

The Rise and Fall of Equity Crowdfunding: Lessons from China

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This presentation is an updated version of the following article:

Lin Lin, Managing the Risks of Equity Crowdfunding: Lessons from China (2017) 17(2) Journal of Corporate Law Studies, 327 – 366

SSRN author page:

https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1721858

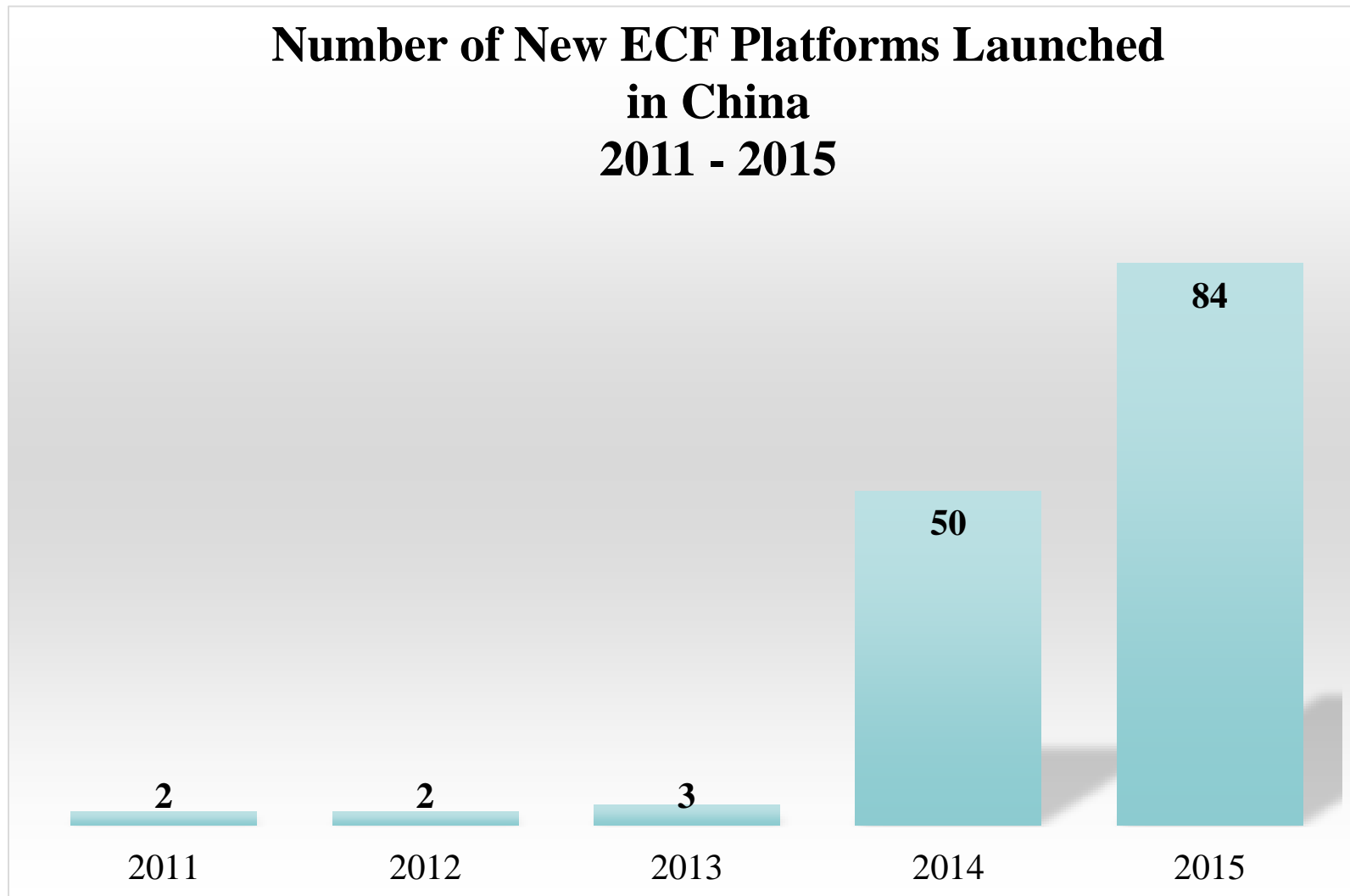
Roadmap

- **What** --- the rise and fall of the Equity Crowdfunding (ECF) market in China.
- **Why** is there a dramatic change?
- **How** should we regulate the ECF market?

Roadmap

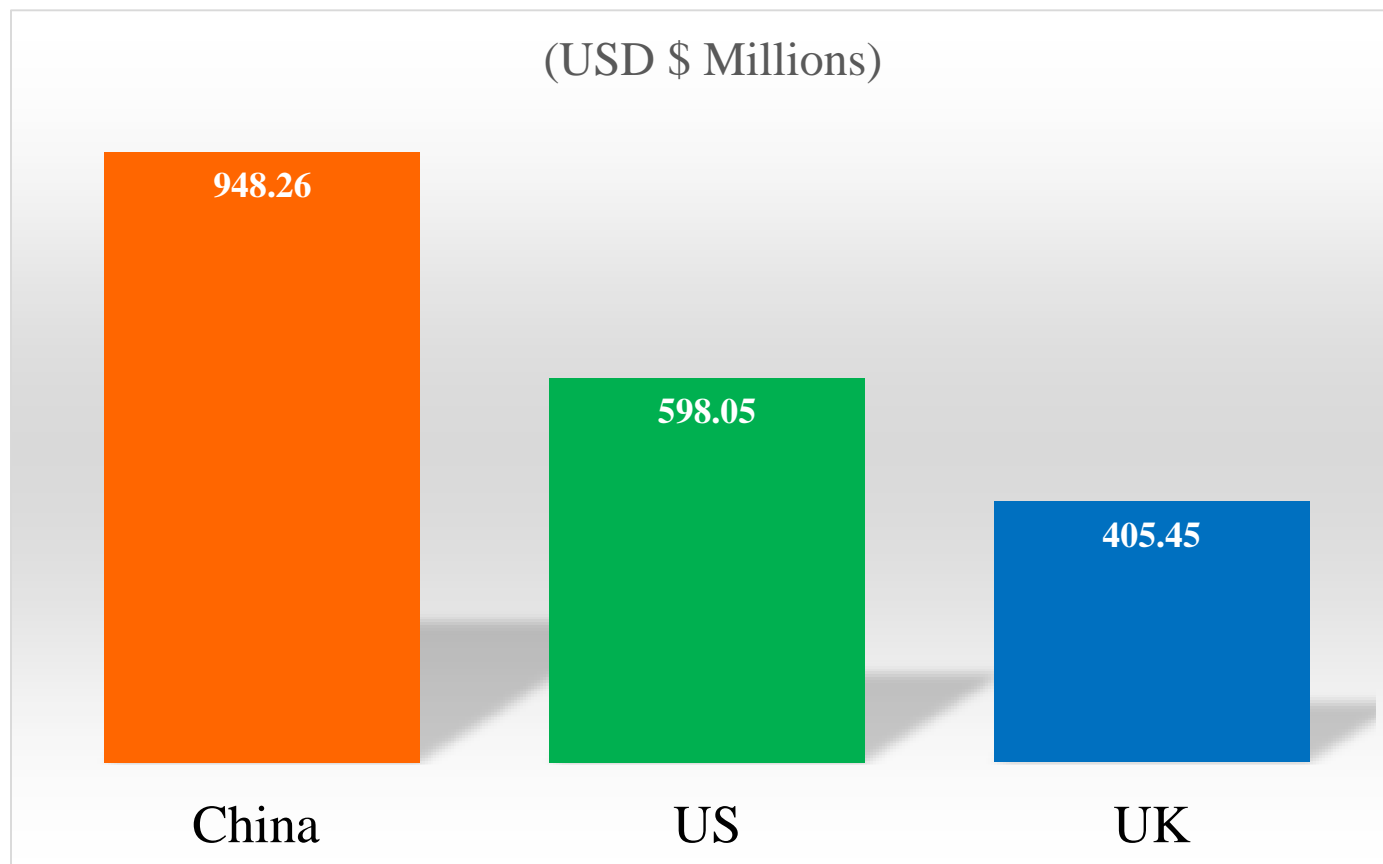
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The Rise (2011-2015)

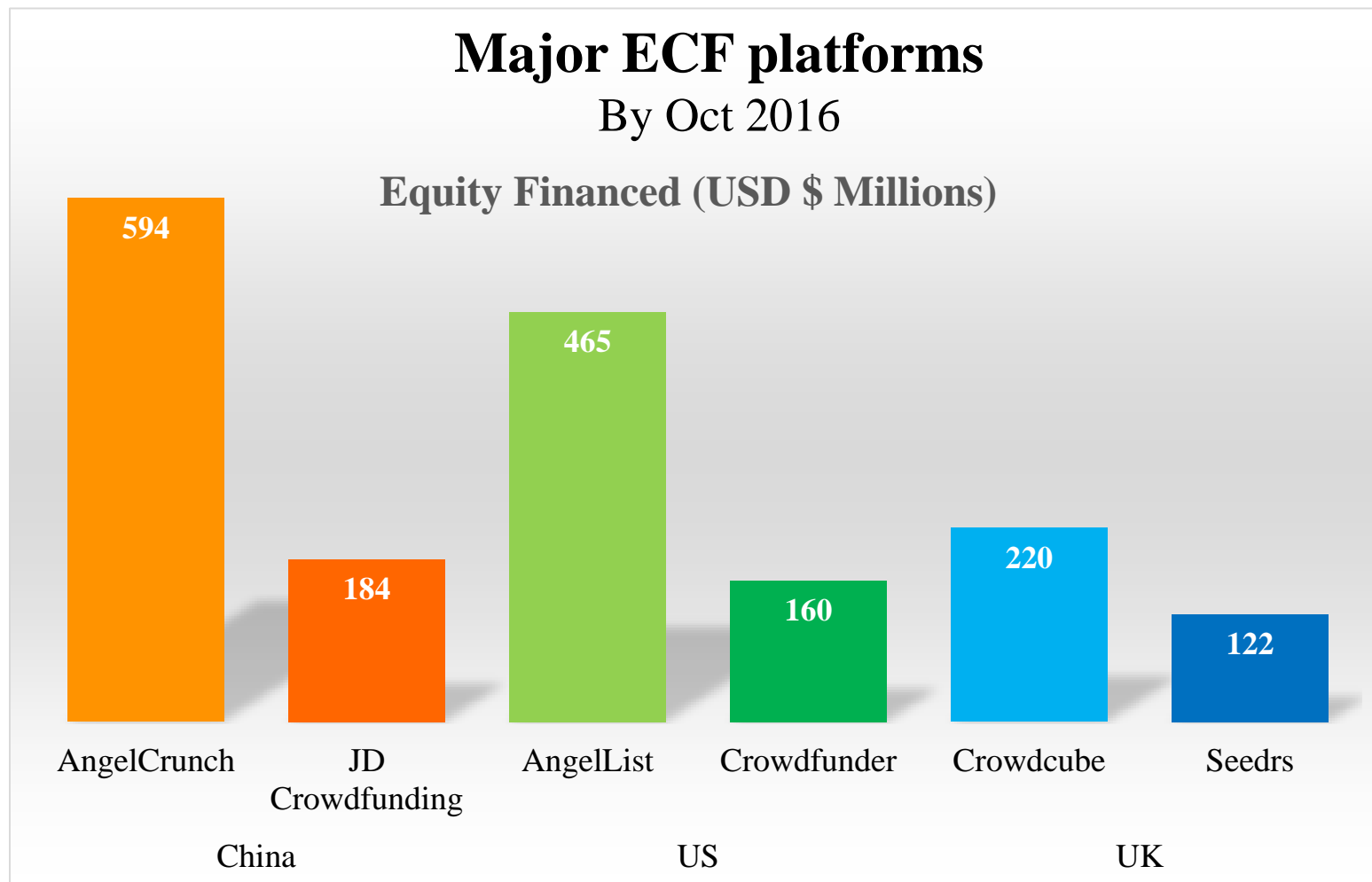


Source: Cambridge Centre for Alternative Finance & Yingcan, author's calculation

Size of **2015** ECF Industry



Source: Cambridge Centre for Alternative Finance & Yingcan, author's calculation



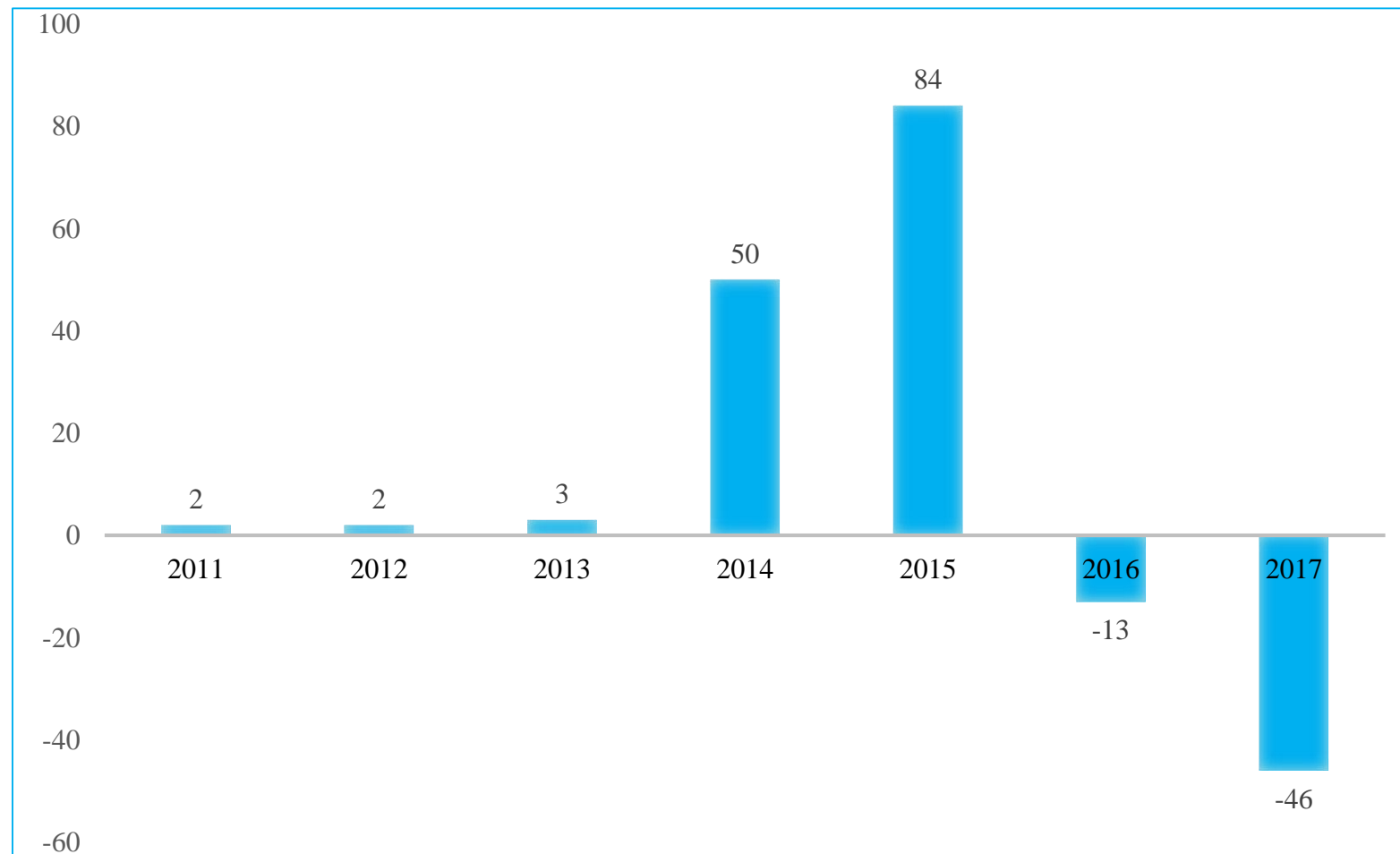
Source: author's calculation

Contributors to the Rise

- **Benefits of ECF**
 - solves the severe capital gap problem for start-ups
 - a supplement to VC/angel investors as it can be utilised by a wide spectrum of enterprises
 - more efficient, expedient and less costly for start-ups seeking equity financing
- **There was a lack of specific regulation.**
 - There was neither a clear definition of ECF nor a legal framework governing ECF in China before 2016.

The Fall (2016-present)

Number of **new** ECF platforms launched in China
2011-2017



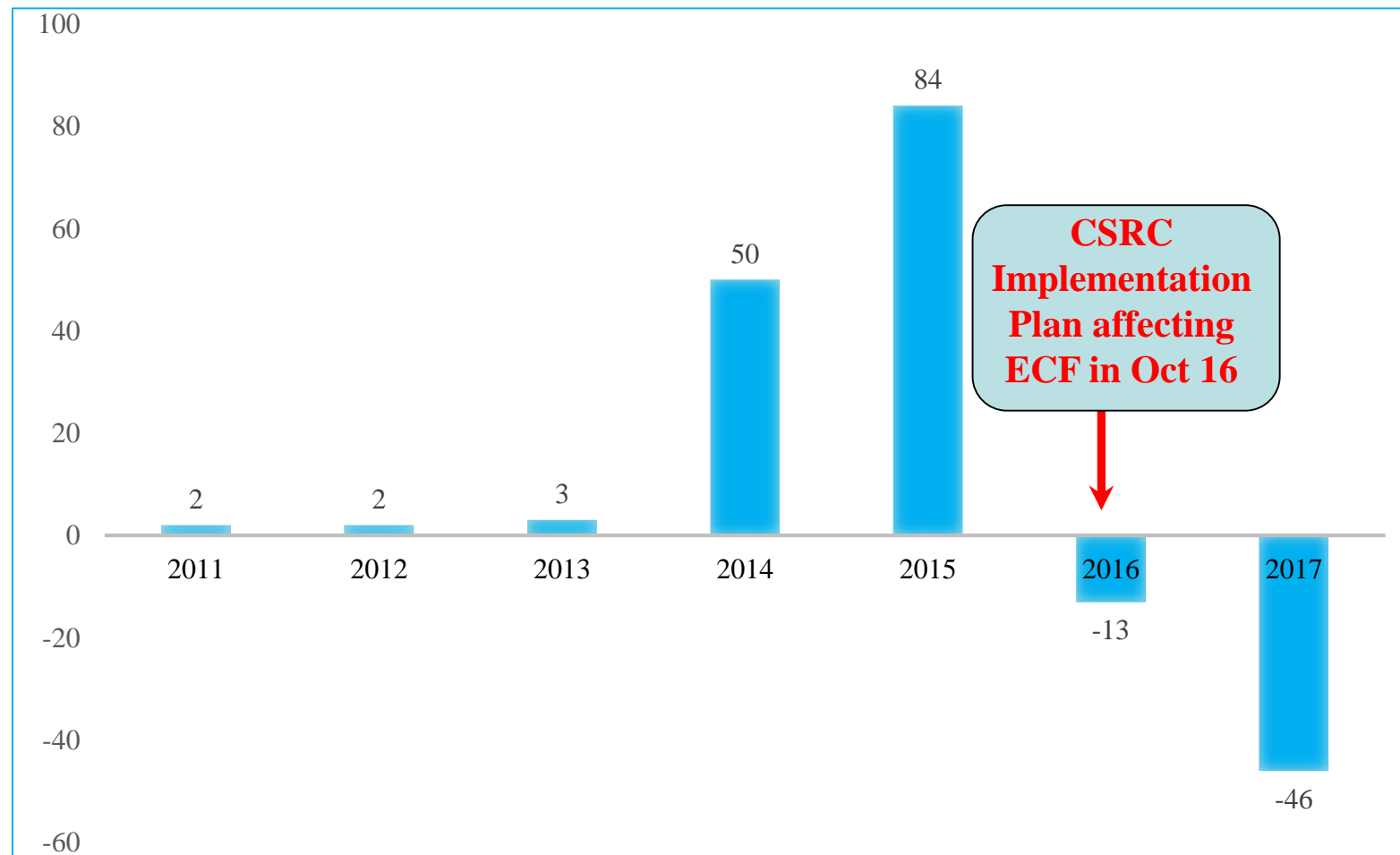
Source: Yingcan Consulting, author's calculation

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Source: Yingcan Consulting, author calculation

The 2016 CSRC Implementation Plan

- The China Securities Regulatory Commission (CSRC), along with 15 other departments, jointly issued the “Equity Crowdfunding Risk Special Regulation Implementation Plan” (*The Implementation Plan*) on 13 October 2016.
 - *“Issuing equity to non-specific persons and/or to more than 200 specific targets is deemed to be an issue of securities to the public and is subject to approval by CSRC.”*
 - *Investigation of the platforms raising funds under the pretence of ECF; platforms engaging in false advertising; platforms and their officers committing misappropriation or conversion of investor funds, etc*

Why 2016 Implementation Plan?

The **high-risk nature** of the industry

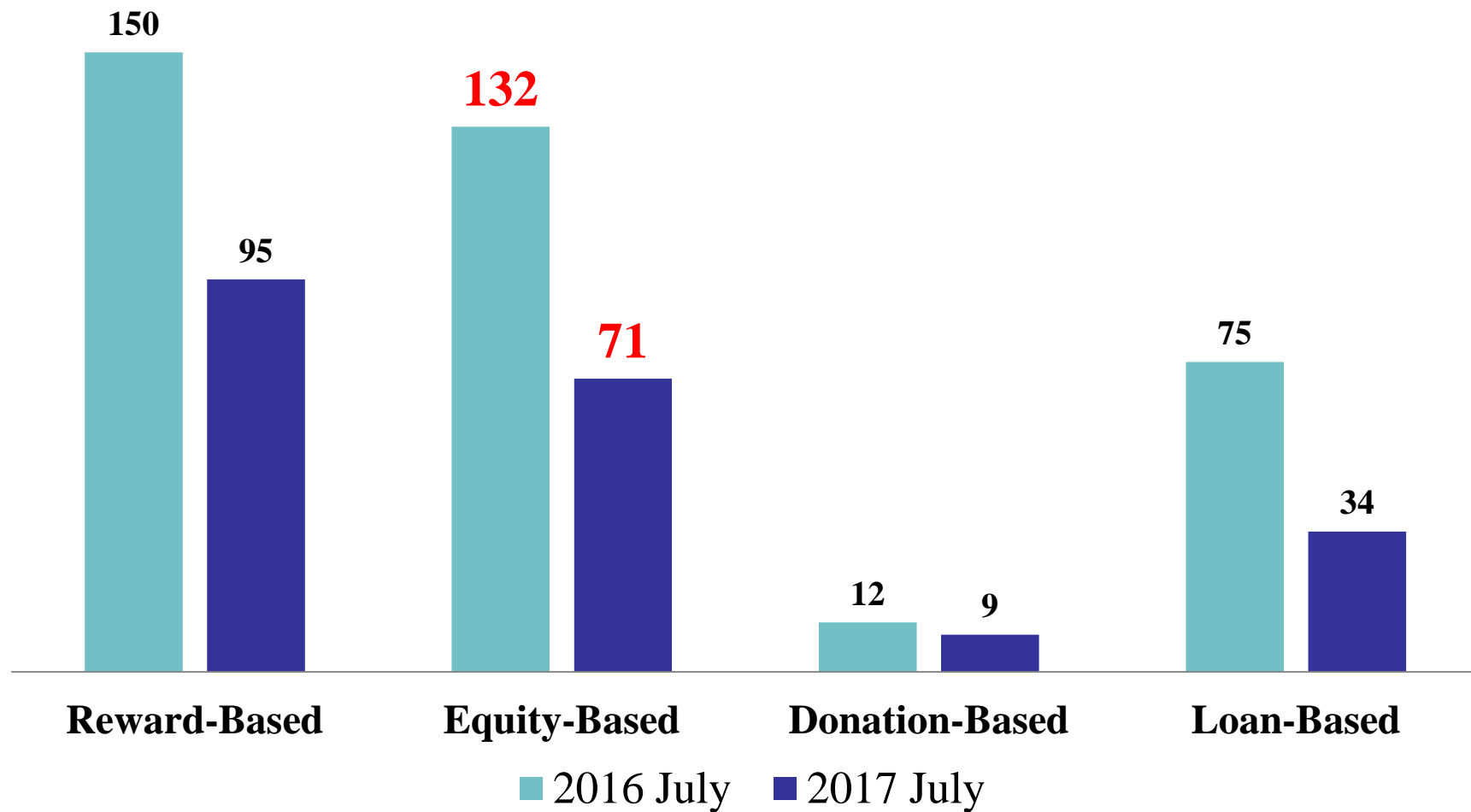
- Opportunism (**platforms lack neutrality** due to their business and revenue model)
- Agency costs and information asymmetry in an extreme form
- Illiquidity
- Herding problem

Scandals and lemons:

- The case of “Zhongchoujie” (Oct 2016) – fraudulent funding raising, platform CEO has absconded.
- The case of “36Kr” (July 2016) – false information on issuers

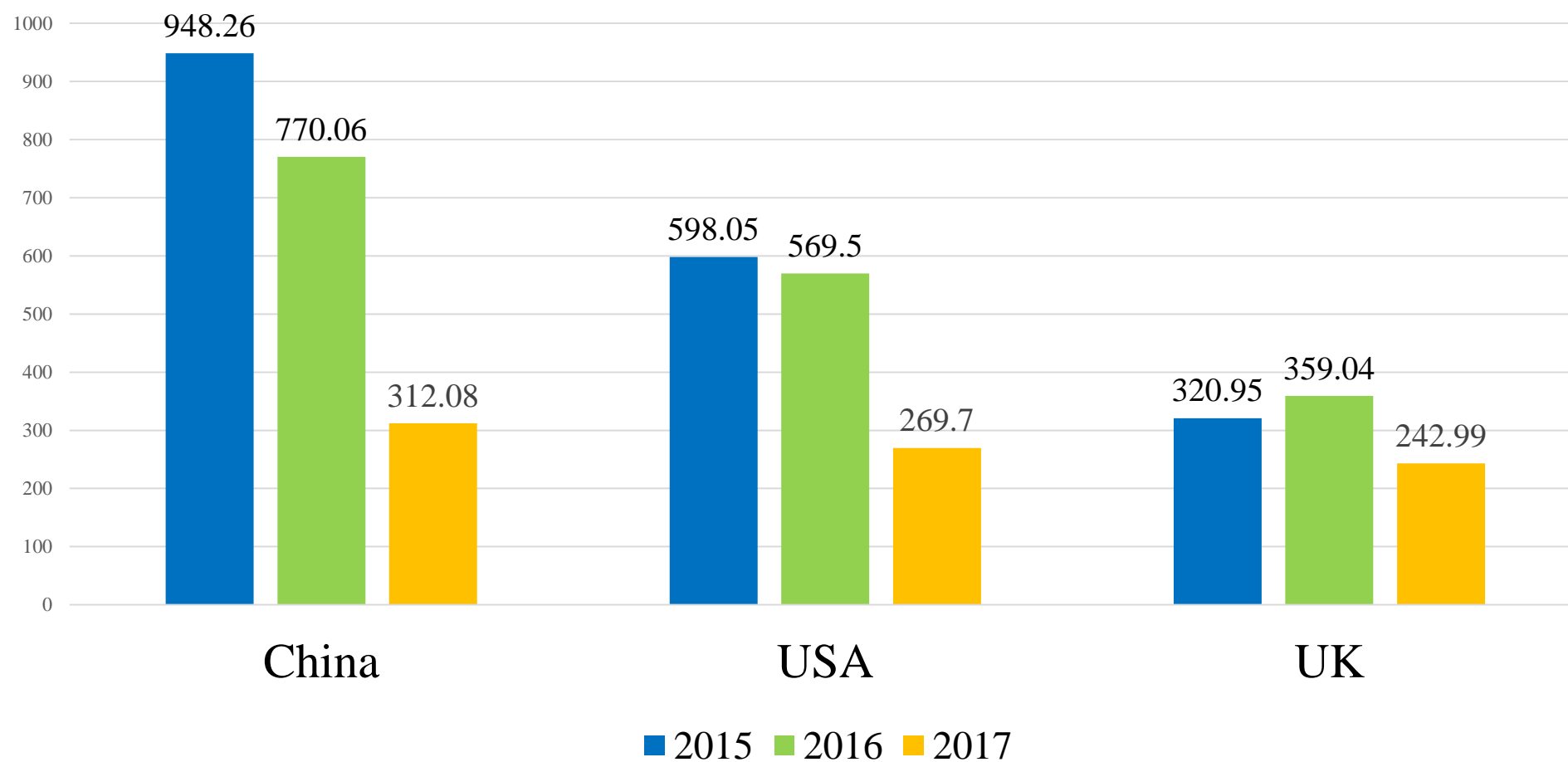
An over reaction to market failure?

Types of Crowdfunding in **China** 2016 and 2017 (By Number of Platforms)



Source: Yingcan, author's calculation

Size of ECF Industry by country (USD \$Million)



Source: Cambridge Centre for Alternative Finance & Yingcan,
author's calculation

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Market Mechanisms

- **Contractual Designs**
 - one-sided contracts
 - the syndicate model (lead investors)
 - escrow bank
- Exits?
- Reputation?
- Insurance?
- Replicating VC/angel investors' techniques
- IPO market institutions, e.g. gatekeepers, due diligence

Regulation

- **Platforms**
 - Licensing
 - Mandatory disclosure and due diligence obligations
 - Restrictions on unlicensed activities, advertising, and conflicting interests
 - Confidentiality obligations
 - Restrictions on conflicts of interest
- **Investors**
 - Investment cap on retail investors
- **Fundraisers**
 - The nature and type of the company
 - Cap on capital to be raised
 - Types of securities that can be offered
 - Disclosure requirements

Lessons and Ways Forward

1. **High-risk nature** of the industry → investor protection required.
2. Most ECF **platforms** are **NOT neutral** intermediaries, given their business and revenue model.
3. **Private ordering alone is inadequate** → a comprehensive network of legal and market institutions required.
4. Nevertheless, **over-regulation may damage** the market → focus on ensuring the neutral role of the **platform**.
5. Instead of issuing piecemeal and administrative measures, the **rule-based approach** should be adopted by the regulator.

NB: CSRC Piolet Scheme on ECF 2018 moving forward