

## **CROWDFUNDING – AN ALTERNATIVE FOR FINANCING A BUSINESS**

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**ABSTRACT:** *One of the most important trends in the world of the Internet in the past two years was the process of crowdfunding. In the paper I presented several defining elements of this financing practice of social projects or companies, ranging from a quick evolution over time and a presentation of the theoretical concept to a statistical presentation of the number of crowdfunding platforms and also of the amounts collected worldwide, thanks to them. In the second part of the paper we presented the three major platforms in Romania and some of the projects financed entirely due to their help. At the end of the paper one may find legislative guidance regarding crowdfunding in the USA, Europe and Romania.*

**KEY WORDS:** *Crowdfunding, Platforms, Investment-based Projects, Creative Projects, Charitable projects*

**JEL CLASSIFICATION:** *G 21, M 15*

### **1. INTRODUCTION**

The history of crowdfunding begins in the 17th century, when collective fundraising was used to finance subscriptions to print future publications. In the 1870s, Bartholdi had the idea of a statue called "Liberty Enlightening the World." to be bestowed by the French people to the Americans on the anniversary of 100 years.

The statue was to be paid by the French, while the Americans had to pay for the building of the pedestal. Because the American Union had not approved the funding, Pulitzer had the idea to call upon the Americans' pride and asked them for small donations in order to raise the required amount for building the pedestal and he managed to raise \$ 100,000 in just six months from 125,000 people. In the long run this type of crowdfunding has been preserved in various forms but the most important step in its development was the use of the Internet.

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## 2. CONCEPT

The English term "crowdfunding" takes into account a number of activities which aim at involving a large group of people (Eng. "crowd") in funding a particular project. Thus in a narrow sense, the crowdfunding practice represents the completion of a project by raising funds from a group of people. In a broad sense, crowdfunding involves raising financial resources in order to support a project proposed by a group of initiators by mobilizing the resources of a large number of paymasters who are asked for small amounts of money.

As shown on [multifinantare.ro](http://multifinantare.ro) crowdfunding represents an evolved form of fundraising (raising funds) that eliminates the classical system of donation and replaces it with a reward-based methodology<sup>1</sup>. The initiators of projects create around them a network whose members offer money in exchange for services or products generated by the project. There are also types of projects, becoming more common, by which paymasters have the role of a donor, because they do not seek financial gain from this funding and most of the time they have the opportunity to participate with ideas when designing it.

## 3. TYPES OF PROJECTS

Having regard to *the purpose and the way of rewarding* those who are financing projects of crowdfunding, one can distinguish three categories of projects:

- **Investment-based Projects** are developed by companies that receive securities, particularly stock holdings in exchange for a financial contribution. In this case, the project manager retains a share of the amounts accumulated, usually 10%;
- **Creative Projects** created and developed either by individuals or by legal entities who will receive rewards in the form of products or services in exchange for financial support. Even in the case of this type of project, the project manager or the administrator can hold 6% of the accumulated funds;
- **Charitable Projects**, which unlike the other two kinds of projects, do not offer any type of reward and their finality should not materialize in products or services generated by a profit-making economic activity. Usually, these types of crowdfunding projects have a humanitarian character and they are initiated by NGOs.

Considering the direct or indirect way of approaching investors, one can determine the following:

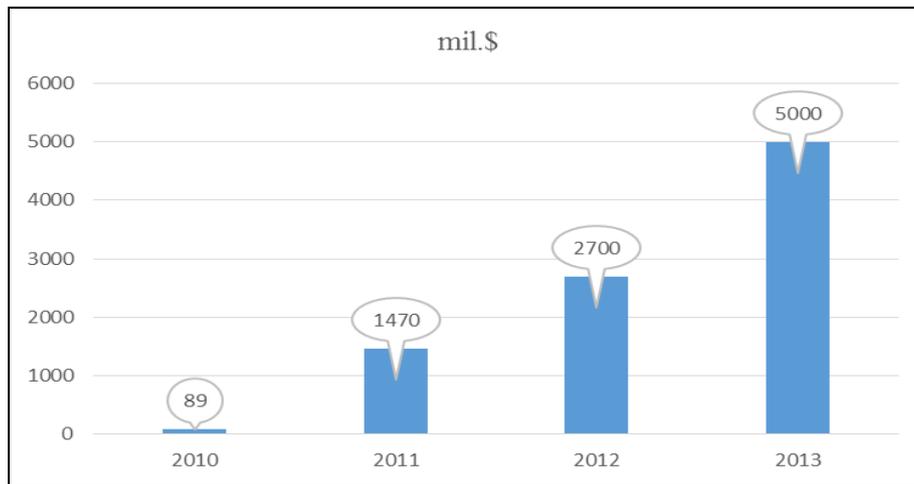
- **Crowdfunding by direct approach**, privately, by legal means, such as donation, sponsorship, reward, allocation of a share of the profits;
- **Crowdfunding by indirect approach**, which includes: direct credits or loans with interest, known as "peer-to-peer lending," or offers of securities in the form of shares or bonds.

The stunning development of crowdfunding platforms is proven by the evolution of the funds raised through them. Thus, if in 2010 online crowdfunding

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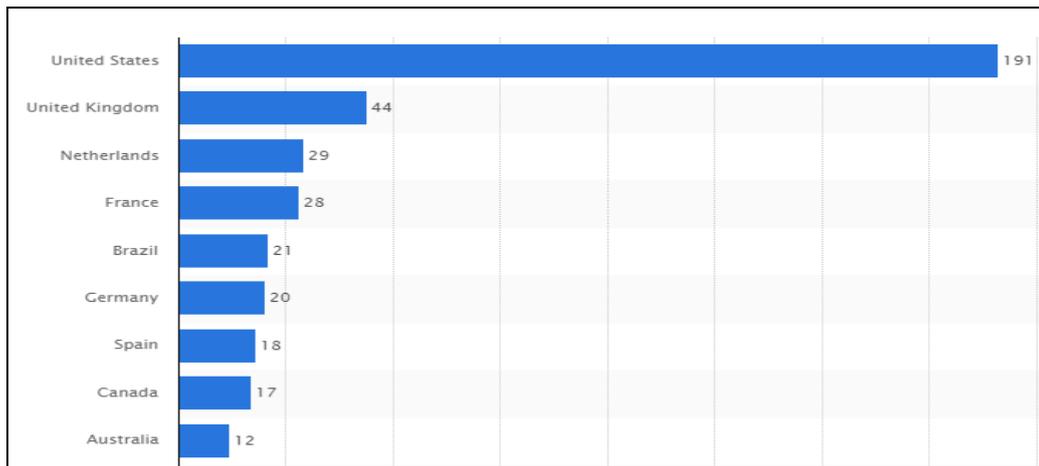
<sup>1</sup> [www.multifinantare.ro](http://www.multifinantare.ro)

platforms have facilitated the raising of about \$ 89 million, in 2011 the amount increased by over 60%, that is to say 1.47 billion dollars. The highest increase was recorded between 2012 and 2013, by more than 90%, from \$ 2.7 billion to over \$ 5 billion, respectively.



**Figure.1. Review of the funds raised through crowdfunding in the period 2010-2013**

In terms of the number of crowdfunding platforms, in 2013 there were 413, mostly in the USA with a share of over 46% of the total and in European countries with a share of nearly 40%. Platforms were operational in Australia, India and China, as well.



Source: <http://www.statista.com/statistics/251573/number-of-crowdfunding-platforms-worldwide-by-country/>

**Figure 2. Review of the number of platforms worldwide**

The best known financing platforms were IndieGoGo, Kickstarter or GoFundMe, open from 2008 till 2010. According to statistics by the end of 2012 there would have been 530 such platform and over 40% of the projects developed with their help received funding of over 100% of the amount requested, among them the greatest share being granted to projects in the IT field. Such examples are:

- *Pebble* applied for financing in order to create an intelligent watch that can be connected to iPhone or Android. After raising [venture capital](#) for the product under their former name *inPulse*, the company failed to attract traditional investors under their new brand name, therefore the company asked for crowd funding in April 2012. Migicovsky's company Pebble Technology launched a Kickstarter campaign on April 11, 2012 with an initial fundraising target of \$100,000. Backers spending \$115 would receive a Pebble when they became available (\$99 for the first 200), effectively pre-ordering the \$150 Pebble at a discounted price<sup>2</sup>. Within two hours of going live, the project had met the \$100,000 goal, and within six days, the project had become the most funded project in the history of Kickstarter to that point, raising over \$4.7 million with 30 days left in the campaign. On May 10<sup>th</sup>, 2012, Pebble Technology announced they were limiting the number of pre-orders. On May 18<sup>th</sup>, 2012, funding closed with \$10,266,844 pledged by 68,928 people.
- *Ouya*, a gaming console using the Android operating system, raised 9 million dollars<sup>3</sup>. The Ouya, stylized OUYA, is a micro-console running its own version of the Android operating system, developed by Ouya Inc. Julie Uhrman founded the project in 2012. Development was funded via Kickstarter, raising \$8.5 million and becoming the website's third-highest-earning project in its history<sup>4</sup>.
- *Finding Vivian Maier* - a feature documentary about the American photographer Vivian Maier. Requested funding: \$20,000. Raised funds: \$105,042 from 1.495 people.
- *Joullies* – engineered beans that cool coffee to the right temperature faster and they keep it there longer. Requested amount: \$9,500. Received sum: \$306,944 from 4,818 people.
- *Diaspora* - a „free" social network, that can be controlled by users. Requested amount: \$20,000. Received sum: \$200,641 from 6,479 people - including Mark Zuckerberg, the co-founder of Facebook.

#### 4. SITUATION IN ROMANIA

In Romania, as of the end of 2012 there began to appear the first platforms for the financing of a business or a project and in present their development is still in an early stage because we cannot talk of crowdfunding as a source of business financing

<sup>2</sup> <http://go.bloomberg.com/tech-deals/2012-04-17-rejected-by-vcs-pebble-watch-raises-3-8m-on-kickstarter/>

<sup>3</sup> <http://www.moneystreet.ro/cluj/it-c/idei-care-se-nasc-si-cresc-pe-internet-despre-crowdfunding-in-romania/>

<sup>4</sup> <http://en.wikipedia.org/wiki/Ouya>

since we are at a start characterized by financing small projects such as: festivals, books or entertaining activities. Although in Romania this type of funding is used more recently, there are three platforms for collecting and their activity is quite intense and shows that the development of crowdfunding in Romania has passed the stage of adolescence. The most important platforms are:

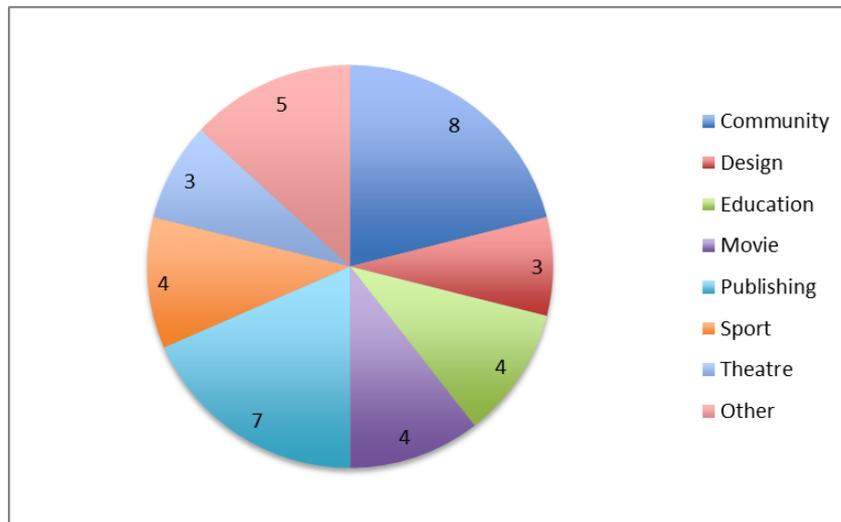
*Multi-financing* - that aims at stimulating start-ups, developing the economy and reducing unemployment rate nationwide. Multi-financing is the first crowdfunding platform in Romania which is based on the principle of network fundraising and it is addressed to entrepreneurs/small and medium sized companies that need multi-financing for the implementation of business or creative projects.

On the site of the platform there are a multitude of projects, structured in investment projects and creative projects. Among the crowdfunding projects that were successfully completed, the following ones stand out:

- led lighting fixtures proposed by Flinders that collected 60,000 lei out of 21 backers and it offers lighting solutions as rewards; that is to say, for a financial support of not less than 500 lei one can get a led fixture, for 1000 lei you get a set of 4 led fixtures and if the financial support exceeds 5000 lei one can opt for a personalized solution of a concept and design with LED lighting;
- in order to encourage the international festival "Graf-Art" from Gura Raului in Marginimea Sibiului, the 12 supporters donated \$ 7250, which is more than 20% compared with the original amount requested and they received as rewards free invitations at the festival;
- publishing a book written by Mihai Florin Talpos called *Designing and Developing an e-Business. Practical guide*. Being part of a field within the theory of strategic management of online businesses, the book is a multidisciplinary work with a large attendance, which had 22 supporters on the platform and a collection weight of 102,75%;

These projects demonstrate that the platform proposes an evolved vision on the concept of fundraising, establishing itself on the financing and investment market by creating a reward system via a social network designed as an alternative of financing, whose members can invest, donate or support certain projects, contributing to the development of the real economy.

On *crestemidei.ro*, the founders show that whoever has creative projects that are valuable for a community or represent an innovative solution is approved by the Crestemidei team and is enrolled on the platform. The founder together with those who verify the eligibility of the project establishes a maximum number of days in which the necessary funds are raised. If the targeted sum was not collected, the funds are redistributed by the donor to other active projects or they are returned at his request. The promotion of the project is carried out by both the Crestemidei team and by the initiator of the project who has the necessary tools to promote his project online. Ever since the platform was founded, there have been presented 38 projects, 18 of which were financed successfully, i.e. over 47%. Out of the total of 38, 8 are intended for financing projects with an impact on the community, 6 are dedicated to publishing, while the fields of education and film have 4 projects, each.



**Figure 3. Review of the field of projects financed by Crestemidei.ro**

The most interesting projects uploaded on the platform turned out to be: Volunteers Fest 2014 that supported an action dedicated to the community for which 2,000 lei were needed to cover logistic costs: materials for creative workshops and trainings, diplomas etc. The amount collected was \$ 2435, i.e. 122%; Clujul meu si Clujul tau (My Cluj, Your Cluj), a publishing action that facilitated the publishing of an album of the city seen through the eyes of talented artists! The album has 120 pages, includes 30 works, interviews and profiles of artists and is written in three languages: Romanian, English and Hungarian. The amount collected was 6510 lei, representing 110%

“*Babes-Bolyai*” (UBB) from Cluj-Napoca dedicated a part of its website to crowdfunding. Babes-Bolyai University is the first university in Romania that will use a crowdfunding platform for financing its academic projects, replacing the old donation form. Among the most important projects proposed through this platform, there are: one of the projects on the crowdfunding platform is that of artificial blood, a project proposed by Mr. Radu Silaghi Dumitrescu which had a financial support of 94.54% 20 days before the dead line; another project is the one that aims at the restoration of the fresco from the Auditorium Maximum, worth 10,000 lei for which supporters will receive a free weekend in the sports park Iuliu Hateganu; developing a museum complex represents an integrated concept proposed by the Direction of the Cultural Heritage of the Babes-Bolyai University, aimed at upgrading the BBU museums and their opening to the community. The value of the project is \$ 10,000 lei and the rewards will result in free entries to these museums.

## 5. LEGISLATION

In 2013, the Securities and Exchange Commission (SEC), the competent authority in the field on US territory, has adopted rules for equity crowdfunding which

has as main objective the financing of start-ups and of small and medium sized companies through the internet, and it allows investors to buy stocks of companies through financing platforms. According to these regulations, the multi-financing portal is defined for the first time as a website that is intended to put investors in touch with the newly created companies in search of capital, the operation of which must be approved by SEC. Other features of crowdfunding are:

- Companies that carry out projects based on crowdfunding platforms are required to submit annual financial statements and other documents and data required by the SEC and also to provide useful information to investors;
- For companies that are set to raise amounts larger than \$ 500,000, it is required to draw up an audit report and to provide additional information required by the SEC; To reduce the risk of small investors, who have an annual net income below \$ 100,000, they are limited to a maximum investment ceiling of \$ 2,000 or 5% of their revenue;
- Attaching an inalienable clause according to which the stocks purchased through these portals should be kept in the portfolio at least one year.

Legislative concerns about crowdfunding are analyzed by **the European Commission** which explores the potential and the risks of this new form of financing, currently required especially for start-ups that are not yet prepared to launch an IPO. Thus, in October 2013, the European Commission launched a consultation procedure on crowdfunding based on its increasing role recorded in recent years, as an alternative financing instrument and on the need for transparency, financial control, security mechanisms of electronic payments and functionality of the platforms.

In Romania as well, it is necessary to regulate the crowdfunding and the adoption of legislative measures with clear rules and standards in order to support the development of crowdfunding and to ensure investors' protection and the opportunity for small investors to participate in this type of financing. For a proper operation, crowdfunding needs to set up an institution/authority with supervisory duties in the field.

## **6. CONCLUSIONS**

One of the most important trends in the world of the Internet in recent years has been the practice of crowdfunding. Crowdfunding is a developed form of fundraising that modifies the classic system of donation and adds a series of rewards for investors. Thus, the initiators of projects create a network whose members offer money in exchange for services or products generated by the project.

In conclusion, the mobilization of the resources of a large numbers of backers who are asked for small amounts of money represents an interesting alternative for financing SMEs and start-ups in particular.

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