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### *Prospects for Crowdfunding Development*

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Perspektywy rozwoju crowdfundingu

**Keywords:** alternative finance market; crowdfunding; types of crowdfunding

**Słowa kluczowe:** rynek finansów alternatywnych; crowdfunding; modele crowdfundingu

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#### **Introduction**

According to the data prepared by the Cambridge Centre for Alternative Finance (CCAF), dynamic development of the alternative finance market has been observed in recent years. While in 2014 the value of this market in Europe amounted to EUR 2.833 billion, in 2015, it almost doubled, reaching the level of EUR 5.431 billion. A year later, this value increased by over 41% and rose to EUR 7.671 billion. In 2016, the predominant share in the alternative finance market (EUR 5.6 billion) was still maintained by the United Kingdom, although it should be noted that in 2016, the value of this market dropped compared to the previous year (81% in 2015 vs. 73% in 2016) [CCAF, 2016, p. 24; CCAF, 2018, p. 21].

Undoubtedly, crowdfunding is one of the most important alternative financing models in Europe, in particular equity crowdfunding. In its May 2016 document titled *Crowdfunding in the EU Capital Markets Union*, the European Commission stated that this form of financing “has the potential to become a key source of financing for

small and medium-sized companies in the long run”. Bearing in mind the importance of new alternative sources of financing, the commission stressed the need to observe the development of this sector and the effectiveness of national regulations [European Commission, 2016, pp. 30–31].

In this context, it is appropriate to examine the prospects of crowdfunding development in Poland. This article discusses the essence of crowdfunding, characterizes its types and shows its scale, thereby presenting the value of the crowdfunding market for the selected European countries. The article also highlights the main advantages and disadvantages of this form of financing from the perspective of the beneficiaries (project authors). Against this background, the author has identified a set of factors determining the effective development of crowdfunding in Poland.

### 1. The essence and models of crowdfunding

In the statement of the European Commission, the Council, the European Economic and Social Committee and the Committee of the Regions titled *Releasing the Potential of Crowdfunding*, dated March 14, 2014, crowdfunding was defined as social financing that

[...] basically refers to an open invitation aimed at the society, the purpose of which is to obtain financial resources to realise a particular project. Often, such invitations are published and disseminated via the internet and with the help of social media and are valid in a defined period of time. Financial resources are raised from a substantial number of participants in small sums; however there are exceptions to that [Opinion of the European Economic and Social Committee on the communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2014, p. 4.3].

Funds are raised using crowdfunding platforms.

The general idea of crowdfunding is not new, but its contemporary form came into being owing to technological progress and developed in the years 2006–2009. The main factors that contributed to the development of crowdfunding include [European Parliamentary Research Service, 2017, p. 2]:

- opportunities created by Web 2.0 technology with tools like Internet forums, chats, and blogs;
- limited access to banking services due to the financial crisis, which shifted consumers’ interest towards new sources of financing; and
- the decrease in interest rates, forcing the search for alternative ways of positioning funds to obtain higher returns.

Among the best known and most useful crowdfunding classifications in the world literature is the one suggested by the consultancy agency Massolution. The agency iden-

tified four crowdfunding types: 1) donation-based, 2) reward-based, 3) lending-based, and 4) equity-based [European Parliamentary Research Service, 2017, p. 2].

In Poland, one of the most detailed crowdfunding classifications was devised by the Working Group on financial innovation development (FinTech; see: Table 1). The team was initiated by the Polish Financial Supervision Authority, which coordinated its work, the Ministry of Finance and the Ministry of Development in response to dynamic technological changes in the financial services market.

Table 1. The characteristics of crowdfunding models

Crowdfunding model	Characteristics
Donation-based	It has a philanthropic character and no form of gratuity is available, apart from possible acknowledgements. The projects are usually of social nature (they are non-profit). They are most often initiated by foundations and organizations, although the project authors can also be enterprises. Most frequently, the projects that are not continuously fund-raising assume the minimum sum (the so-called 100% threshold), which can be repeatedly exceeded. Additionally, the duration can also be extended. The projects do not have to reach the assumed minimum amount. Some of the platforms do not charge commissions on deposited payments.
Reward-based	In reward-based crowdfunding, donors receive the type of gratuity that is a consideration for donation. Economic equivalence of the transaction does not always occur (the funder often receives a “reward” that is lower in value than the financial provision received by the beneficiary). It is a model most often used by Polish crowdfunding platforms for realising mostly creative projects. The project needs a minimum amount (the so-called 100% threshold can be repeatedly exceeded) and duration. Most often, when the project fails to reach 100%, it is subject to the principle of “everything or nothing”. The platforms charge commissions on payments made.
Pre-sales crowdfunding	In this model, the funders, through the platform, provide funds for the creation of a given product, which, after some time (it can even be many months), is provided for them by the beneficiary. Pre-sales crowdfunding uses a sales contract or an unnamed contract, similar to a sales contract. The projects have a minimum amount (the so-called 100% threshold, which can be repeatedly exceeded) and duration. Most often, a project that does not reach 100% in the assumed duration is considered unsuccessful, and the money is returned to the people who supported the project (the “everything or nothing” principle).
Equity-based (investment)	The classic model of investment crowdfunding consists of the possibility of raising capital for the company for the development of a specific project through the issue of securities, for example, shares or bonds. These securities are offered to Internet users who, by buying them, support the project. To enable the issuance of shares, the project promoter must operate in the form of a joint-stock company or limited joint-stock partnership. The issuing or sale of shares involves handing over part of the shares in the company (i.e. partial control of the company). Buyers of shares are investors who count on achieving investment profits.
Lending-based	Lending-based crowdfunding consists of granting loans, mainly in small amounts, between persons, one of whom is interested in investing cash, and the other who wants to acquire mostly short-term capital from external sources. Transactions take place via websites without the participation of financial institutions. The investor’s benefit to the beneficiary is repayable. The beneficiary is obliged to return the funds provided by the investor together with the declared amount of interest.

Source: Author’s own study based on KNF [2017, Annex No. 2, pp. 126–142].

It should be noted that with regard to the classification proposed by the Massolution consulting agency, this approach also includes pre-sales crowdfunding.

## 2. Crowdfunding in Europe

According to the data prepared by the CCAF for 44 surveyed European countries (excluding Great Britain<sup>1</sup>), equity-based crowdfunding and reward-based crowdfunding in 2016 were two of the five alternative finance models that have the largest share in the European alternative finance market. The largest share in the alternative finance market was recorded by P2P (peer-to-peer lending) loans at 34%. The fourth position with the share of 10.6% belongs to equity-based crowdfunding, while the fifth position was taken by reward-based crowdfunding with a share in of 9.2% in 2016. It should be noted that despite the increase in the market value by 37% in both models over the years 2015–2016 (from 159.32 million to 218.64 million in the case of equity-based crowdfunding and from 139.7 million to 190.45 million in the case of reward-based crowdfunding), their shares in the total alternative finance market declined<sup>2</sup> [CCAF, 2016, p. 31; 2018, pp. 28–29].

The average transaction value in 2016 for Europe (excluding Great Britain) was definitely higher for equity-based crowdfunding (EUR 302,621) than for reward-based crowdfunding (EUR 15,069). Even lower average value of transactions characterizes donation-based crowdfunding (EUR 4,631) [CCAF, 2018, p. 35].

The analysis of the activity of European countries (excluding Great Britain) in the field of crowdfunding shows that in 2016, Germany was a leader in both equity-based crowdfunding (EUR 47 million) and donation-based crowdfunding (EUR 15 million). France, on the other hand, took the lead in reward-based crowdfunding (EUR 48 million).<sup>3</sup> It should be emphasized at the same time that in 2014, France – the first country in Europe to do so – implemented legal solutions dedicated to crowdfunding.

Figure 1 presents the three leading countries as part of each type of crowdfunding.

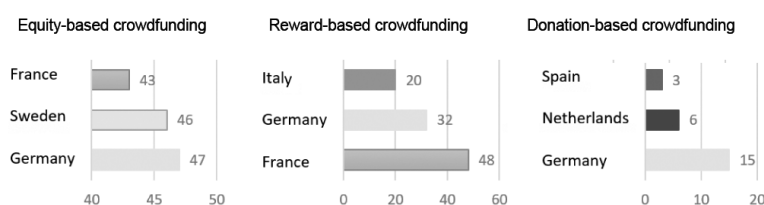


Figure 1. Leading European countries for individual types of crowdfunding in 2016, excluding Great Britain (market value in EUR million)

Source: CCAF [2018, p. 31].

<sup>1</sup> Due to its dominant role on the European market of alternative finance, Great Britain is often excluded from analyses.

<sup>2</sup> Respectively, from 16% to 10.6% for equity-based crowdfunding and from 14% to 9.2% for reward-based crowdfunding.

<sup>3</sup> Significantly, France and Germany are among the leaders in terms of the value of the alternative finance market in 2016. For France, this value stood at EUR 444 million, and for Germany at EUR 322 million. The next position was held by the Netherlands (EUR 194 million). Poland ranked 14<sup>th</sup>, showing the value of the alternative finance market at the level of EUR 38.1 million.

For comparison, a year earlier, France was the leader both in equity-based crowdfunding (EUR 75 million) and reward-based crowdfunding (EUR 48 million). Germany, again, similarly to 2016, recorded the highest position in donation-based crowdfunding (EUR 10 million).

### 3. The advantages and disadvantages of crowdfunding and related risks

One main advantage of crowdfunding from the perspective of project authors is that the existence of this form of financing reduces the funding gap, while also reducing costs associated with obtaining funds from traditional forms of financing. Equity-based crowdfunding plays a particularly important role in underdeveloped markets, in which there are no venture capital funds or their presence is negligible, filling the gap in raising funds by small and medium-sized enterprises. For investors, crowdfunding opens up opportunities to purchase more complex investment products. Table 2 presents the advantages and disadvantages of crowdfunding.

Table 2. The main advantages and disadvantages of crowdfunding from the perspective of beneficiaries (project authors) and investors

Benefits	Disadvantages
It reduces the gap in traditional financing of projects (especially in the initial phase of development).	It requires the necessity to publish an idea, some detailed information in the way that is available to a large number of recipients.
It enables obtaining financing at lower costs.	The risk of not raising funds even in the case of attractive, well-calculated projects.
It provides more control over the venture than in the case of venture capital or banks, making this financing model more flexible than traditional solutions.	Required time and commitment devoted to the development of campaigns, updates or answers given to questions of potential investors.
Project financing by many investors spreads the risk.	No secondary market for the sale of shares (in specific cases).
It facilitates financial inclusion.	Unclear legal regulations, including tax regulations.
It helps build financial immunity.	Basing the activity of platforms on the Internet and Web 2.0 tools causes lack of accessibility or limited availability of platforms in countries with low Internet penetration rate (e.g. African countries).
Owing to the feedback from investors, crowdfunding enables tailoring products to customers' expectations and introducing improvements.	
It helps gain access to traditional forms of financing in the future.	
It can be a tool for investors in developed markets to have access to higher rates of return by investing in emerging markets.	
It helps project authors in emerging markets raise funds from investors from other markets (developed).	

Source: Author's own study based on Gabison [2015, pp. 15–20], Król [2013, pp. 43–44, 53–55], Jenik et al. [2017, pp. 24–26].

One important aspect of dealing with the issues related to crowdfunding is its capacity for financial inclusion. Characterized by low entry barriers, lower costs, shorter time frames and greater flexibility than traditional forms of financing, crowdfunding enables access to funds and financial assets for individual clients and companies from the sector of micro, small and medium-sized enterprises (MSME) that have limited access to financial services. Low barriers to entering the crowdfunding platform allow these entities to obtain the necessary funds, which may be particularly important for people belonging to the Bottom of the Pyramid (BoP) segment who have very low incomes. Access to a new asset class – investment assets – also allows people using crowdfunding to build financial immunity, which can be extremely important for the least affluent. If necessary, i.e. in the situation of unfavourable scenarios of the course of events, the investment products may help them overcome difficult situations, without causing the need to sell off assets or borrow in extremely unfavourable conditions. By offering easier access to financial resources, crowdfunding helps individuals smooth consumption over time and endure negative financial consequences of events, such as job loss or illness [Jenik et al., 2017, pp. 24–26].

In a wider perspective, i.e. globally, crowdfunding enables (or facilitates) the acquisition of funds by persons and companies operating in emerging markets. It is possible to identify crowdfunding platforms that, by offering investments in emerging markets to investors from developed countries, contribute to the redistribution of funds between various regions of the world (e.g. Emerging Crowd) [Jenik et al., 2017, p. 25].

Among the disadvantages of crowdfunding, unclear legal regulations deserve special attention because they may significantly limit its development. Figure 2 shows the risks related to the activity carried out under various alternative finance models (including crowdfunding) and identifies the importance of a given risk in the opinion of the analysed 367 platforms operating in this area in 45 European countries. Undoubtedly, the analysis of responses provided by the surveyed platforms confirms the high importance of legal regulations to give parties engaging in crowdfunding activities a sense of security.

The importance of this problem in the Polish financial market was confirmed by the report of the Working Group on financial innovation development (FinTech) in November 2017, in which, among 85 barriers to the development of financial innovation, the last one is “lack of legal certainty regarding the operation of crowdfunding platforms in Poland” [KNF, 2017]. The entities that reported the occurrence of this barrier include the FinTech Poland Foundation, the Coalition for Polish Innovation (KPI) and the Conference of Financial Enterprises in Poland (KPF). As part of the initiative, crowdfunding models were developed (see: Table 1), and legal acts related to them were listed. Additionally, the need for a comprehensive explanation of doubts about the application of legal acts relating to the operation of crowdfunding platforms was pointed out. Further indications include:

- the need for KPF to develop market principles of good practice in the operation of platforms,

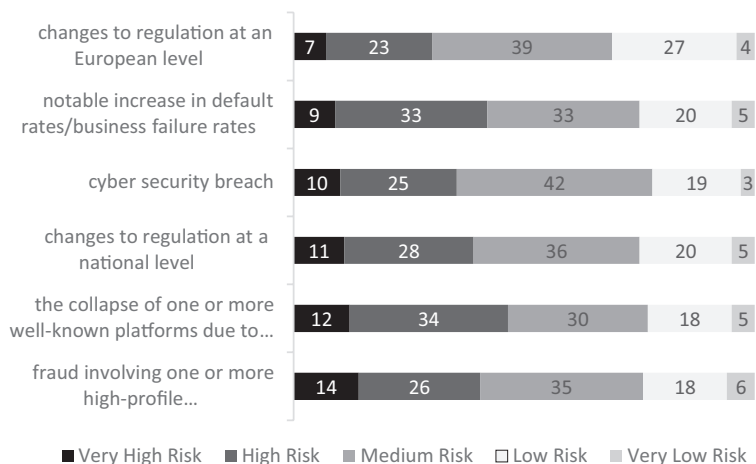


Figure 2. The level of risk connected with individual threats related to the activity conducted under various alternative finance models, including crowdfunding (in % of indication)

Source: CCAF [2016, p. 47].

- the inclusion by MF of a legislative proposal introducing provisions simplifying the procedure for submitting public offers up to EUR 1 million,
- preparation by UKNF of guidelines for the application of amended Article 72 of the Act on Trading in Financial Instruments, and
- introduction of an institution of unregistered activity that would include operations related to granting loans under lending-based crowdfunding.

## Conclusions

Prospects for crowdfunding development are obviously related to the activities aimed at eliminating the limitations and risks associated with this activity, from the points of view of both project authors and investors.

Referring to both the risks identified by CCAF and the PFSA report, as well as the crowdfunding defects included in Table 2, the actions that should be taken in Poland to efficiently develop crowdfunding in the future include:

- 1) a detailed description of the types of crowdfunding and definition of platforms included in crowdfunding platforms (it seems that the introduction of lending-based crowdfunding leads to the inclusion of crowdfunding activities and platforms (e.g. kokos.pl) that differ significantly from other types of crowdfunding and should instead be distinguished as P2P lending);
- 2) increasing legal certainty by creating a clear set of legal regulations relating directly to running crowdfunding activities; these provisions should regulate both the rights and obligations of project authors and investors (including tax

regulations, instruments for protection of both parties). They should refer to the operation of the crowdfunding platforms themselves (including issues related to liability for fraud with the participation of platforms or the demise of the platform). Since big concerns over crowdfunding are also caused by regulations at the EU level, the tasks recommended for relevant organizations at the national level should also include inserting both EU legal regulations related to crowdfunding and current and proposed changes in this area in one place in the network;

- 3) creating legal provisions related to the cyber security problem (because platforms operate online, this problem is of fundamental importance for the sense of security of all three sides – beneficiaries, investors and the platforms themselves);
- 4) raising awareness among small and medium-sized enterprises and individuals with regard to the possibility of using crowdfunding to obtain financial resources, thus supporting specific initiatives or access to certain goods or investments; showing the advantages of crowdfunding, but also the disadvantages and risks associated with it, which will allow the conscious use of crowdfunding (currently, only a small percentage of small and medium-sized companies in Europe know about this form of financing);
- 5) increasing the level of trust in the activities of crowdfunding platforms (crowdfunding is still a new phenomenon, and thus the lack of knowledge about it and about the principles of its functioning create lack of confidence);
- 6) creation of the principles of good practice (as intended by the Working Group for the development of financial innovations (FinTech). These principles will refer mainly to risk management and are to be developed by KPF to harmonize the business practices of the entire market. Ultimately, they are also to constitute a tool for building the image of the industry and the safety of participants in this market); and
- 7) testing alternative scoring models used in the case of lending-based crowdfunding and determining their usefulness in the long run. As Jenik et al. [2017] pointed out, untested credit scoring models, which are undoubtedly innovative, improve access to credits on the one hand, but on the other hand, they may exacerbate excessive indebtedness. It seems that ultimately, lending-based crowdfunding should be excluded from crowdfunding activity models.

The determinants of the development of crowdfunding in Poland undoubtedly include the openness of the society to the use of financial services outside the banking sector. When analysing the changes observed in societies both worldwide and in Poland, it should be emphasized that such a tendency is particularly visible among the young generation.<sup>4</sup>

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<sup>4</sup> Broader discussion: Swacha-Lech [2017, pp. 167–179].

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## Perspektywy rozwoju crowdfundingu

Celem artykułu jest ukazanie crowdfundingu jako znaczącego segmentu rynku finansów alternatywnych oraz określenie perspektyw jego rozwoju. W opracowaniu nakreślono istotę crowdfundingu, omówiono jego rodzaje oraz ukazano jego skalę, prezentując wartość rynku crowdfundingu dla wybranych państw europejskich. Praca uwypukla ponadto główne zalety i wady tej formy finansowania z perspektywy beneficjentów (autorów projektów). Na tym tle autorka dokonała próby określenia zespołu czynników determinujących skuteczny rozwój crowdfundingu w Polsce.

## Prospects for Crowdfunding Development

The aim of this paper is to show crowdfunding as a significant segment of the alternative finance market as well as the prospects of its development. The article presents the main idea of crowdfunding and describes its kinds and its scale by showing the value of crowdfunding market in selected European countries. It also emphasises some main advantages and disadvantages of this form of financing from beneficiaries' (project authors) perspectives. In this context, the author identified the factors that determine the effective development of crowdfunding in Poland.