

# China Equity Crowdfunding Regulatory and Market Study

Briefing Note

# Introduction

This document is intended as an introduction to equity crowdfunding in China for professionals, investors, regulators and policy makers. It seeks to support China and the UK to cooperate through equity crowdfunding.

It is supplemented by a separate China-UK equity-crowdfunding regulatory and market comparison study.

This study is not intended as a comprehensive guide that could replace the need for further due diligence, nor do we attempt to offer any legal opinion on the regulatory mechanisms described.

The work has been carried out on behalf of the British Government's China Prosperity Fund by BOP Consulting, the UK innovation charity Nesta and ZhouYue Crowdfunding Industrial Park.

The partners do not warrant any of the information contained herein as the basis of any investment decision.

## Trends within the Chinese market

- A savings ratio of 30% (compared to 5.60% in the UK) and central bank base rates below the rate of consumer price inflation have combined to create huge demand for alternative investment products in China.
- From a base of 32 platforms that raised approximately 1 billion CNY (£118.6 million)<sup>1</sup> in 2014, the market grew fivefold in 2015 to 130 platforms that raised approximately 5.2 billion CNY (£615.7 million).
- Equitycrowdfunding remains a small proportion of the total market for alternative investments. For example, the size of the Chinese equity crowdfunding market is around 0.5% that of the Chinese P2P market which raised 975 billion CNY (approx. £115.6 billion) in 2015. This is in part due to a lack of regulatory clarity.
- Growth continued into the first half of 2016, with 144 platforms engaged in equity crowdfunding raising 3.6 billion CNY (£427 million), only to stall in the third quarter following a regulatory review and a loss of investor confidence.

## Chinese regulation and policy

- While the Chinese government has announced policies in support of internet financing and equity crowdfunding, the regulatory environment remains uncertain and in a state of ongoing review. There is no clear catch-all regulation or regulatory body for equity crowdfunding in China.
- Existing equity crowdfunding platforms that operate in China adhere to one of two sets of regulations, for 1) financial institutions or 2) internet financing platforms. Neither set of regulations satisfactorily covers all forms of equity crowdfunding as it exists in China, although revisions to the Securities Act (expected early 2017) may address the current state of limbo.
- For now, however, nominee structures and secondary markets (through issue of shares) are barred, and regulations to monitor and minimise personal foreign exchange transactions effectively block individual investments in cross-border equity crowdfunding.

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<sup>1</sup> £GBP 1 = 8.43 CNY (exchange rate as of March 2017) This is the exchange rate used through the document.

- Regulatory uncertainty and the government's hesitancy in this area is brought about by a wish to strike a balance between: encouraging new forms of financing for entrepreneurs; providing new forms of investment services to investors; protecting less sophisticated 'retail' investors; guarding against outflows of private capital; and avoiding the fraudulent activity that has beset the P2P industry.
- While there are many wealthy individuals in China, there is not a mature retail investment environment. Information failures and regulatory uncertainty combine to create barriers to entry to the market.

## UK platforms' perspective on the Chinese market

UK platforms are interested in the Chinese market, but currently they have little or no activity in China.

### Key areas for improvement include:

- More clarity on regulation of the Chinese market.
- More insight into the Chinese market, particularly into which sectors are most suited to equity-based crowdfunding.
- More clarity on: the Chinese government's position on a foreign platform operating in China; Chinese investors bringing money out of China by investing in UK businesses; and overseas investors taking stakes in Chinese businesses via equity-based crowdfunding.

## Chinese platforms perspective on the UK market

- Chinese investors have a sense of the potential of the UK market: it offers a stable and transparent regulatory environment and access to new 'advanced' / 'high' technology that could be scaled for the Chinese market.
- However, the same opportunities exist on a larger scale in the US, and at time of writing this is a market with which Chinese investors express greater familiarity and a sense of security.
- It seems that governments and industry in both UK and China may need to invest in pilot projects to exchange knowledge and investment in more structured ways, including experimentation with new technologies: e.g., 'bitcoin', 'block chain' and to provide a proof of market to investors.

# Understanding Chinese equity crowdfunding

The alternative investment market in China, of which equity crowdfunding forms a small percentage, is configured very differently from that in the UK. The difficulty of presenting a clear picture is exacerbated both by a lack of data transparency and a very different (and frequently ambiguous) set of regulatory policies. With those caveats, and the further qualification that this is not intended either as a comprehensive guide to the market or a legal reference, here we attempt an overview of the equity crowdfunding sector in China.

Equity crowdfunding exists in a quasi-regulated state in China. It is effectively limited to institutional and 'sophisticated' investors and the regulatory position is under constant review. While government is keen to harness the potential in equity crowdfunding to support the development of entrepreneurialism in China, this enthusiasm is countered by concerns about risk to 'unsophisticated' investors, i.e., retail investors and the general public. The government is concerned that retail investors and the public do not understand the potential risks associated with equity crowdfunding, and that any widespread market failure and investor losses would be damaging to the government.

This is reflected in unclear regulation conditions which attempt to strike a balance between encouraging new forms of financing for entrepreneurs; providing new forms of investment services to investors; protecting retail investors; and avoiding the fraudulent activity that has beset the P2P industry.

# Size and growth of the Chinese market

- In 2014, crowdfunding platforms in China initiated 3,091 equity crowdfunding projects that raised approx. 1 billion CNY (approx. £118.6 million)<sup>2</sup>. By the end of 2014, there were 32 equity crowdfunding platforms in China<sup>3</sup>.
- In 2015, equity crowdfunding platforms in China raised 5.19 billion CNY (approx. £615.7 million) in total, a fivefold increase from the previous year. By the end of 2015, the number of platforms had risen to 130<sup>4</sup>.
- In the first half of 2016, 144 platforms engaged in equity crowdfunding and 3,254 projects<sup>5</sup> raised total 3.6 billion CNY<sup>6</sup> (approx. £427 million).
- However most recent data from August to November 2016 indicate that sector has severely contracted, with the total funds raised in November 2016 estimated to be 200 million CNY (approx. £23.7 million)<sup>7</sup>. This is due to changes in the regulatory environment and a loss in confidence in the sector.

Note - Information on the size and volume of individual investments is not available.

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<sup>2</sup> <http://www.199it.com/archives/337065.html>

<sup>3</sup> <http://www.chinabgao.com/stat/stats/43525.html>

<sup>4</sup> <http://finance.sina.com.cn/roll/2016-01-16/doc-ixnrahr8378737.shtml>

<sup>5</sup> [http://www.zczj.com/news/2016-08-01/content\\_8140.html](http://www.zczj.com/news/2016-08-01/content_8140.html)

<sup>6</sup> <http://bank.jrj.com.cn/2016/12/30112321910637.shtml>

<sup>7</sup> <http://bank.jrj.com.cn/2016/12/30112321910637.shtml>

# Chinese market trends

- Research suggests there is a savings ratio<sup>8</sup> of approximately. 30% in China<sup>9 10</sup>. - i.e., that Chinese citizens save some 30% of their earned income.
- The Consumer Price Index (CPI) increased by 2.0% in 2014, while interest rates remained at 1.75%<sup>11</sup>. The low interest rate has stimulated enormous demand in China for alternative investment products.
- Compared with other alternative finance sectors the market size of equity crowdfunding is relatively small. For example, the size of the Chinese equity crowdfunding market is around 0.5% that of the Chinese P2P market which raised 975 billion CNY (approx. £115.6 billion) in 2015<sup>12</sup>. Ongoing regulatory review and the government's cautious attitude hinders the sector's development<sup>13</sup>.
- Starting in 2015, large technology and e-commerce companies including Alibaba<sup>14</sup>, JD<sup>15</sup>, 360<sup>16</sup> and Xiaomi<sup>17</sup> established their own equity crowdfunding platforms. These companies leverage their brand and existing user base to support entrepreneurs looking to raise funds<sup>18</sup>.
- More recently vertical and specialised equity crowdfunding platforms have started to emerge, including industry-specific platforms for agriculture<sup>19</sup>, automobile<sup>20</sup>, real estate<sup>21</sup> and restaurants<sup>22</sup>.
- Pending regulation for 'public equity crowdfunding' (equity crowdfunding that is accessible to the general public), the sector has become known for serving wealthy and more sophisticated individual and institutional investors: angel investors and venture capital firms<sup>23</sup>.
- Due to the risks associated with start-up and early stage investment, some platforms exclusively offer investment opportunities in mature businesses: both 360<sup>24</sup> and Xiaomi<sup>25</sup> choose to encourage institutional investors, rather than individual investors<sup>26</sup>.

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<sup>8</sup> savings ratio = (residents average revenue – residents average expenses)/ residents average revenue

<sup>9</sup> <http://money.163.com/16/0519/17/BNEOIDU800253B0H.html>

<sup>10</sup> The savings ratio published by World Bank contains also corporate savings (64%) which is not representative for residential savings ratio.

<sup>11</sup> <http://money.sohu.com/20150923/n421884047.shtml>

<sup>12</sup> <http://p2p.hexun.com/2016-01-04/181584365.html>

<sup>13</sup> <https://zhuanlan.zhihu.com/p/21533461>

<sup>14</sup> <https://www.antsdaq.com>

<sup>15</sup> <https://dj.jd.com/index.html>

<sup>16</sup> <https://t.360.cn>

<sup>17</sup> <https://www.antsdaq.com>

<sup>18</sup> <http://www.100ec.cn/detail-6304102.html>

<sup>19</sup> <http://www.hhgoat.com/home/yx/?cj=yhq9418>

<sup>20</sup> <http://www.qichezhongchou.cn>

<sup>21</sup> They have shut down operation after the regulation issued on October 2016

<sup>22</sup> <http://www.kaoputou.com>

<sup>23</sup> <http://www.weiyangx.com/224466.html>

<sup>24</sup> <https://t.360.cn>

<sup>25</sup> <https://www.antsdaq.com>

<sup>26</sup> <http://www.weiyangx.com/224466.html>

- In June 2016, the press reported investor suspicions of fraudulent behaviour with Hongli Energy's campaign on the platform 36Kr. Sales revenue in 2015 released by Hongli Energy through the campaign didn't match the figure disclosed in its annual report. 36Kr<sup>27</sup> was also accused by investors of not fulfilling its due diligence responsibilities. This case negatively impacted subsequent campaigns on 36Kr and damaged confidence in the sector<sup>28</sup>.
- In October 2016 the government announced that it was undertaking a review of the entire Internet Finance sector, including equity crowdfunding. The review, due to be completed early 2017, is intended to clean up the industry and further protect investors<sup>29</sup>.
- The suspected case of fraud and the recent government review has led to a reduction in the number of platforms offering equity crowdfunding services and the amount of money raised through platforms still offering equity crowdfunding services. (See Figure 1 and Figure 2, below.)

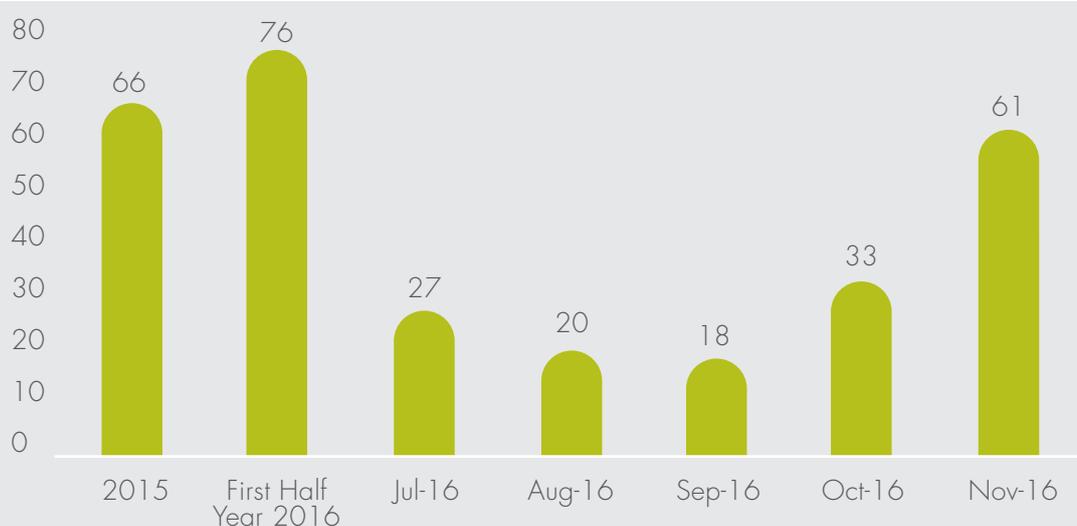


Figure 1. Number of equity crowdfunding platforms that have ceased offering equity investment opportunities<sup>34</sup>

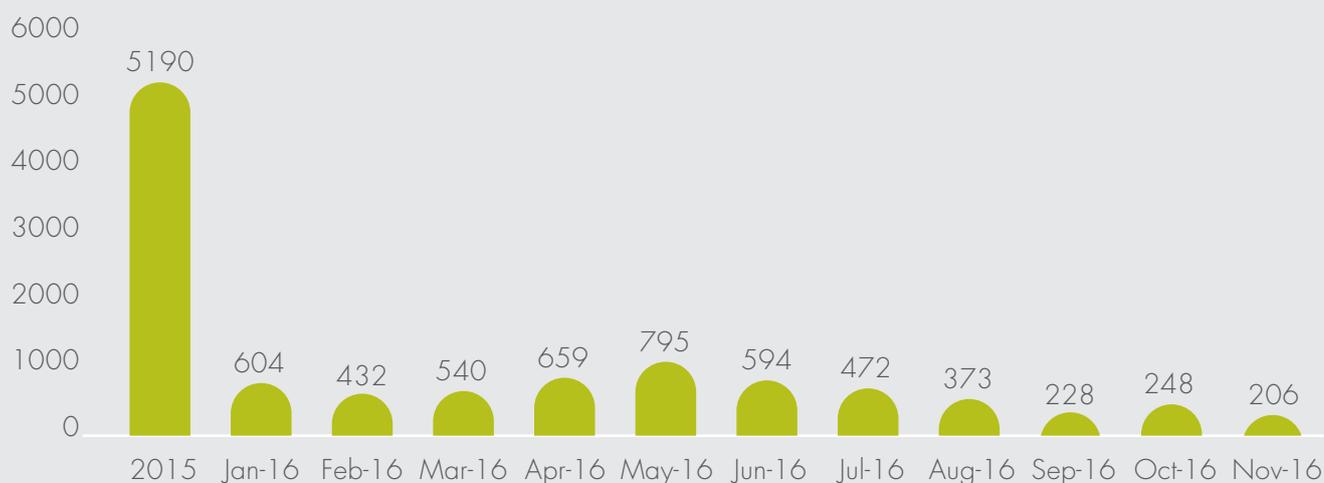


Figure 2. Total raised on equity crowdfunding platforms (million GBP)<sup>35</sup>

<sup>27</sup> <https://www.36jr.com>

<sup>28</sup> <http://www.tmtpost.com/1920834.html>

<sup>29</sup> 10月13日国务院办公厅印发《互联网金融风险专项整治工作实施方案的通知》 [http://www.gov.cn/zhengce/content/2016-10/13/content\\_5118471.html](http://www.gov.cn/zhengce/content/2016-10/13/content_5118471.html)

<sup>34 35</sup> <http://bank.irj.com.cn/2016/12/30112321910637.shtml>

# Case-studies and business models in the Chinese market

The restricted forms of equity crowdfunding available in China predominantly attract sophisticated and institutional investors. Platforms are not open to the 'crowd'.

Unlike in the UK, there is no public data available for individual platforms; Chinese platforms have not to date volunteered data comparable to that available for their UK counterparts. Consequently, there is little known of the average campaign sizes, number of investors and the types of companies that have successfully and unsuccessfully used equity crowdfunding in China. It is unclear if equity crowdfunding is providing businesses and start-ups with new sources of funding and investors with new investment services as the government hopes.

Unlike in the UK, the nominee model is not encouraged in China: platforms tend to offer investment in companies directly or via a special purpose vehicle (SPV).

Platforms in China tend to operate on a commission-based business model, similar to UK platforms. There follows an overview of some of the main platforms operating in China. Where available, we provide details of their business model and sectors of focus.

## Angel Crunch (天使汇) - [angelcrunch.com](http://angelcrunch.com)

Angel Crunch, established in 2011, is one of the longest standing investment platforms in China. It aims to support start-up businesses find 'angel investors'. The platform targets sophisticated experienced investors. It has strict requirements for investors to gain access to the platform, including evidence of prior experience of investment and an existing portfolio. Angel Crunch's model resembles that of Syndicate Room in the UK in that a project is required to have a lead investor before it is available to other investors on the platform. A lead investor must purchase a minimum of 5% and maximum of 50% of the equity on offer, and must have a history of at least one successful investment exit.

SPVs, typically Limited Partnerships, are set-up for projects with more than three investors. The platform offers a form of nominee structure for projects with less than three investors. The platform charges a 5% commission to investees and 5% commission on dividends earned.

## Dajia Tou (大家投) - dajiatou.com

Dajia Tou, established in 2012, aims to enable small businesses to solicit investment from the 'crowd'. While there are still minimum requirements for investors to gain access to the platform, the threshold for what qualifies as an investor is lower than Angel Crunch. The platform targets less sophisticated investors; but heavily vets all business and projects available through the platform.

SPVs are set-up for all projects that raise funds successfully. Funds collected are authorized and managed by the Industrial Bank of China (CIB). The platform charges a 5% commission from businesses who successfully raise funds through the platform.

## JD Dongjia (京东东家) - dj.jd.com

JD is one of China's top three E-commerce platforms. JD's online private equity financing platform, JD Dongjia, launched in March 2015 and has raised a total amount that exceeds 1.1 billion CNY and involves more than 60,000 investors<sup>30</sup>. JD Dongjia offers a similar investor lead model to Syndicate Room and Angel Crunch; a lead investor must purchase a minimum of 30% and maximum of 80% of the equity on offer<sup>31</sup>.

## Mic Finance (米筹金融) - micfinance.com

Xiaomi Technology is one of the best-known manufacturers of mobile and intelligent devices in China. Established in March 2016, Mic Finance is a Xiaomi subsidiary and supports Xiaomi's diversification beyond hardware manufacturing. Mic Finance stated aim is to support entrepreneurship through equity crowdfunding<sup>32</sup> and to help small businesses develop new technologies<sup>33</sup>. Xiaomi's move into the Internet finance sector illustrates an appetite and the potential in China for large technology companies such as Xiaomi to make use of equity crowdfunding to support and develop their core business.

## Youke Tou (优客投) - youketou.com

Youke Tou, established in April 2015, is the first platform in China to focus on cross-border equity crowdfunding, with most investment opportunities in US and Australia. Priority sectors include cultural and creative industries, real estate, technology and education. The minimum fundraising target is typically more than 10 million CNY. The platform targets high net worth domestic accredited investors who are looking for overseas investment opportunities. Cross-border payments are managed by an unspecified 'third party'; it is unclear how the platform adheres to existing cross-border investment restrictions for individuals.

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<sup>30</sup> <http://tech.sina.com.cn/i/2016-05-06/doc-ifyryahs0170257.shtml>

<sup>31</sup> [http://www.zczj.com/news/2015-10-12/content\\_4230.html](http://www.zczj.com/news/2015-10-12/content_4230.html)

<sup>32</sup> <http://it.sohu.com/20160615/n454419062.shtml>

<sup>33</sup> <http://finance.qq.com/a/20161217/009291.htm>

# Recommendations

Below outlines several recommendations to support China-UK cooperation through equity crowdfunding. These recommendations constitute an initial framework for cooperation in this area.

## Industry to industry dialogue: China-UK equity crowdfunding alliance

UK and Chinese platforms expressed interest in better understanding respective markets, business models and regulatory environments. At present, there is little opportunity and no formalised means for these platforms to connect, share knowledge and cooperate.

It is recommended to establish a China-UK Equity Crowdfunding Alliance that brings together UK and Chinese platforms and industry bodies i.e. UK Crowdfunding Association (CFA) and the National Internet Finance Association of China (NIFA).

The alliance should convene as an annual forum that alternates between China and the UK. The idea is to enable industry stakeholders from both countries to work together to promote regulatory development in the respective countries, promote industry cooperation, share industry best practice and provide support and advice for platforms interested in working in the respective countries.

The alliance should be supported by the relevant government bodies in China and UK through funding and a commitment to participate.

## Regulatory knowledge sharing

Regulatory stakeholders and platforms in China and the UK expressed a lack of knowledge of the respective regulatory environments.

It is recommended that regulatory conditions and changes to regulatory conditions should be published and made available in the respective countries. The China-UK Equity Crowdfunding Alliance proposed should work to disseminate appropriate regulatory information. That work would include publicly sharing regulatory information in the respective languages to the relevant regulatory, industry and media bodies.

Building on the above and the complementary regulatory comparison study, we also recommend regularly publishing regulatory guidance of the two respective markets for platforms, businesses and investors.

The objective is to promote knowledge of the respective regulatory environments and encourage the adoption of industry best-practice.

# Data framework

Unlike in the UK, there is a lack of available data on the equity-crowdfunding industry in China. This data deficiency limits knowledge of the Chinese sector domestically and internationally, and thus inhibits the development of the sector.

It is recommended to develop an international data framework (or a set of data standards) for equity-crowdfunding platforms. The data framework would detail the data that platforms should collect and how that data should be made available to support the development of the industry. Through the alliance proposed, UK and Chinese industry bodies should devise the framework and promote its adoption internationally.

A common data framework would provide investors, platforms and regulators with a better understanding of the state of the market. It would enable investors to improve their understanding of the risk and opportunity through equity crowdfunding, support knowledge sharing across platforms and enable regulators to make data informed decisions to develop the industry better.

A data framework wouldn't be specific to China and the UK, but its adoption in China and the UK would promote its adoption internationally.

# Government backed pilot programmes and initiatives

There is no precedent for cooperation between equity-crowdfunding platforms in China and the UK. However, both sides have expressed a strong desire to cooperate but lack the knowledge and government support to do so.

It is recommended that relevant government bodies in China and the UK develop several pilot projects and initiatives to create a precedent for and encourages cooperation between Chinese and the UK platforms. Pilot projects could include:

- Devise and run a number of campaigns that supports UK businesses to raise funding on Chinese platforms and vice-versa. The campaigns should be devised to include different models including civic and matched based initiatives with government.
- Support existing UK platforms to localise for the Chinese market i.e. enable a UK platform(s) to deploy a campaign in China and vice-versa.
- Devise and run a campaign that harnesses innovations such as 'bitcoin' and other distributed ledger ('Blockchain') technologies that enable cross-border investment transactions.
- The development of a pilot region/zone in China that provides businesses and platforms registered in the zone with reduced restrictions on outbound individual investment specifically for equity crowdfunding. The zone could be part of the China-UK FinTech bridge initiative.

This briefing note was prepared by BOP Consulting, an international research and strategy firm.

Our China operation was established in 2013 and focuses on supporting international businesses and governments understand the political context and practical realities of doing business in China.

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