

CROWDFUNDING – FORMS, FACTS AND IMPLICATIONS**LAURA VASILESCU**

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e-mail: tudorsorin2007@yahoo.com**Abstract**

In the context of actual international economic and financial context, the firms, Small and Medium Enterprises (SMEs) especially the start-ups, still confront with accessing to finance problems. This fact determined a reorientation towards other alternative forms of financing. Thus, in recent years, an increasing range of financing options (crowdfunding, angels investors, venture capital) has become available to SMEs, although some of them are still at an early stage of development or, only accessible to a part of SMEs.

As an alternative form of financing, the crowdfunding is often used by start-ups or developing businesses. Crowdfunding is an innovative way to identify new sources of funding for projects or business and to get useful market information, to access new customers using the power of online community.

In less than a decade, crowdfunding extended in many developed countries from Europe and all over the world but also it is attracting an important interest in the developing countries. Despite these positive trends, there are still many barriers against the new forms of alternative financing. Besides the new programs developed at the national and international level, should be undelined that a credible and relistic crowdfunding system require entrepreneurs and willing investors but also a number of key determinat factors (regulatory framework, ecosystem, technological solutions, etc) that enable all parties to participate and take benefits from this new financing alternative.

Cuvinte cheie: crowdfunding, alternative financing, start-up, SMEs

Classification JEL: G32, L21, M21

1. Introduction

The inconsistent financial evolutions in the last decades (financial crisis, interest rates volatility, foreign exchange fluctuations, increased risks and uncertainty) determined the companies to be confronted with many challenges and one of the most important was the access to finance. Especially after the year 2008, the restrictive condition for banking lending, determined the investors to try to find other alternative financing sources.

In this context, the crowdfunding represents an alternative mechanism for entrepreneurs and especially, the start-up enterprises to raise money in the form of investments or donations from multiple individuals, using online platforms. Crowdfunding can take several forms which include peer to peer lending and equity crowdfunding (Bottiglia and Pichler, 2016).

Starting as an extension online of traditional financing, crowdfunding conquered important steps in the process of funding business ideas. Thus, in the last decade, crowdfunding become a more important alternative financing tool in the developed economies such as: United Kingdom, Switzerland, Italy, France, the Netherlands and all over the world (United States and Australia). But with an effective support from governments, development organizations and institutions, the crowdfunding could also become a useful financing instrument in the developing countries.

The SMEs still confront with some barriers in order to benefit of such diversified financial offer through alternative financing tools. Till now, a lack of awareness and understanding on these alternative instruments by part of SMEs, financial institutions and governments represent a step backward for their broader use. At the national and international level should be taken new measures and initiatives in order to support and enhance the use of the new alternative financing instruments.

2. Theoretical fundamentals

Crowdfunding represent a modern way to attract funds in order to finance business projects and new business ideas. This enables the entrepreneurs to collect money from a large number of investors using the online platforms (Dresner, 2014). A distinction is made between the types of crowdlending: consumer, business and real estate crowdlending (Dietrich at all, 2018).

Crowdfunding is often used by startup firms or developing businesses as a tool of accessing alternative funds (Dapp, 2013) (Hagedorn and Pinkward, 2013). In that way, crowdfunding represents an innovative way to finance new projects or business ideas. Besides, this can be considered a tool to develop the links between the market participants through the online platforms.

The crowdfunding platforms are online websites that enable the communication between fundraisers and the investors. If the fundraising campaign has been successful, the crowdfunding platforms charges the entrepreneurs and in return, the platforms should provide secure and easy to use services.

The borrowers of capital include private individuals and companies while the potential lenders of capital are the private individuals and institutional investors.

There a number of different crowdfunding types but the most common types of crowdfunding used by the small firms and startups are the followings: crowdlending, equity crowdfunding and reward-based crowdfunding (EC, 2015). Each of these forms present some specific features and differences.

Equity crowdfunding (peer-to-peer lending) consists of selling a share of the business to a number of investors in return for investment. The equity crowdfunding has some specific characteristics:

- the entrepreneur establishes the terms, the price, the rewards which requires a good expertise for a correct evaluation;
- there will be charged fees for raising equity finance on the crowdfunding platform: legal or administrative fees or advisory fees;
- in general, the costs are lower than is the case of the stockmarket firms;
- can be attracted many investors and can be many small co-owners instead of large investors;
- there is an opportunity for the investor to evaluate his own business because should prepare a business plan and financial forecasts;
- should be considered the legal aspects and documents, the necessary costs and activities (meetings with shareholders, annual reports, other procedures).

The main methods used to obtain capital by crowdfunding are: stock shares, silent partnership, participating loans (Hagedorn and Pinkward, 2013).

The equity crowdfunding could generate benefits for the firms and investors but should be considered the possible risks:

- loose of capital or expected returns for the investors;
- dilution of capital;
- inability to exit investments;
- insufficient information or misinformation regarding the invested securities;
- conflict of interests between issuers, platforms and investors;
- insolvency of the platform operators;
- security of client data;
- fraud and related reputational risk for platforms.

Crowdlending (peer-to-peer lending) represent a direct alternative to a bank loan with the mention that, in this case, companies can borrow directly from many individuals instead of borrowing from a single one. The process is based on the offers made by the lenders for loans - the

interest rate at which they lend - and the borrower's acceptances of the lowest interest rate. Internet platforms are used to facilitate the connection between the lenders and borrowers. The crowdfunding platforms have the responsibility to protect both businesses and investor interests and the platforms require financial accounts and a trading track record (EC, 2015).

In the case of crowdlending should also be considered some risks: insufficient information or misinformation for investors; insolvency of the platform operators; conflict of interests; security of client data; illicit activities; fraud and related reputational risk.

Rewards-based crowdfunding suppose a donation made by individuals for a project or business with the expectation of receiving goods or services as reward in return for investment, at a later stage. The main features of this alternative consist on:

- the funds will not be repaid, instead the promised should be delivered;
- orders are secured before the launch of a new product;
- it is a popular option for startups;
- it can be used for innovative products and services (EC, 2015).

By comparison, considering several aspects, the forms of crowdfunding - equity, peer to peer and reward-based - have some advantages and disadvantages (table nr. 1).

Table nr. 1. Comparison between forms of crowdfunding

Elements	Equity crowdfunding	Crowdlending	Reward-based crowdfunding
Profitable growing business	√	√	-
Established stable business	√	√	-
Launching new product	√	√	√
Making acquisition	-	√	√
Investing in new facilities	-	√	-
Pre-profit	√	-	√
Refinancing	√	√	-
Capital restructuring	√	√	-

Source: EC, *Crowdfunding Explained - a guide for SMEs on crowdfunding and how to use it*, 2015

Some of the benefits of crowdfunding consist on the followings (Gabison, 2015):

- the owners have more control over their project (i.e.the maturity period, the share schemes) than in the case of banking credit or venture capitalists;
- the lower cost of financing; the spread of risk to a with range of investors;
- the owners can do market tests for their products or services during the campaigns and to obtain other funds from financial insitutions in the future.

There are many benefits of using the alternative financing instruments such as crowdfunding, but should be considered also the risks and some others barriers (the lack of awareness and understanding of these alternative instruments by part of SMEs, financial institutions and governments) which keep them at a lower level than the existing potential despite the positive evolutions in the last years.

3. Method and results

The evolutions of the alternative finance market in Europe în the last years reveals an important increase from about 4800 million Euro in 2012 to 7.7. billion Euros in 2016 (figure 1).

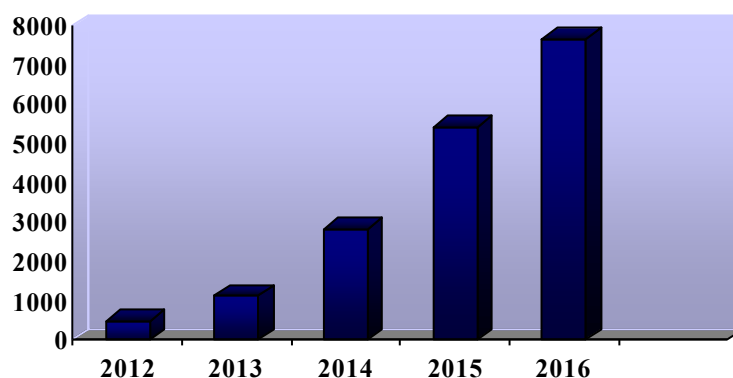


Figure nr. 1. Alternative finance market in Europe (million Euro)

Source: Statista, Crowdfunding in Europe – Statistics&Facts, 2018

A great share of the alternative finance market using finance platforms was registered by United Kingdom (5.6 billion Euro in 2016) followed by France and Germany (table nr. 2).

Table nr. 2. Alternative finance market by countries

Country	Funding amounts (million Euro)
United Kingdom	5608
France	444
Germany	322
The Netherlands	194
Finland	142
Spain	131
Italy	127
Georgia	103
Denmark	88
Sweden	86.5
Estonia	82.5
Ireland	76.8
Belgium	51.5

Source: Statista, Alternative finance: funding amounts in selected European countries, 2016

The European crowdfunding sector is characterised by its highly heterogeneous nature. In many ways this reflects the range of different starting points of national crowdfunding sectors which have originated in EU Member States over the past decade, largely determined by the regulatory frameworks (EC, 2017).

EU platforms employed a variety of funding mechanisms. In 2016, the three most common types of return offered by platforms were in the form of rewards (30.4 %), equity (22.9 %) and loans (21.0 %) (figure 2).

Equity crowdfunding is relatively new and currently comprises the smallest part of the crowdfunding market. However, it is more active in Europe than in other regions (Wilson and Testoni, 2014).

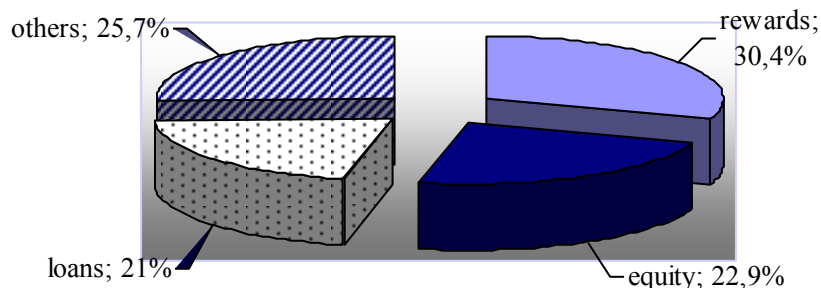


Figure nr. 2. Crowdfunding by types

Source: European Parliament, *Crowdfunding in Europe. Introduction and state of play, 2017*

An analysis by funding type revealed the following trends (EP, 2017):

- considering the equity crowdfunding, the UK was the largest market in terms of participating platforms followed by France (13.8 million Euro) and Germany (11.1 million Euro). Only a small part of the equity activity of participating platforms was identified as being intra-EU and cross-border in nature;
- considering the crowdlending, the UK registered the largest amount (1.1 billion Euro) followed by Estonia (10.8 million Euro), Germany (10.3 million Euro) and France (10.0 million Euro).

Regarding the crowdlending market at the global level, the forecasts indicate a constant growth in the next period of time (figure nr. 3).

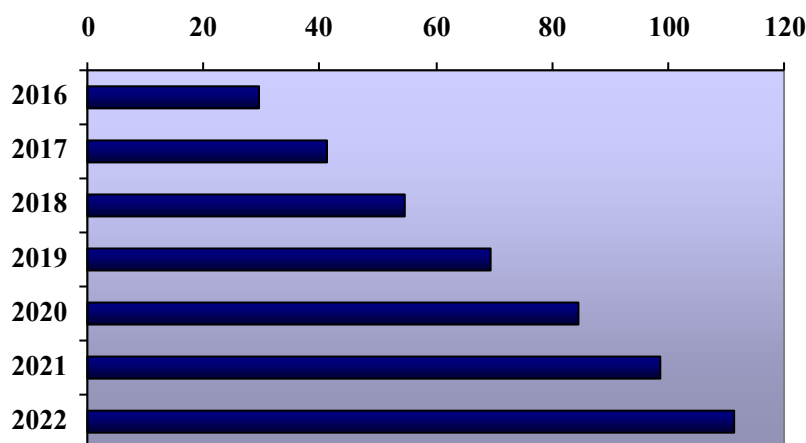


Figure nr 3. Crowdlending – transaction volume (million Euro)

Source: Statista, *Crowdfunding in Europe – Statistics&Facts, 2018*

Considering the financial markets, there are some demand and supply barriers regarding access to alternative financing for SMEs. On the demand side, there is a lack of financial knowledge, strategic vision, resources for many entrepreneurs. Also, the lack of interest for alternative financial instruments (especially equity) by SMEs is mostly due to the higher tax level compared to the regular debts.

On the supply side, the potential investors are confronted with illiquid markets, with a low number of participants, a lack of exit options and regulatory rules which can discourage the suppliers of financing (Nassr&Wehinger, 2016).

In order to facilitate the financing through the crowdfunding platforms, the European

Commission adopted in May 2018 a regulation on crowdfunding, which is part of establishing a Capital Market Union and aims to broaden access to finance for innovative companies, start-ups and other unlisted firms. The crowdfunding platforms have to comply with only one set of rules, both in their home market and other EU countries (EC, 2018).

The governments launched new initiatives all around the world in order to ease access to various sources of finance (OECD, 2018):

- An increased support for equity-type tools especially for start-ups and innovative firms (for instance, elaboration of the European Fund for Strategic Investment in 2015 by the EIB Group);
- Credit guarantees are one of the most important instrument used by many countries and many changes were taken place in the last years regarding the volumes, eligibility criteria, risk management, and other elements;
- Stimulation of crowdfunding activities by the governments, mainly through changes of financial regulation in order to allow the firms to raise money by online platforms;
- Accomplishment of local and regional needs of SMEs by the governments, which should elaborate policies to enable a better access to the public finance initiatives;
- Improvement of SME skills and strategic vision for their financing needs through targeted financial education programmes, counselling and mentoring;
- Development of digital instruments which can guarantee consumer protection, data protection, privacy restrictions and financial stability;
- Development of information infrastructures to reflect the level of risk financing for SME and encourage investors' participation (credit bureaus, data warehouses) can reduce the risks and financing costs associated with SMEs for the potential investors;
- Improving the evidence base by providing a framework for data collection and information regarding the policy initiatives, that can allow the analysis of new developments and trends in SME financing, the evaluation of policies in this field, dissemination of good practices, an increased transparency and international coordination in this field.

These measures and initiatives can contribute to the access to a diversified set of alternative financing options for SMEs and thus, to the reduction of the financing risks and elimination of the financing barriers for both the entrepreneurs and the potential investors.

4. Conclusions

Crowdfunding represent an alternative way to raise funds especially for start-ups, and SMEs and has the potential to bring significant benefits to the EU economy regarding new jobs, growth and innovation.

All forms of crowdfunding present many advantages and could generate benefits for the firms and investors but in the same time should be considered the possible risks.

Considering the barriers regarding access to alternative financing for SMEs on the demand and supply side, some measures should be taken in order to broaden the use of the alternative financing instruments such as:

- development of the skills and strategic vision for financing needs;
- improvement of knowledge of the alternative financing instruments for SMEs;
- development of an appropriate regulatory framework for the instruments that imply a higher risk for investors than traditional financing tools;
- increasing transparency in the markets and addressing information asymmetries could contribute to the development of alternative financing instruments for SMEs;
- cover the information gap between SMEs and potential investors by facilitating their direct interaction;
- implement policies that attract private resources and develop some risk-sharing mechanisms with the private sector.

Regarding the crowdfunding, the last proposal of the European Commission (2018) try to establish a European label for crowdfunding platforms which enables cross-border activity, facilitate the scaling up of crowdfunding services across the internal market and seeks to address risks in an effective way.

Investors on crowdfunding platforms could benefit from a higher protection regime and level of guarantees (based on rules on information disclosures); new norms on risk management and governance and an appropriate framework on supervision (EC, 2018).

Besides, defining a regulatory framework that balances financial stability could open new financing channels and mechanisms for SMEs and increase the confidence of the potential investors in SMEs and entrepreneurs in need of funding, particularly start-ups.

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