

Investment potential of crowdfunding in the development of projects and entrepreneurial ventures

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Abstract: Crowdfunding is a popular form of financing entrepreneurial ventures, especially in America and Western Europe. Crowdfunding is an innovative way of raising money to finance projects and businesses. It is a type of alternative fundraising that involves presenting ideas that need investment, in the most convincing and original way possible, through special platforms. It belongs to the so-called FinTech new market segment, which is a combination of financial services and technology. This specific model of financing in the world is growing rapidly with the development of the Internet and social networks, which has experienced real expansion over the last decade, and now investments in this form of financing reach tens of billions of dollars a year. However, despite the importance and popularity of crowdfunding, this form of funding is not given enough attention in the professional and scientific public. Crowdfunding is an alternative to classic, bank financing. There are several different types of crowdfunding: peer-to-peer lending, equity-based crowdfunding, reward-based crowdfunding, donation based crowdfunding. Each of these types of crowdfunding provides entrepreneurs with certain benefits, i.e. advantages in relation to traditional bank financing. When it comes to the type of crowdfunding with the largest market (peer-to-peer lending), the main advantages over bank financing are: lower interest rates than the ones charged by banks, lower transaction costs, connecting with investors without an active intermediary, shorter administrative and formal procedures, because there is no extensive paperwork and guarantees and guarantors requirements, etc.

Key words: crowdfunding, investments, Investment Crowdfunding, alternative financing, start up, project, entrepreneurship

JEL: O1

Introduction

Many projects and ideas have not had the opportunity to be realized due to lack of interest or sense of their potential and possibilities. Crowdfunding is a type of alternative fundraising that involves presenting ideas that need investment in the most convincing and original way possible - through special platforms. Fundraising through crowdfunding platforms is generally faster than when it is done by traditional methods, by submitting a request to a bank or other financial institutions. In this way, complicated bank lending procedures are avoided, and sometimes it takes very little time to raise the necessary funds. Unlike banks that are reluctant to invest in innovative ideas, crowdfunding platforms motivate investors (or donors) to invest in such ideas. However, the fundraising campaign on the platforms

requires serious preparation, which can take months. Of the thousands of campaigns launched to promote group fundraising platforms, only a certain percentage are successful and receive donor support.

Crowdfunding is a way of entrepreneurial financing that involves the joining of, often small, amounts of capital from a large number of interested investors or donors. Individuals seeking and/or offering funds generally have no historical or personal ties. Crowdfunding [Belleflamme, Lambert & Schwienbacher, 2014] is an innovative way of raising money to finance projects and businesses. Terminologically, the term is derived from the English words "crowd" and "funding". It belongs to the so-called FinTech new market segment, which is a combination of financial services and technology. This specific financing model in the world is growing rapidly with the development of the Internet and social networks, which have experienced a real expansion over the last decade. Investments in this form of financing reach tens of billions of dollars a year. Despite the importance and popularity of crowdfunding, this form of funding has not received enough attention in the professional and scientific public. Only recently, this form of venture financing has attracted the attention of scientists and entrepreneurs [Li & Du, 2020]

Crowdfunding, as a financing model, has several basic advantages. First, crowdfunding significantly reduces transaction costs, as the Internet allows for the collection of small sums from a large number of investors. In this way, large amounts of capital can be raised. Secondly, the Internet allows direct connection of financiers with fundraisers, without an active intermediary. Thirdly, crowdfunding is an effective way to raise funds for beginners in business or idea development, especially because other forms of funding are often unavailable for such ventures. Fourth, administrative and formal procedures are reduced here, because there is no extensive paperwork and the requirement of guarantees and guarantors, as in the case of bank loans. In general, crowdfunding has a positive effect on improving market conditions and the general economic climate by encouraging transparency and stability of the financial market, enabling access to the global financial market, improving the entrepreneurial climate, creating new financial sources by strengthening confidence, reducing dependence on foreign funding and encouraging social activism.

Characteristics and origins of crowdfunding

The first forms of crowdfunding date back to the fourth century AD in China, with the appearance of savings and credit cooperatives (so-called lun-hui) , whose members lent money to each other for various endeavors. Such examples also existed in other parts of the world, and later on, more and more forms of investment appeared, the motive of which was not money earnings. The first form of crowdfunding in Europe was founded by Jonathan Swift, with the launch of the Irish Loan Fund, which allowed funds to be allocated to families who had no collateral but only guarantees from their neighbors. In the 18th century, Alexander Pope, with the help of 750 financiers, published the "Iliad" in English, and in return, the names of all those who participated in this endeavor appeared on the cover of the book. This was a kind of forerunner of award-based crowdfunding, which will be discussed later.

The Statue of Liberty in New York City was funded by 120,000 American citizens in 1885. Then Joseph Pulitzer appealed to the readers of the New York World newspaper to donate money for the completion of the statue [Short, Ketchen, McKenny, Allison & Ireland, 2017].

People who invest money in various ideas can be from anywhere in the world and are called "backers". The first form of crowdfunding that works online appeared in 1997, when an online campaign funded a tour of the British rock band Marillion, raising \$ 60,000.

This was the inspiration for the first official crowdfunding platform ArtistShare that still exists today. ArtistShare was launched in 2003 as a platform that connects fans and artists to encourage creative creation and the creation of works of art [Rabasovic, Vicentic & Markovic, 2019].

After the great success of this platform, the possibility of applying the same principle of fundraising to the implementation of different types of projects is realized. In 2005, Kiva was founded, which is a non-profit organization that gives individuals a chance to lend interest-free loans to entrepreneurs in poor areas around the world. In 2008, one of the largest crowdfunding platforms today appeared - IndieGoGo, which enables backers to support the realization of various ideas in order to find innovative solutions for everyday business. Kickstarter is another leading crowdfunding platform that was established a year after IndieGoGo, i.e. in 2009. This platform also operates on the principle of award as IndieGoGo.

Crowdfunding is continuously developing around the world, because the development of technology and the growing number of Internet users enables investors and those who need financing from all parts of the world to connect with each others. Thus, crowdfunding bridges the time and space distances between surplus and deficit markets and economic participants in terms of capital. Today, this method of financing enables the collection of money from a large number of people through Internet sites, and is most often used by newly established trading companies and developing companies as a way to access additional funds or by any other person who has an idea for a project, product or service.

Crowdfunding is a fast-growing phenomenon, and entrepreneurs are directly seeking funds for their own entrepreneurial activities from potentially large audiences of interested individuals. Crowdfunding platforms are websites that interact between those who want to invest their money and those who need funds. The basic characteristics of crowdfunding are shown in the following table.

Table 1. Key characteristics of crowdfunding investors

Criterion	Crowdfunding (equity)
Background	Different backgrounds, many have no experience in investing
Access investing	Investing from personal funds
Investment stage	Seed and early stage
Investment instruments	Common stock
Venture agreement	Via web platforms
Due diligence	Carried out by individuals or via the platform
Geographical features of the investment	Most investors are geographically far from the business they want to invest in
Role after investment	It depends on the individual investor, but most remain passive
Return on investment and motivation to invest	The financial side is important, but it is not the only reason to invest

Source: [Wilson, Testoni 2014]

Forms of crowdfunding

Those who raise funds in this way usually pay a fee to the platforms if the financing was successful. Many platforms operate based the "all or nothing" model, which means that the money is obtained if the goal is achieved, and if not - the money is returned, i.e. without financial losses for investors. Depending on the subject of the project being financed, as well as whether the motivation of the investor is rational (material) or emotional, there are several types of this method of financing:

1. Peer-to-peer lending - lending money to a company is done with an agreement that the money will be returned with interest. This method is similar to traditional bank financing, except that borrowing is done from a large number of investors. In this case, the interest rate is lower than those offered by banks, but the earnings are higher than with traditional savings. The market for this type of crowdfunding is larger than the other three combined;
2. Equity-based crowdfunding - the investment is made in exchange for shares in the company, so it is suitable for start-ups. This method is similar to buying shares on the stock market or investing venture capital funds. One of the platforms with this type of financing is Funderbeam;
3. Reward-based crowdfunding - investors make donations for a project or company, and in return, at a later stage, receive a reward (perk) that is not of a financial nature, but in goods or services. Prizes range in value, from symbolic ones such as badges and T-shirts, to valuable prizes such as smart devices. This is the most well-known form of crowdfunding, and the platforms that operate in this type of fundraising - Kickstarter and Indiegogo - have a great contribution to this;
4. Donation-based crowdfunding - individuals (backers) give smaller amounts of money in order to achieve a higher goal of social benefit, i.e. charitable character, without achieving financial or material benefits.

These are the most common forms of crowdfunding, and there is also crowdfunding that is based on profit sharing, bond-based crowdfunding, as well as hybrid crowdfunding models that combine more than one type of this investment.

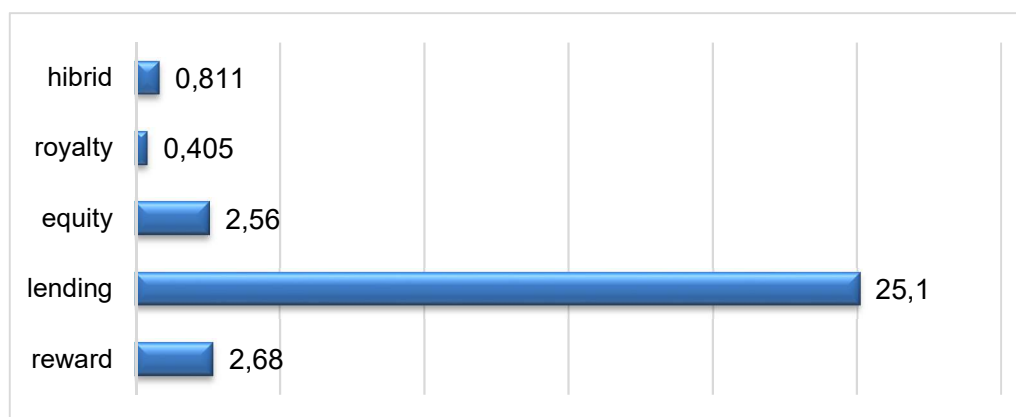
Crowdfunding in the world

In the beginning, crowdfunding was most often used in the field of art, i.e. the creative sector. However, it is increasingly recognized and used as a way of initially financing small businesses and start-ups. Different forms of crowdfunding can be used at different stages of business development. A great chance for the development of crowdfunding was provided by the increasing use of the Internet and technology, but also by the beginning of the crisis in 2008, when banks limited their lending to companies that they considered too risky. Crowdfunding is changing other potential sources of funding at all stages of small business

development. Initial bank financing is being replaced by award-based crowdfunding. Then, instead of the business angels's investments, we have share-based crowdfunding, and instead of institutional investors, we have peer-to-peer lending, which implies financing a project and business by borrowing money at an agreed interest rate, which is favorable both for those who lend and the ones who use the funds.

There are more than 1,300 crowdfunding platforms in the world that facilitate the interaction between entrepreneurs and potential donors for mass financing, and which differ in certain characteristics [Mital, 2020]. It is estimated that in 2015, the total amount of funds raised by the crowdfunding industry in the world amounted to over 34 billion dollars [Wang, Li, Liang, Ye & Ge, 2018; Đekić, 2019, p. 112]. This form of financing ventures and projects is most prevalent in America, where it is estimated that as many as 22% of the population participated in some crowdfunding campaigns [Gregović, Tranfić & Lauš, 2017, pp. 11-12]. The following chart shows the total amount of funding through crowdfunding in the world [Wang, Li, Liang, Ye & Ge, 2018; Đekić, 2019, p. 112].

Chart 1. The total estimated amount of funding for various forms of crowdfunding for 2015 is billions of dollars



Source: [CrowdExpert.com 2017]

As underlined Crowdfunding is most prevalent in North America, but is also developing rapidly in other regions of the world. In 2015, the distribution by regions was as follows: North America \$ 17.2 B, Asia \$ 10.54 B, Europe \$ 6.48 B, Oceania \$ 68.6 M, South America \$ 85.74 M, Africa \$ 24.16 M.

The World Bank predicts that the crowdfunding market reached a value of about \$96 billion by 2020 [Šebek, Klašnja, Harbers, Krneta & Stojanović, 2019]. World Bank studies show

that, according to income, the number of households that can participate in this type of investment ranges from 240 to 344 million. Given these and other assumptions about the speed of crowdfunding development and the existence of incentive regulations and other factors, the total market potential of this form of financing by 2025 is estimated at \$90-96 billion per year [World Bank, 2013, pp. 33-43].

Some of the most well-known global crowdfunding platforms are Kickstarter (the most famous reward-based crowdfunding platform), Indiegogo (the oldest and largest reward-based crowdfunding platform), Globalgiving (the most famous global donation-based crowdfunding platform). The importance and number of platforms have increased in recent years, as a growing number of people are using the Internet in order to place and raise funds. The Internet gathers a huge number of people, and sites like the ones mentioned above mobilize huge funds from a large number of people around the world. Thus, for example, through Kickstarter, a platform that was established in April 2009, as many as 196,045 projects have been successfully realized, collected from almost 19.2 million backers. The total funds raised so far amount to almost five billion and 570 million dollars [Kickstarter, 2021]. However, the legality of sites such as Kiva, MicroPlace, Indiegogo, or Kickstarter was questioned and it was thought that they should be registered as broker-dealer, in order to facilitate the sale of shares so as to reduce fraudulent offers. In early April 2012, the law was signed - The Jumpstart Our Business Startups (JOBS) Act, which sets this method of financing as an exception to the regulations of the Securities and Exchange Commission (SEC) for companies that collect less than two million dollars, but restrictions on individual investments are also set [Board of Governors of the Federal Reserve System, 2012, p. 40]. The law allowed companies to seek funding from the public, but investment was only allowed to accredited investors. However, the goal of this type of financing is that every citizen can freely invest in companies that seek funds through the platform.

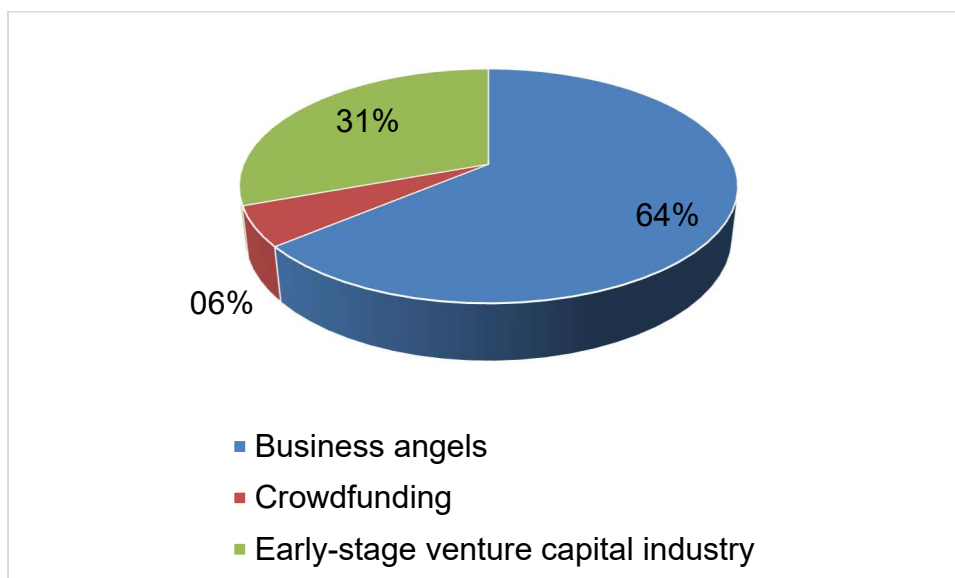
Status and perspectives of crowdfunding in the European Union

Some of the most important non-banking sources of financing for small and medium enterprises in developed countries (increasingly also in countries in transition) are financial leasing, forfeiting and factoring, microcrediting, crowdfunding, venture capital funds and business angels. The financing of a company mostly depends on the life cycle phase of the

company. Start-ups will seek finance in the capital market, from angel investors, crowdfunding investors or venture capital investors.

Crowdfunding, venture capital funds and business angels are characterized by different goals, motivation, amounts of funds that can be raised, but are to some extent complementary in financing companies in the early stages of development. It is important to say that these are the three most common forms of business investment in the early stages of development in Europe. According to EBAN data, the total volume of investments of these three forms of corporate financing reached 8.6 billion euros in 2015. The largest part of investments in the early stages of the company are investments of business angels in the amount of 6.1 billion euros, followed by investments from the venture capital industry in the amount of 2.1 billion, while crowdfunding, as a new form of investment, reached 4 billion in the European market, which has been growing rapidly and this trend is expected to continue [European Business Angel Network, 2016, pp. 1-2]. Two years later, in 2017, investments in these forms of financing reached 11.4 billion euros, of which business angel investments amounted to 7.3 billion, venture capital industry investments 3.5 billion, and crowdfunding investments amounted to 1.75 billion euros. The percentage share of each of these investments in the total European investment market of the early stages of enterprise development, according to EBAN data, is shown in the following chart.

Chart 2. The three most common forms of company investment in the early stages of development in 2017



Source: [European Business Angel Network, 2018, p. 5]

When looking at the general crowdfunding market in Europe, there were 597 platforms operating during 2017, through which the turnover amounted to 10.4 billion dollars. In 2018, the number of platforms increased to as many as 794 platforms with a turnover of 18 billion dollars. Most of the platforms are concentrated in large European economies: 89 in Great Britain, 63 in Germany, 51 in France, 51 in Italy, 45 in the Netherlands and 39 in Spain. On the other hand, in the countries of Southern and Eastern Europe, there were less than 10 platforms, most of which were based in foreign countries [Wenzlaff, Odorovic, Ziegler & Shneur, 2020].

Crowdfunding is developing rapidly, and it should be borne in mind that crowdfunding in the West was at the very beginning of development only fifteen years ago. In the direction of creating a good basis for the development of crowdfunding, it is necessary, first of all, to provide a legal basis, i.e. to create an incentive legislative framework that would reduce tax and financial barriers. Also, it is necessary to work on introducing the public to this concept, and even to work on educating citizens within the formal education system. In addition to legal restrictions and lack of knowledge of how this form of project financing works, a major problem is the lack of public confidence in financing "via the Internet", but also insufficient commitment to developing a critical group of experts to improve this concept and spread awareness among potential investors. Efforts have recently been made to bring crowdfunding closer to the public, but this requires greater support from the system. The existence of regulatory frameworks in the field of market financing is extremely important for the development of modern economies based on entrepreneurial spirit. According to [Demirguc-Kunt & Maksimovic, 1995, p. 8], companies that are granted access to capital grow and develop more expansively than those that are practically prevented from doing so.

With the recent outbreak of COVID-19, the crowdfunding market has grown significantly, especially donor crowdfunding intended to support and assist communities, individuals and many organizations in the fight against this pandemic. For example, in April 2020, Facebook launched the Facebook Fundraiser, a platform where people can raise funds for charity to help others during the pandemic [Mordor Intelligence, 2020]. Also, new regulatory changes and strategies adopted by the European Parliament regarding crowdfunding should contribute to the growth of these investments in Europe and its better understanding.

Summary, recommendations

Crowdfunding is an alternative way of raising money to finance projects and it involves presenting ideas that need investment through special platforms. The main advantages of crowdfunding in comparison to bank financing are: lower interest rates than those charged by banks, lower transaction costs, connecting with investors without an active intermediary, shorter administrative and formal procedures, because there is no extensive paperwork and guarantees and guarantors requirements, etc.

Some of the obstacles in the current weak development of crowdfunding as a financing model: low level of awareness of the target public about the existence and mechanisms of the functioning of this method of financing, lack of knowledge about its potential benefits, a lack of response from backers from certain markets, and many others. The conclusion is that there is a lot more room for development, but also that it is necessary to educate all parties and provide better information about the opportunities and motivation for participants from both sides.

Once the biggest regulatory barriers have been addressed, the platforms should focus on improving public education and understanding crowdfunding so as to support its acceptance in different markets.

By having regulatory changes and a strategic approach to understanding this way of investing and financing projects, the community will support the implementation of projects and avoid the difficult and complicated procedures of the traditional way of raising money. Many start-ups can obtain the necessary funding in this way, because the decision on whether an investment application will be approved by various financial institutions does not depend on the few experts in charge of these types of jobs, as in the case of traditional financing. In fact, in crowdfunding, the fate of new ideas is decided by a large number of people around the world, who are also potential loyal buyers and consumers of products or services.

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