

Exploring the Crowdfunding Revolution: Reaching the Right Goal

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Abstract

The present paper analyzes the potential of crowdfunding as an alternative source for financing the economy, but also the limitations of the process and the current gaps. Structured as a practical guide in the field, the study offers examples of crowdfunding platforms, systemizing the theoretical background of the concept in accordance with the Romanian context. Community financing is still poor understood by the Romanian public, the analysis focusing on a consistent literature review that reach the mechanism and the main typology of the crowdfunding platforms, defining the concept and exploring its novelty. Legal regulations and technological development are also considered in the frame of the Industry 4.0, revealing the advantages of using the Fintech tools for both investors and entrepreneurs. Due to the distributed risks, the crowdfunding platforms make easier the investment effort, while still protecting the rights of the capital-seeking. The next step of this evolutionary process is the integration of the blockchain technology in the crowdfunding system, adding substantial features as: anonymity, decentralization and transparency.

Key words: blockchain, crowdfunding, Industry 4.0, finance

J.E.L. classification: D26, E22, M13

1. Introduction

The present paper is devoted to the crowdfunding concept, as a popular alternative of financing for enterprises through community, exploring its development in the Romanian context. Even if crowdfunding is often used internationally, in Romania it represents a new phenomenon which is still characterized by a not-for-profit project-based approach rather than a business approach. Starting from the idea that crowdfunding is at its very beginning in Romania, the aim of the paper is to find answers to several research questions related to this unique method of fundraising: (1) Are the entrepreneurial initiatives encouraged or the not-for-profit projects prevailed? (2) What types of campaigns are reaching the proposed target in the Romanian crowdfunding framework and what is the key-factor that define their success? (3) What is the role of the intermediary platforms in the crowdfunding process and how ensure them information transparency?

In order to provide answers to these research questions we have identified several crowdfunding platforms that activate in Romania, choosing three main platforms with large number of projects submitted. Then, we have match the theoretical background with the particularities of the practical crowdfunding approach in Romania, identifying the rules of the third-party platforms and comparing the services offered in order to highlight the quality of the crowdfunding platforms in Romania and the relationship between the crowdfunding policies of the dedicated websites and the success of the campaigns.

2. Theoretical background

Crowdfunding can be defined, in simple terms, as a way to raise funds for a project from the "crowd", without the direct involvement of a traditional financial institution. Instead, the whole process is organized through a crowdfunding platform that unifies the needs of both project managers and investors. Thomas Erickson defines crowdfunding as "the use of the perceptual and cognitive abilities of a large group of individuals to solve a problem" (2010, p. 2), while Belleflamme et al. noticed that "crowdfunding involves an open call, mostly through the Internet,

for the provision of financial resources either in the form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes" (2013, p. 4) In the same extent, Ethan Mollick insist on the idea that "crowdfunding refers to the efforts by entrepreneurial individuals and groups - cultural, social, and for-profit - to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries" (2014, p. 2).

Crowdfunding is an accessible alternative for the bank's loans, mainly for the small companies, but also a way to promote the business activity or to raise the interest for the company in its early stage of development. Some entrepreneurs use crowdfunding for marketing purposes, in an attempt to validate their business ideas, offering valuable information to investors in the initial phase of creation. Golić, Z. concluded in her research study that "crowdfunding is a kind of innovation that is an outgrowth of social media, and is respected by all three participating parties - entrepreneurs, investors and intermediaries" (2014, p. 42).

Through the crowdfunding platform, which has the role of a third-party, the project manager can reach the right public in short amount of time. Even if the platform intermediates the process indirectly, its contribution to the crowdfunding mechanism is essential, facilitating the relationship by adding key-features to it: secure, riskless and cheap. On the one hand, the platform has the possibility to close down some doubtful projects, being the trusted third-party on a multi-sided market. On the other hand, the fraud issues are constant in the online crowdfunding, due to the regulation gap and the limited legal responsibilities of the initiator: delay in delivering the products or rewards (in some cases the promised project is never delivered), communication problems or lack of transparence in reporting. From this point of view, the main advantages in the crowdfunding process are for the capital-seeking, while the capital-giving can be protected through the services provided by the intermediary, which can avoid some asymmetries. In this sense, some platforms transfer the money when a particular goal is reached, otherwise the money is returned to the contributors. Unfortunately, the regulatory system is still unclear in Romania, the legal framework for the activity of the crowdfunding platforms being influenced by the different positions of the authorities that block the legislative initiative since 2015.

In fact, the online crowdfunding platforms create an information bridge between two types of agents (capital-seeking and capital-giving), reducing in the same time the transaction and monitoring costs. The typology of the crowdfunding platforms depends on the services provided: (1) the funds raised are delivered to the project managers when the campaigns are completed; (2) fundraisers pay some fees to the crowdfunding platform for the transactions; (3) charges must be supported in order to sustain the activity of the platform. In a model that is more related to the bank's pattern, the financial support involves some kind of payments at maturity or interest rates, while other models are more similar to the investment security or are based on a separate account principle. One of the most secure models is the guarantee model, which offers more power and responsibility to the platform in order to reduce the risks. Depending on the responsibility features, there are three basic models of crowdfunding platforms: (1) low responsibility model, (2) medium responsibility model and (3) high responsibility model.

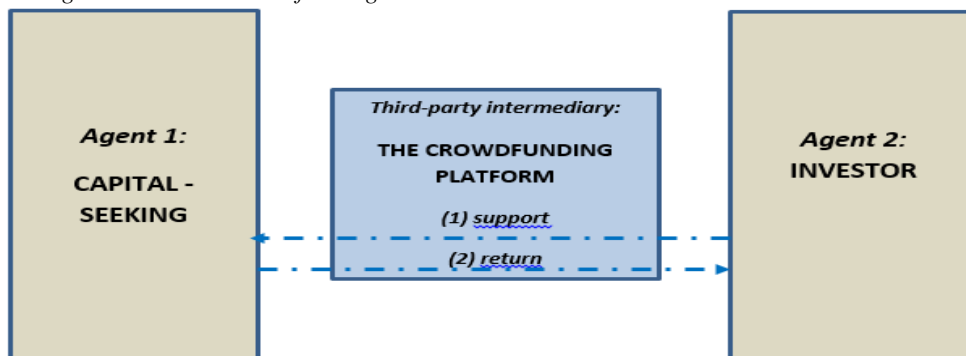
3. Research methodology

The research methodology is based on the case study method, which was used to investigate the crowdfunding process in Romania in terms of how and why, focusing on an in-depth qualitative analysis based on three crowdfunding platforms: Startarium, SeedBlink and Good Causes Award. The cases were selected to represent various crowdfunding mechanisms in terms of risk/return for the capital-giving and the type of payoff associated to the financing. We have considered the existing literature on crowdfunding in order to provide a clear insight in the mechanism, testing the idea of replacing the crowdfunding platforms with the blockchain technology through the smart contracts tool. We have focused on presenting three major crowdfunding platforms in Romania and some of the projects entirely financed through the platforms in order to provide some guidance for project registrations. The activity of the mentioned platforms is quite intense, despite the novelty of the phenomenon in Romania, while their portfolios suggest that they have passed the adolescence stage.

4. Results

The services provided by the crowdfunding platforms will be outlined in this section, including a brief explanation of the crowdfunding mechanism according to the Figure 1. First of all, the platform represents an interface between two types of agents: the capital-seekers and the investors. The platform creates a bridge of information in this multi-sided market, assuming the role of matchmaking between the capital need and the capital offer. In order to complete this task, the platform activate "the crowd", offering a possible pool of investors for the accepted business ideas, changing the subjects on the financial industry from the most powerful investors to the consumer market, with significant lower capital availability, but willingness to face the risks. The platform validates the obligations of each party through standardized digital contracts, but also associates risk-scores to the capital-seeking agents in order to protect the investors.

Figure no. 1. The crowdfunding mechanism



Source: author interpretation

The crowdfunding platforms are based on an authentication system, the data being securely stored in a trustworthy environment. In order to allow rapid movements of capital, the crowdfunding platforms usually integrate payment activities or banking services and have user friendly interfaces, suitable to maintain constant communication between parties. The main advantages of the crowdfunding platforms are: visibility, better financing conditions or market research opportunities. First of all, companies can improve their positions through the level of awareness that can be reached and their public exposure on the market, extending the network at possible collaborators (not only possible clients). There is also a variable financing structure, both funders and fundraisers being involved in a profitable investment scheme. Moreover, market research is another reason to use crowdfunding, due to the large potential to validate the business idea and to develop the new product/service according to the consumer needs.

In this context, we cannot neglect the crowdfunding related disadvantages which can be materialized in various risks, mainly for the investors. On the one hand, there is obvious information asymmetry in the crowdfunding process, the investing decision depending on the level of transparency in the project description, the entrepreneur capability in producing the promised products and the consequences of "hidden information". Another critical point is known as the "Moral Hazard" (Strausz, 2017), which appears after the funds are raised and is based on the moral value of the capital-seeking to keep unchanged the business idea and the implementation diagram. A common issue in the crowdfunding mechanism is the existence of divergent interests between funders and fundraisers, due to the miscommunication problems, but also the risk that someone else copy the business idea. Unfortunately, there is not a secondary market for investors to prevent these situations, the capital-giving remaining blocked in an investment that is no more in line with its concerns.

According to the European Commission (2019), small and medium enterprises represent approx. 99% of total businesses in the European Union, being the most important source of new employment. One of the key problems identified in the SMEs operational activity is the limited access to the financial resources (Rakićević et al. 2013, p. 33). Romania performs well above the EU average for SMEs productivity, while the value added raised in the period 2014-2018 by

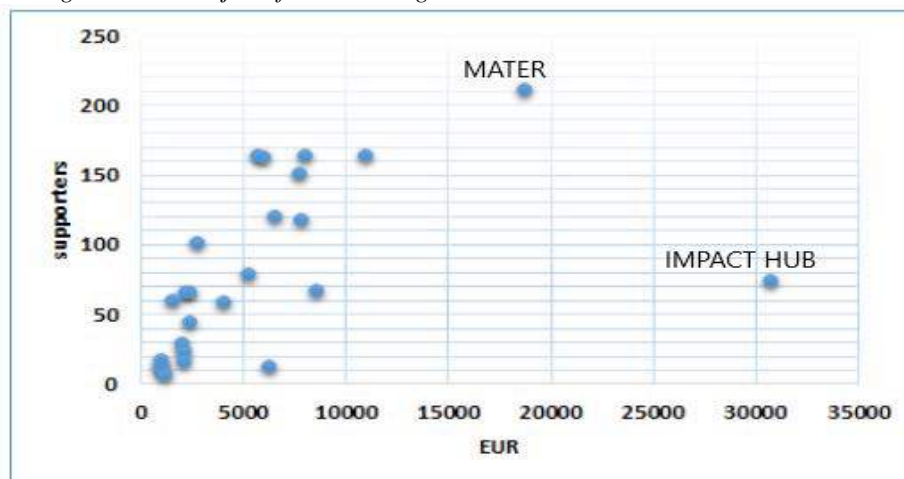
43,1%. The highest increase was generated by micro-firms, while the manufacturing sector generated more than 19% of the total SME value added in Romania (2018). According to the figures provided by CNIPMMR (2019), more than 65% of the Romanian SMEs use self-financing as the main source of funding, followed by bank credits (25,88%), supplier credits (24,93%) and grant funds (16,85%). In this context, crowdfunding is a suitable financing method for SMEs, startups or NGOs, which can test the business idea and raise the money in a secure environment.

Startarium is a project of Impact Hub and ING Bank that facilitates the business launch and development, including a special area where the entrepreneurs are in touch with mentors and possible investors, networking, pitching, online courses, mentoring and other business tools. The launch of the project was doubled by an event of great significance, *Startarium Pitch Day* (2016), with total awards of 100.000 EUR for startups with more than one-year experience and less than three years. Another project developed by *Startarium* was launched in august 2019 under the title *Startarium Crowdfunding Makeathon*, putting together business consultants, mentors, experts and media specialists in order to sustain the entrepreneurs, even if they have not started their businesses yet. *Startarium – The City of Entrepreneurs* is much more than a crowdfunding platform, being based on three main pillars: learn, test and finance.

The platform provides several services: no intermediary fees and 2% for the payment agent, access to a large community of entrepreneurs, investors, innovators and members, free mentorship and marketing consultancy, special campaigns regularly organized. One of these campaigns was *Startarium Crowdfunding Makeathon*, accessible to entrepreneurs which can register their projects and prepare the campaigns by using the tools provided by the platform in a guided activity during one month. The final phase of the project campaigns is the launching day, which corresponds to *Startarium PitchDay*, when ten initiatives are presented to the public: details about the business, prototype of the product, business model, strategies and the reward structure.

Over 2.000 people have already supported campaigns on *Startarium*, being rewarded with some material privileges: the first access to the product, access to the limited series created especially for supporters or discounts available only in crowdfunding. Since the launch of the *Startarium* platform, 53 campaigns have already been carried out through the crowdfunding section, of which 25 campaigns have attracted a total funding of EUR 148.368 from investors, along with the financial support offered by the *Startarium* platform for promotion. The largest amount raised by a single project was over EUR 30.000 and the record time in which a campaign was financed was only 3 days.

Figure no. 2. Projects funded through Startarium



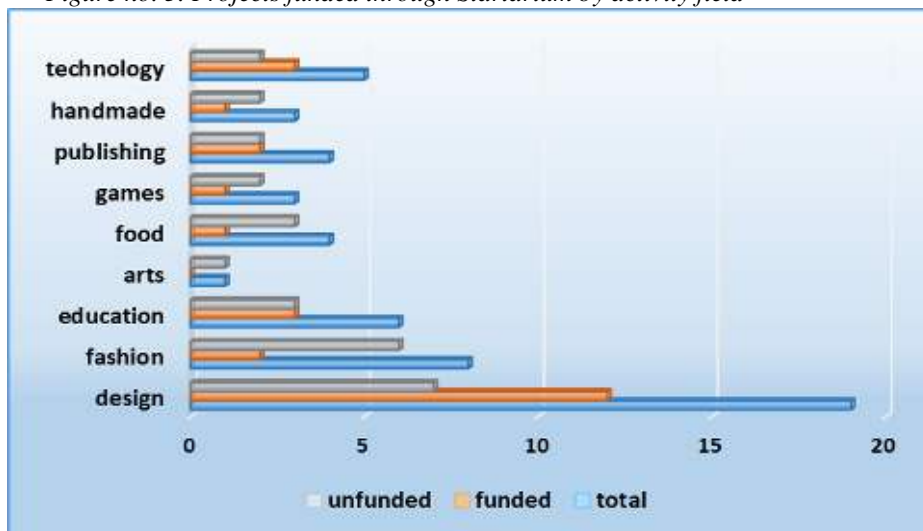
Source: processed based on data released by <https://www.startarium.ro/crowdfunding/sustine>

According to the Figure 2, the project entitled *MATER – The Materials Library* was sustained by the largest number of supporters (211 people), while *Impact Hub* raised the largest amount (EUR 30.750). In fact, the last-mentioned project has doubled the required amount (EUR 15.000), being successfully financed (205%), while the first one has attracted the public support and also exceeded the amount initially requested (125% financed – EUR 18.722). *MATER – The Materials*

Library is an extensive and constantly renewed collection of samples of materials dedicated to professionals working with materials: architects, interior designers, product clothing and jewelry designers, illustrators, visual artists, etc. The rewards offered by *MATER* were: co-founder *MATER* (EUR 1.000), *MATER* subscription for companies (EUR 8.000, EUR 450 or 250 EUR, depending on the number of employees and other benefices), co-working subscription for 6 months (EUR 500), access to the *MATER* conference room for one day (EUR 400), *EARLY BIRD* subscription (EUR 60), design objects made of special materials (EUR 30 and EUR 35), invitation at the launching party (EUR 10) or a postcard signed by the whole team (EUR 5). The rewards offered by *Impact Hub* (from EUR 60 to EUR 3750) refers to subscription discounts (Hub Connect, Hub Casual, Hub Regular, Hub Resident) or discounts for the pack (logistics, space and catering) for events (Event Pack).

The platform functions under the fixed funding principle, according to which the project must be 100% funded, otherwise the money is returned to the investors. According to the activity field of the business, most of the initiatives registered are from the design area and this is the reason why the same field has the highest percentage of funded campaigns (Figure 3). The second place for registered projects is occupied by the fashion industry, followed by education, while the top funded fields are: design (12 campaigns), education and technology (3 campaigns/field).

Figure no. 3. Projects funded through Startarium by activity field



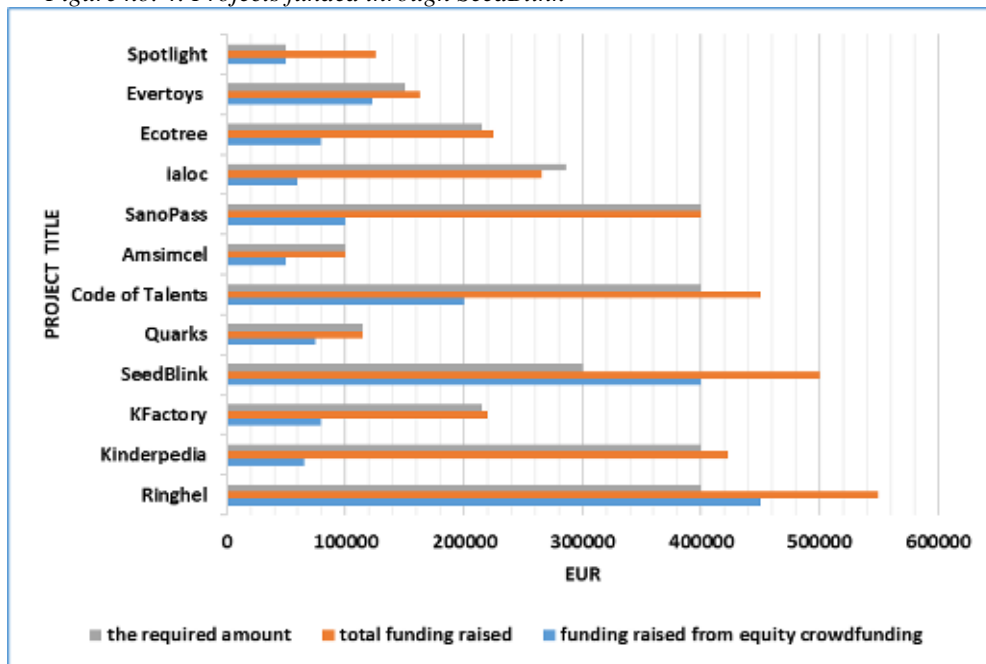
Source: processed based on data released by <https://www.startarium.ro/crowdfunding/sustine>

SeedBlink was launched in 2019, being the first equity crowdfunding platform in Romania through which everyone can invest only EUR 2.500 to support the startups they appreciate. This is the reason why the campaigns submitted to the platform have attracted a total funding of EUR 1.732.565 from investors, much more than *Startarium*. The platform filters the companies and the investor decide the project he wants to finance. If the business is doing well, the investor can have an income, otherwise he can lose the money. The process is very risky and there is no secondary market, because the startups from *SeedBlink* are at the very beginning and the outputs depends on various factors. The platform makes agreements with the startups in order to keep the process transparent, assuring the investors that they will be regularly informed about the financial situation of the companies. The startups selection is based on four basic principles relating to the founders and the implementation team, testing the assumptions, growing the number of clients and the business assessment.

According to the Figure 4, the total funding raised by the founders in the period 2011-2020 has exceeded the required value, suggesting a high interest for investments, even in an uncertain context. At present, the only campaign which is open is *Kinderpedia*, with EUR 422.500 raised of EUR 400.000 needed and 60 confirmed investors. The project is based on the cooperation family-school-community in the EdTech context by optimizing the administrative activities and strengthening the performance in schools. The largest amount was raised by *Ringhel*, which is

developing PROCESIO, a technology that helps companies to grow by reducing the costs and adjusting to the market conditions. The main target of *Ringhel* is to become an unicorn by 2027, developing a platform as a service designed for non-technical people.

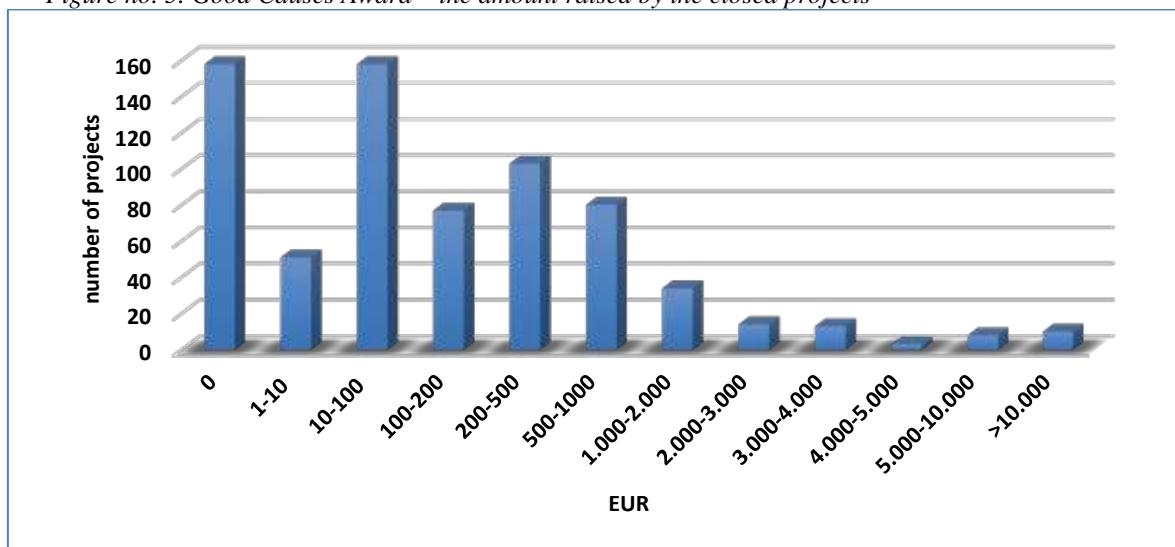
Figure no. 4. Projects funded through SeedBlink



Source: processed based on data released by <https://investors.seedblink.com/>

While *Startarium* and *Seedblink* are more focused on entrepreneurial initiatives, there are also other platforms focused on social causes, donations and social entrepreneurship. *Bursa Binelui - Good Causes Award* is a crowdfunding platform developed by BCR in cooperation with EuPlatesc, bringing together both organizations and community in order to support the NGO sector by encouraging donors to participate with small amount without any fee. The figures available on the website at July 2020 suggest a high number of initiatives registered on the platform: 88 active projects and 709 closed projects. The total amount for the founded projects was LEI 2.336.825 (EUR 482.545), while 158 of the closed projects remained unfunded (22.28%).

Figure no. 5. Good Causes Award – the amount raised by the closed projects



Source: processed based on data released by <https://www.bursabinelui.ro/>

According to the Figure 5, most of the initiatives have raised between EUR 10 and EUR 100, while only 11 projects have raised more than EUR 10.000. Approx. 36,67% of the closed projects have raised between EUR 100 and EUR 1.000, 8,88% of them have attracted funds between EUR 1.000 and EUR 5.000 and only 8 projects (11,12%) have collected amounts between EUR 5.000 and EUR 10.000. Only 14 projects have exceeded the total amount required, the largest amount being raised by the initiative entitled *Joy in the Real World*. The main objective of the project was to improve the quality of life of those for whom every day is a struggle for survival by providing food, clothing, hygiene products, firewood, etc. and to support the education field for disadvantaged children.

The future of crowdfunding is related to the blockchain technology that has the power to improve the services offered by the platforms by adding significant features like safety, transparency and efficiency. Through the use of smart contracts, the campaigns can be executed during a fixed period of time, if a goal is reached, otherwise the money will be returned to the investors. Thus, the use of the blockchain technology increase the investor's confidentiality and eliminates the need of a third-party authority due to the implementation of the smart contracts, which are automatically executed when the required conditions are met. Blockchain has a decentralized structure, where every node ensures the integrity of data. According to this principle, blockchain is based on a consensus algorithm, which means that all the nodes of the system have a copy of the blockchain that cannot be altered and a block can be added to the chain only through the mining process. Blockchain has the power to completely change the digital infrastructure technology in a new architecture with various opportunities, that can be an anchor to cross the line of traditional financing in Romania.

5. Conclusions

The crowdfunding revolution is still fragmented in the Romanian context, with few specialized platforms that have the potential to disrupt the traditional financing mechanisms in different ways. First of all, crowdfunding can be a significant alternative for financing the SME sector, representing a financial innovation that can replace the bank's loans in the near future. At present, it is still a limited approach that needs guidance for both capital-seeking and investors, revealing a new kind of intermediation which takes the shape of an open call. The results of this paper suggest an alignment of the Romanian crowdfunding platforms with the typology identified by Belleflamme et al. (2015):

(1) investment-based crowdfunding and (2) reward/donation-based crowdfunding. The Romanian crowdfunding framework is more connected to the second category, the founders exploring this opportunity in a restrained manner. They reach their goal mainly by following the platforms guidelines in terms of project structure, sometimes using the mentorship programs, sustaining the idea through dedicated promotion efforts. Even if the not-for-profit projects prevailed in the Romanian ecosystem, the entrepreneurial initiatives are also encouraged by a few number of crowdfunding platforms that assist the founder in the submission process.

The results suggest that both project quality and personal networks can be associated with the success of a campaign, while the services offered by the crowdfunding platforms increase trust from sophisticated investors, much related to the financial and entrepreneurial fields. In order to reach the right goal, the campaigns must be structured in accordance with the requirements of the platforms, offering sufficient information in all stages of implementation, proposing a veritable entrepreneurial idea that can attract investors through the reward system. Regarding the charitable actions, there are more efficient the campaigns that refer to large groups of disadvantaged people, rather than a particular case, whereas for the entrepreneurial initiatives the success is related to the viability of the business idea and the reporting transparency through the crowdfunding platform.

In Romania, the results suggest that the funding success is strongly related to the services provided by the crowdfunding platforms, being improved by the validity-test of the projects. Once the ideas pass the first step and they are refined through the platform's tools, they have more chances to reach the target. Instead, the social causes can be best associated with the „crowd”, in its primary sense, defined as people from non-financial sectors who invest in the registered projects without waiting any kind of rewards. These projects are rarely entirely funded, due to the reduced

power of the donors, the multitude of the submitted campaigns and the poor influence of the crowdfunding platform to enhance the ideas.

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