# *Crowdfunding: beyond the hype*

*16 May 2014*

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The value of crowdfunding is to allow even small entrepreneurs to raise money through the general public. This new financing channel is today possible thanks to the development of the internet.
There are different types of crowdfunding models, depending on the type of compensation:

- Models with non-financial return: donation and reward-based models;
- Models with financial return: loans, participation in revenues or profits and securities issuance (also called *crowdinvesting*).

Crowdinvesting in particular is receiving much attention in recent times. There are ongoing reforms in different countries to address some of the issues of this particular form of financing.
In Europe crowdinvesting relies on exemptions in the prospectus regulation, which allow the issuing securities without a prospectus. In particular, firms are not required to comply with the prospectus requirement if the total offer does not exceed a certain threshold (usually €100,000, but varies in many member states, such as the Netherlands where it is €250,000 or the UK where it is €5,000,000) or if the number of investors does not exceed 150 per member state.
Partially as a result of the varying regulations, crowdfunding platforms have adopted different investment models. They differ in terms of the kind of securities sold, whether the investments are made directly by the investor or are pooled in a financial vehicle, whether voting rights are provided to investors, and restrictions on the type of investor allowed to participate (i.e. whether accredited or not).
Evidence shows that people investing in equity crowdfunding are quite different from the average funder of the other types of models. Indeed, in crowdinvesting a substantial share of the money comes from wealthy individuals with some expertise in financial markets, not from the "crowd".

**Guillaume Desclée**, MyMicroInvest, Belgium

MyMicroInvest is a Belgian equity crowdfunding platform that allows crowdfunders to co-invest with professional early-stage investors by allowing a minimum investment of 50€).
The crowdfunding concept is actually not new. For example, in 1884 part of the Statue of Liberty (the base) was financed through the funds pooled from several citizens that volunteered to contribute. However, the development of the internet and a change in mentality helped to boost this form of financing and in 2013 the estimated volume of this industry reached $5.2bn, while the estimate for 2014 is $10bn.
Equity crowdfunding, the segment in which MyMicroInvest operates, in 2012 was about $115m. This financing model provides the opportunity to help address the equity gap for financing SMEs and thus contributing to job creation. Indeed, evidence for EU 27 shows that SMEs account for about 66 percent of the employment and 85 percent of net job creation, most of which is driven by start-ups.
Clearly, equity crowdfunding entails opportunities and risks both for the crowd and entrepreneurs. The opportunity for the crowd is to be able to invest in start-ups with high potential for growth, while the risk is to receive wrong information in making the investment assessment (information asymmetries which exist in seed and early stage investment more generally and even more so in the case of crowdfunding). This risk calls for appropriate investor protection. For entrepreneurs the opportunity is to secure funding and to

have a community of people willing to contribute and give suggestions for product development, while the risk is to increase the cost and the time devoted to manage a large crowd of investors.
The solution provided by MyMicroInvest is to allow the crowd to co-invest alongside with a professional investor. In particular, funds from the crowd are pooled in a single fund and then the fund co-invests into the company with a business angel. This model benefits from the combination of the advantages of the crowd (large pool of funds) with those of angel or venture capital investments (expertise).
Since its launch in September 2012, MyMicroInvest has collected more than 3,300,000€ and enabled 16 projects to get funding. This platform is currently one of the top 5 in Europe.

**Maria Teresa Fabregas Fernandez**, Head of Unit, Securities Markets, DG Internal Market and Services, European Commission

The European Commission is currently studying this new financing model and trying to assess its risks and opportunities. In this respect, the Commission launched a public consultation late last year to coordinate efforts to understand this new phenomenon. The findings that emerged form the basis of the Communication entitled "*Unleashing the potential of Crowdfunding in the European Union*" that was published in March 2014 .
Crowdfunding benefits the economy because many – if not most – of the projects that received finance through crowdfunding would have not been financed otherwise. In addition to the provision of funds, crowdfunding also provides entrepreneurs with a powerful marketing tool to get precious information on product demand and preferences. Overall, this new financing model provides benefits to the economy by contributing to innovation, growth and employment.
However, there are several risks that should be taken into account and they vary in the different models of crowdfunding. There are risks both for project owners (e.g. in terms of intellectual property protection) and risks to contributors (e.g. fraud). In particular, in financial return models the investor runs the risk of losing money, either because of fraud or because the business fails.
While many European regulations already impact the crowdfunding industry in some way, a few Member States have introduced an *ad hoc* legislation (among them Italy). Many others (including France) will introduce new laws soon. The objective of these new regulations is to provide some protection to investors, while avoiding introducing too burdensome rules that could kill this nascent industry.
At this stage the efforts of the Commission are focused on increasing awareness of the risks of crowdfunding, promoting transparency and diffusing best practices. Moreover, the Commission is considering how to promote the internal market for crowdfunding, since so far this industry has developed mostly at the national level.

**Some messages from the Q&A session**

- The average investor is not able to understand several of the covenants used by professional early-stage investors in their contracts. Therefore, platforms should make significant efforts to educate and inform their crowd of investors.
- The differences in national regulations currently constitute a significant obstacle to cross-border deals.
- There is a risk that the crowdfunding phenomenon will form the basis for a new bubble.

*Notes by Marco Testoni*