companies are trying to attract potential lenders. These efforts usually include the presentation of a business plan on the platform, a financial projection, a description of the company and its history, information about owners and promotional activities through digital marketing.

Such campaigns can give a good insight to innovative companies into the perception of their business model, product or service. Namely, most platforms allow two-way communication between companies and interested parties who have previously registered on the platform, many of whom are experienced investors, whose critical thinking challenges the presented project and provides feedback

of potentially high value for the company. Many platforms nurture such communities through organising specialized events, setting up an internet forum within the platform, by setting up advisory boards involving prominent businesspersons, etc. Such an investment community is of great importance to the platform and is an important part of its added value.

In addition to experienced investors with an expert level of knowledge, feedback can also be obtained from less sophisticated investors who have not yet had the opportunity to come across the company and are mostly not that familiar with the specific industry. Their perception can also bring new value to a company that intends to enter the wider market. The same is true for foreign investor who did not have the opportunity to hear about the company in their country, who can bring new perspectives and information that domestic stakeholders do not have (especially regarding global trends, competitors, potential partners, etc.).

In addition to funding, a campaign to collect crowdlending loans offers companies an opportunity to test their own model, analyse how the market perceives them and, if necessary, respond promptly. Sometimes corrections are essential and relate to a business model, product or service itself, but very often the problem is solely in communication (especially in the case of small companies with no resources for professional marketing and PR). In this way, borrowers raise the chances of their company's success and consequently increase its attractiveness for potential investors.

Marketing effect

The method of fundraising through a campaign described above requires promotional activities and a kind of marketing campaign. The marketing effect is also increased thanks to the attention that the platform itself attracts, especially in the investment community, but also in the media and in the general public. In this way, a fundraising campaign becomes a kind of marketing channel.

The effect of marketing activities is reflected in increased awareness of the existence of a company and its product or service, as well as the fact that it turns investors and borrowers into buyers, supporters and even promoters. Namely, the fact that an investor has decided to lend money to a company shows that he or she values company's product while financial interest motivates him or her to become a loyal buyer and customer. For that reason, the lenders are motivated to promote the company and its product in their environment, thus becoming a sort of brand ambassador. In case of foreign investors, the marketing effect is even bigger as it enables larger visibility of companies in foreign countries, which provides for new opportunities to find partners on new markets.

There is not a single offer on the Serbian financial market which offers companies a marketing effect similar to that offered by crowdfunding platforms. Even though a marketing campaign also incurs costs for a company, its effects are not only reflected in attracting investors, but in increasing awareness of the company brand and the consequential production growth. Such effects can be quite important given the fact that lenders are usually small-sized companies.

Competence test of entrepreneurs/management

Apart from the described testing of the company's business model by the market, a crowdfunding campaign can be regarded as the confirmation of entrepreneur's ability to "market" its product and company.

Quality product and service development as well as setup of efficient organisation structure are crucial for company's success. However, when it comes to micro and small-sized companies without resources for hiring marketing and PR experts, the ability of the existing team to present its idea and/or business model in a comprehensible manner is very important for company's successful growth. The ability to persuade a sufficient number of unknown people to lend money to their company is the confirmation of management's skill to convince the market of the quality of products or services that the company offers.

Taking into consideration the importance that professional investors attach to the quality of the team behind a company carrying out fundraising campaign, platforms offer a unique opportunity to test management quality on an actual example, which represents an added value for the investors that they would not be able to achieve by themselves even with the help of an intensive analysis. There is

no offer on the Serbian financial market that would offer a comparable value to potential investors.

Crowdlending as a new investment class

For crowdlending platforms to operate as a source of funding for companies and entrepreneurs, first they must attract a sufficient number of investors or lenders that will invest enough money to meet demand. Thus, apart from funding, crowdlending platforms also offer an investment opportunity and are competitive not only for traditional funding services but for the existing investment classes, such as bank deposits, investment funds, life insurance, shares and bonds.

Platform investing is characterised by:

- A transparent investment, traceable all the way to the borrower and its business model. Unlike bonds or shares issued by large companies with complex business dependable on a variety of factors, crowdlending platform borrowers are of smaller sizes and their business is simpler. While the knowledge of accounting and financial analysis is important for a business analysis of a listed company, understanding of business operations of micro and small-sized companies, even innovative start-ups, is much more comprehensible for most investors.
- The possibility to choose a project and/or a borrower at its sole discretion and under own criteria. Unlike bank savings, which the bank freely disposes of and invests through loans to borrowers, a platform investor decides on its own who to borrow money to, so it can invest it under its own criteria and for its own reasons that may not be exclusively motivated by the investment return, but by a broader strategy.
- A small initial investment amount enables an investor to invest quite small amounts of money in start-ups and small-sized companies. Such a possibility is currently reserved for well-off individuals and professional investors, whereas crowdfunding platforms lower the minimum investment sum to a very small amount and thus make investing available to most investors. A small minimum investment amount enables better diversification possibility since the investment amount may be allocated to a larger number of investments.
- An appropriate risk/reward ratio, which needs to exist so that the investors are rewarded for the risk taken.
- Favourable investing taking into consideration that the investor costs are low on many platforms. The whole mediation cost is covered by the borrower.

The above described characteristics of crowdlending platforms would offer a new investment type and instrument on the Serbian market, which would enable different investors with different investment motives to invest their money in a simpler and more efficient manner. Some of the investors with specific motives are as follows:

- Individuals with a small investment amount – they can be motivated exclusively by the return on investment, but also by some less rational motives, such as the desire to participate in innovative projects or support local economy with a product that the investor knows and appreciates.
- Entrepreneur's friends and family – taking into consideration the level of dependency of local micro and innovative companies on this source of funding, the instrument such as a crowdlending platform can be of great importance given the process simplification by introducing model contracts between the company and the borrower that contain clearly defined rights and obligations. Instead of hiring a lawyer and handling negotiations which neither of the parties is good at, the platform provides them with a transparent and simple investment instrument.
- Corporations (mainly retail chains) – can have the role of a lead investor in case they see interest in developing capacities of their own suppliers. Therefore, if they recognise good potential investors that currently do not have sufficient capacities or do not meet the required quality standards, corporations can support them with a (interest bearing) borrowing and oblige themselves to purchase supplier's product under specific conditions. In this way, corporations obtain a new supplier, make profit from the marketing and "market testing" effect, thus increasing their income (since the sale of their product marketed through their sales network is incentivised), and increase their chances to have their loan repaid with interest.

- Business angels, risk capital funds, banks, development agencies – existing bidders can also benefit from crowdlending platforms, which is described in detail in the following section.

2.5 Synergy potential with existing suppliers

Based on experience from foreign markets and taking into consideration everything that has been written about the Serbian financial market, it can be concluded that, for the existing suppliers, the potential for cooperation with crowdlending platforms is much bigger than the risk that the market entry of such competitors or substitutes carries. Since crowdfunding offers unique added values (Section 2.4) and allows the participation of competitive funding suppliers in platform campaigns, crowdlending can be seen as a service compatible with the existing services on the market.

Each of the existing funding suppliers can, in some way, benefit from combining their own service with fundraising through platforms. This can be achieved by introducing the so-called lead investor. Namely, a lead investor can be a business angel, a risk capital fund, a bank, a corporation, a development agency, etc, which, apart from money, bring to companies legitimacy, expertise, experience, network, etc, thus increasing the chance for borrower's success, loan repayment and bigger return on investment.

On the other hand, lead investors are motivated to participate in such campaigns since they can greatly benefit from marketing and market testing effect, characteristic for crowdfunding campaigns:

- In case of business angels and venture capital funds, crowdlending campaign can be utilized as a confirmation of entrepreneurs' ability to market their products and companies. Moreover, the publicity that the company gets through such campaigns also increases the chances for success. If platform offers the so-called hybrid contracts that contain both debt-like (repayment obligation and fixed interest) and equity characteristics (share in company's success by means of bonus interest and debt-to-equity swap), business angels and funds can invest using the platform instead of directly buying equity shares.
- Banks can also benefit from the so-called marketing effect (in the same way as business angels and funds), which increases the likelihood of loan repayment and mitigates risk.

Additionally, banks can offer crowdlending as an alternative or a supplement to its own product. In case a borrower fails to meet the conditions required for obtaining a loan due to a capital shortage, taking a subordinated loan (subordinated to a bank loan) can be a solution to the problem. In this case banks do not take the role of a platform investor, but they forward clients to platforms while marketing their own product at the same time. In this way bank meets needs of a client at the beginning of their life cycle, while establishing a new or maintaining an existing good client relationship, which might repay in future when client meets the criteria for standard bank products.

Some of the examples of cooperation between banks and crowdlending platforms are: Aegon and Funding Circle, BNP Paribas and Ulule, WebBank and LendingClub.

- Development agencies, banks and funds that provide incentives to start-ups and small and medium-sized enterprises can also use such platforms as an instrument that enables them to test applicants and improve the allocation of resources.

Cooperation examples are the following: Funding Circle and British Business Bank, Funderbeam and the EBRD.

The cooperation method between traditional funding suppliers and platforms largely differs on various markets and even different cases, which corroborates the flexibility of platforms' business model and their compatibility with the existing bidders.

3. The crowdlending effect on national economy

3.1 Market failure mitigation

We talk about a market failure in cases when relying exclusively on the free market mechanisms does not lead to an efficient resource allocation. One of the main reasons of the market failure is information asymmetry, i.e. a relationship in which one party has access to all relevant information and is better informed than the other.

In the case of the Serbian banking market, the fact that banks are poorly informed about certain market segments may result in inappropriately high interest rates, extremely high criteria for loan approval or complete suspension of funding supply and thus non-existing market for a certain segment. Even though a perfect market is just an ideal that only exists in economic theory and thus, each actual market may be called unsuccessful, the consequences of a market failure and its extent, still need to be mitigated and reduced in practice. Prevention measures of market failure or for increasing its efficiency need to be focused predominantly on reducing information asymmetry.

Crowdlending platforms can be used for this purpose mainly due to the market testing effect that crowdlending campaigns have or the assumption that a successful campaign with many interested individual investors reflects market interest for a borrower's product. Although this assumption has its limits, banks' inability to assess the likelihood of project's failure may be reduced by testing market interest in this way. Moreover, the publicity that such campaigns can attract may additionally increase the chance for company's success and reduce the risk (both effects are described in detail in Section 2.4). These effects can enable banks to offer their clients more adequate lending conditions or to enable them access to funding, thus contributing to a more efficient allocation of the resources that would otherwise remain unallocated.

Nevertheless, information asymmetry is not the only reason for failure (or even non-existence) of a banking services market for certain client segments. There are also objective reasons, above all a high-risk level that affects the banks' decision to give up on some clients. In that case, other sources of funding are needed, such as equity investment, grants, subsidised loans, etc.

Crowdlending platforms can be useful (through hybrid loans) to standard equity investors, such as business angels and funds. However, market researches show that information asymmetry is even bigger in this case (even two-sidedly). While companies are better informed about their success prospects, investors have an advantage in a negotiation process thanks to their experience. Apart from the described market testing and marketing effects, which reduce the asymmetry on the investor's side, platform campaigns offer both sides standardised, simple and transparent contracts that simplify and accelerate the negotiation process, making it even more attractive for borrowers.

Development agencies, banks and other organisations that offer grants and subsidised loans (directly or indirectly) can also reduce information asymmetry using platforms. The probability of inefficient allocation or corruption during a funding approval process is reduced using crowdlending campaigns as a test for entrepreneur/company quality.

However, information asymmetry is the largest between companies and small investors that are not engaged in investing professionally, mainly due to insufficient knowledge and experience. Although individuals in Serbia can invest in equity or lend money to companies (under specific conditions), in practice this process is quite complicated with companies that are not traded on a stock exchange. A lack of business transparency and the inability to recognise a method of how to achieve such transparency (by the company) prevent an investor from appraising company's value and making an investment decision independently.

Apart from poor transparency, another problem is the conclusion of contracts, which often involves time-consuming and complex negotiations. A lack of legal expertise or negotiating skills can be an insurmountable obstacle for a small investor and prevent them from investing. Such information asymmetry on the Serbian market is usually solved by hiring financial and legal advisors. However, the costs of the consultancy services can be considerable and disproportionate to the profit, especially from the point of view of a small investor/an individual and they can easily make the investment economically inane. Looking from the point of view of a company, the logic behind taking small amounts from investors/lenders is even more disputable taking into consideration that the time and money spent is disproportionate to the funds raised.

A crowdlending platform where a company can carry out an informative promotional campaign increases business transparency and the information level for investors. Moreover, a standardised and explicit contract eliminates the need for hiring expensive legal advisors and reduces incurred costs, whereas small amounts that are grouped through the platform result in a volume that makes lending cost-effective. A functional crowdlending platform would greatly eliminate information asymmetry and enable small investors to invest in a market segment that has been unavailable before. On the other hand, companies are provided access to significant funding sources that they have not been able to use before.

The participation of crowdlending platforms would surely have an effect on reducing information asymmetry/market failure. Even though it has limitations, the platform business model is directly focused on solving the concerned problem of the financial market. On the other hand, the model's scope in terms of its impact on the financial market is still a question mark and depends on many external factors, above all on the willingness of the existing funding suppliers to use these platforms and general trust in alternative sources of financing. A larger number of stakeholders, which would include certain support through guarantee programmes (by national and supranational institutions), would significantly increase the crowdlending effect.

3.2 Increase in gross investments

An average share of investments in the Serbian GDP between 2015 and 2017 was only 17.1%, which is quite below the weighted average for Western Europe (20.4%) and Eastern and Central Europe (21.0%). Due to such a small share of investments in GDP, it is estimated that Serbia loses between 0.5 and 1% of GDP's annual growth.⁶ The presented information shows that any investment incentive is more than welcome.

Taking into consideration the market failure reduction described in the previous section, it is obvious that crowdlending platforms increase the investment level. The funds that would otherwise remain unused become available for investing by introducing mechanisms for reducing information asymmetry, which contributes to increasing the level of gross investments and accelerating the GDP growth accordingly.

Even though crowd loans can also be designated for working capital, it is reasonable to assume that a certain portion of money would be allocated for investments. The share of investment loans on platforms offering long-term loans will probably be much bigger than the share of other loans, which is even more applicable to hybrid contracts that are mainly long-term and intended for financing of company's growth (3 to 10 years).

According to the abovementioned, it can be concluded that the effect on the investment scope in Serbian economy would be positive even though it is, in terms of intensity, limited by the capital that investors have at their disposal and the acceptance level of this form of investing.

3.3 Attracting foreign investments

Previous sections were mainly focused on the Serbian financial market and funding suppliers currently active in Serbia. However, gross investments include foreign direct investments and the potential of

⁶ Why does the Serbian economy growth lag? (March 2019) – Fiscal Council of the Republic of Serbia

crowdfunding platforms to affect the attracting of foreign investments, which deserves special attention.

Investing in small and medium-sized enterprises is accompanied by many difficulties and costs in current circumstances. Information asymmetry is increased for foreign companies due to a lack of knowledge of local laws and business customs and the strict Law on Foreign Exchange Operations. Crowdfunding platforms, particularly in case of hybrid loans, would allow foreign investors to invest in a simple, transparent and familiar manner without having to cope with local administrative procedures.

However, while foreign companies find a way to overcome the lack of market knowledge (which naturally incurs high costs) by hiring local experts, foreign individuals are not presented with such a possibility. Investing in companies that are not listed on a stock exchange is very complicated and expensive, as it is for local small investors, and in case of small amounts it is mainly cost-ineffective for both the investor and borrower. The existence of a platform for quick and simple investing, with a sufficient volume that would justify the incurred costs, would make investing for both local and foreign investors much easier.

The Republic of Serbia with its large diaspora might greatly benefit from allowing its citizens living abroad to invest in Serbian companies. This possibility is currently limited to well-off individuals, whereas small investors face the obstacles described in Section 3.1. Taking into consideration that the income from remittances, i.e. personal transfers, during the first eleven months of 2018 amounted to EUR 3,173 million (a 17.5% increase in comparison to the same period last year), which is mainly used for consumption instead of investment, it would be reasonable to assume that the Serbian diaspora represents a big investment potential that is currently unused.⁷ It is worth mentioning that some members of the Serbian diaspora do not only invest for financial reasons, but they also want to support the development of their homeland in spite of more profitable investment options. This is currently limited to humanitarian donations, but there is no reason not to be extended to include business transactions.

Apart from money inflows, foreign investments can have additional qualitative benefits for local micro, small and medium-sized enterprises, which is the topic of Section 4.3. It should be mentioned that drawing foreign investors' attention to Serbian companies increases their visibility on foreign markets and induces the exit of local companies and their products and services outside the Serbian borders. This effect can be quite important for small companies with limited marketing resources.

3.4 Effect on gross domestic product

The effect of potential establishment of crowdfunding platforms on unemployment and GDP in Serbia is very difficult to quantify. Even though it is obvious that the effect would be positive, for a more precise assessment a model based on many assumptions would have to be developed. Value of such model would be questionable.

However, a research of the British platform for crowdfunding "Funding Circle" which together with "Oxford Economics", a consulting house specialised for quantitative analyses, has analysed the effect of business to the local economy on its four markets may serve as a guideline.⁸ Below are the data for 2017.

⁷ Preliminary data of the balance of payments of the National Bank of Serbia about remittance inflows (personal transfers) during an eleven-month period in 2018.

⁸ The Economic Impact of Lending Through Funding Circle (June 2018) – Oxford Economics | Funding Circle

Country	Value of loans issued during the year	Gross value added	Tax	Jobs
UK *	1.2	2.4	0.7	44,600
USA **	0.5	2.0	0.8	27,700
Germany ***	55.0	103.0	24.2	1,700
The Netherlands****	33.6	65.0	19.9	900

* Billion GBP (except for jobs)

** Billion USD (except for jobs)

*** Million EUR (except for jobs)

Their analysis measures the contribution of gross value added (GVA)⁹ i.e. the value of products and services produced in a given territory, taxes paid and the number of jobs with clients. In order to properly understand the presented table, it should be noted that only the companies that are repaying their loans at the given moment (end of 2017) are taken into consideration. The contribution current borrowers will realize in the future due to the growth financed through the loan, as well as the contribution of the companies that have already repaid their loans, was not considered. Therefore, it is reasonable to assume that the actual effect on GVA and the number of jobs is significantly greater.

The question of comparability of developed countries with a high level of trust between market participants and Serbia is legitimate. It can be argued that such a shallow and undeveloped market is not a suitable environment for this type of platforms, so the effects achieved in the above markets may not be a good indicator for Serbian market. On the other hand, taking into consideration the lack of options offered by the Serbian financial market it can be concluded with arguments that the effect of introducing such an innovative option for financing, in relative terms, could have a much greater effect. While, for example, a small company in UK has a wide range of innovative, but also traditional, sources of financing, a comparable company in Serbia has significantly fewer options. Therefore, the value added and the effect of introducing a new source of financing would be relatively high.

4. Social Impact of Crowdfunding

4.1 Encouraging entrepreneurship

By targeting a clientele that has so far been largely ignored by traditional providers of funding, crowdfunding platforms have positive effect on entrepreneurial spirit in a society. This effect is manifested in several ways, primarily by promoting young companies (their users) by enabling campaigns for raising loans and the accompanying publicity. Promoting success stories and raising awareness of the existence of finance sources suitable for the needs of micro and small-sized companies also encourages potential entrepreneurs. The most direct contribution to entrepreneurship is the value added that the platforms offer, as described in section 2.4, which increase the chances of success for their clients, and hence the entrepreneurs behind them. Finally, the possibility of including corporations as leading investors in crowdfunding campaigns or partners in

⁹ Gross value added = Gross domestic product + Subsidies – Direct taxes

some other sense encourages entrepreneurial spirit in the existing large companies (so called “intrapreneurship”) and contributes to innovativeness also outside of start-ups and small-sized companies in general.

4.2 Fighting unemployment and poverty

By financing companies, positive impact on economic growth, encouraging entrepreneurial spirit and increasing employment, crowdlending platforms have effect on poverty reduction. The very structure of the borrowers, that is, the industrial sectors from which borrowers come, affect the number of employees.

Namely, the experiences from other markets show that platform users are not exclusively innovative start-ups, but also companies from traditional industries, such as construction, catering, food and beverage production, and the like. Bearing in mind this significant share of labour-intensive sectors in the structure of the users of the platform, it can be concluded that the existence of platforms in the Serbian market would contribute to the creation of jobs that do not require the highest level of education and which would be accessible to that part of the workforce that struggles the most to find employment.

On the other hand, in case of high-tech start-ups employees most often come from other, already existing companies, so there is no net effect on unemployment. However, with its potential for rapid growth, in the long-term start-ups can significantly affect unemployment issue. Later phases of the life cycle of such companies involve the construction of corporate organizational structures with jobs requiring staff of different profiles, and therefore also those whose supply exceeds demand on the labour market.

By creating jobs, especially for those profiles of people who are most prone to unemployment, crowdlending platforms help in reducing unemployment and, therefore, alleviating poverty.

4.3 Prevention of “brain drain”

Encouraging entrepreneurship, especially in the case of innovative companies, provides an opportunity for young people to find a job in Serbia that meets their criteria, both in terms of earnings and the very challenge of the job.

The fact is, there are many obstacles to development of people’s own innovative business in Serbia, among others, the difficult access to funding as one of the most important ones, which influence the decision of many entrepreneurs to move or establish their companies abroad, closer to larger markets and potential investors. The existence of crowdlending platforms, which would make domestic companies visible to foreign investors and enable them to invest in a simple and transparent way, would reduce the need for a change of location.

Keeping high tech and innovative companies in Serbia would provide a much better offer on the job market. This is not only a question of the salaries level earned by employees in such companies, but also of job quality itself and the whole perspective of the company they work for. The feeling of being isolated from the most important global technological and business trends and the desire to realize own potential motivate ambitious people to go abroad. Although Serbia can hardly compete with the most developed economies when it comes to offering opportunities for personal development, any effort in this direction can be of great importance. In a small and poor economy like Serbian, several successful companies can make a big difference.

4.4 The impact on regional development

The platforms’ orientation to internet and, therefore, their direct connection with domestic and foreign potential investors and business partners enables the companies located outside large city centres to more easily engage in regional and global business flows and reduces the need to change location.

In the same way the platforms can influence the alleviation of the emigration problem, they can also help regarding the issue of large regional differences in the level of development within Serbia. Namely, the companies’ need for positioning themselves close to big cities due to proximity to the

market and funding contributes to further centralization and growing differences between several large cities (primarily Belgrade and Novi Sad) and the rest of the country.

An entirely internet-based business model enables companies to address investors wherever they are, and the marketing effect helps them to attract attention of customers outside their region. This reduces the need to change the location of the company, and therefore the concentration in large city centres.

In addition, crowdlending platforms have a positive impact on investments from the regions themselves, as they provide investors with the opportunity to support entrepreneurs or local brands from their vicinity. Very often, investors have already been buyers of products or users of the company's services, knowing local circumstances, as well as the entrepreneurs and the companies concerned, and they are able to estimate whether the campaign is worthy of their investment. The combination of a high level of awareness and the desire to support local businesses contributes to raising the level of investment in the region, and hence to regional development.