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Article

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CROWDFUNDING IN THE WIDER PERSPECTIVE INVESTMENT CROWDFUNDING: COMPETITION BETWEEN REGULATIONS, INSTITUTIONS, AND ECONOMIC FREEDOM

LESZEK DZIAWGO¹, DANUTA DZIAWGO²

Abstract

The aim of this article is to present Investment Crowdfunding (ICF) in a perspective wider than merely as a new form of financing a certain category of business ventures. Selected aspects of ICF as a phenomenon that is a manifestation of the conflict between economic freedom and regulations and financial market institutions will be emphasized. New concepts of the part of the modern economy in the period of digitization, referred to as the collaborative economy, mesh economy, or sharing economy, should also be taken into account. The issues of excessive and restrictive regulation of the financial market will be presented in this context, as well as the constraints and risk factors of ICF operation and the Polish ICF experience.

The study hypothesises that Investment Crowdfunding is a viable alternative for financing micro and small economic projects, if compared to the traditional and over-regulated forms of financing. The usefulness of Investment Crowdfunding concerns primarily economic projects of the start-up category. The study uses the following research methods: critical analysis of the literature of the issue, descriptive and comparative analysis, case study, and deduction.

The theoretical considerations and examples presented in the article should be treated with appropriate research caution. However, they make it possible to positively verify the hypothesis.

JEL classification: D24, D53, G23, K23

Keywords: investment crowdfunding, financial market, financial regulations

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INTRODUCTION

Currently we observe the evolution of contemporary management processes. The interaction of technological, social, and economic changes is the foundation for the development of the new economy. In terms of forms of financing business activity, one can see another manifestation of conflict between, on the one hand, economic freedom and, on the other hand, regulations and institutions. Crowdfunding is an example both on the international and domestic markets.

The article is of the nature of a debate, which affects its content and form. The aim is to present Investment Crowdfunding (ICF) in a perspective wider than merely a new form of financing a certain category of business ventures. Selected aspects of ICF as a phenomenon that is a manifestation of the conflict between economic freedom and regulations and financial market institutions will be emphasized. The new concepts of part of the modern economy referred to as the collaborative economy, mesh economy, or sharing economy should also be taken into account. The issues of restrictive overshooting of the financial market will be presented in this context, as well as the factors limiting the functioning of ICF, and the potential risks of implementing this form of financing. In addition, the existing Polish ICF experience will be presented. The study hypothesises that Investment Crowdfunding is a viable alternative to financing micro and small economic projects if compared to the traditional and over-regulated forms of financing. The usefulness of Investment Crowdfunding concerns primarily the economic projects of the start-up category. The study uses the following research methods: critical analysis of the literature of the issue and legal regulations, descriptive and comparative analysis, case study, and deduction. In the article are

presented results of the above mentioned and applied methods.

THE ESSENCE OF CROWDFUNDING

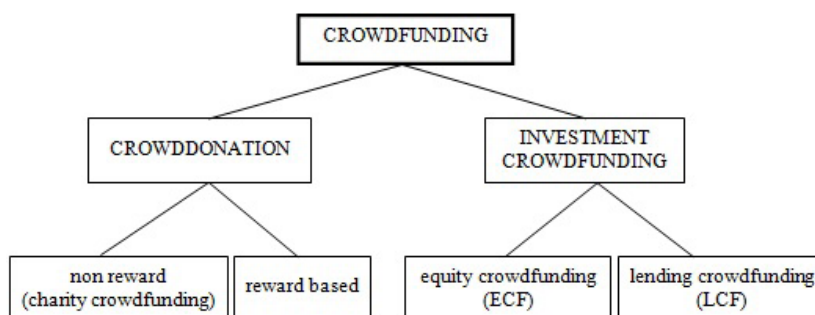
There are numerous definitions of Crowdfunding (CF). An interesting compilation in this respect is included in the study by Krupa and Żołądkiewicz (2017) and Bouncken et al. (2015).

While drawing attention to the most important features of the phenomenon, Crowdfunding can be generally described as gathering capital for the implementation of the initiator’s project through numerous small payments made by interested persons via the Internet.

One can also distinguish a number of types of Crowdfunding (Dziuba, 2018; Gierczak, Bretschneider et al. 2016; Krupa & Żołądkiewicz, 2017; Belleflamme et al. 2015). Synthetically, the basic Crowdfunding classification is presented in Diagram 1. Naturally, the detailed CF classification is much more extensive, but its full presentation is not necessary, due to the purpose of this article.

As shown in Diagram 1, Investment Crowdfunding is one of the forms of Crowdfunding. Taking into account the objective of the study, particular attention is paid to Investment Crowdfunding, a process which needs to be clarified owing to the characteristics of the financial undertaking, this time of an economic nature. Therefore, we can define Investment Crowdfunding as raising capital for the implementation of the initiator’s project through numerous, small payments by interested people made via the Internet, bypassing the regulations and financial institutions appropriate for financial market participants in anticipation of obtaining financial benefits for both

Diagram 1: Basic Crowdfunding classification



Source: Own study

parties to the transaction.

Based on the above, it should be recognized that Investment Crowdfunding is indeed alternative financing, all the more so because the further stage of the project, i.e. its implementation by the initiator, also takes place without the administrative supervision appropriate for the financial market.

As indicated above (Diagram 1), Investment Crowdfunding includes two ways to involve investors in financing a project. In Equity Crowdfunding, it is assumed that investors will receive share certificates in the financed venture in the form of shares in exchange for the amounts paid. In this way, they will become co-owners of the company. In turn, in Lending Crowdfunding, investors become creditors of the initiator of the project.

Investment Crowdfunding is a promising form of financing a certain category of micro and small business ventures, including primarily beginner ones referred to as start-ups (in order to determine the scale of financed economic projects, one can be roughly guided by the classification of enterprises according to of the Polish Act on entrepreneurs).

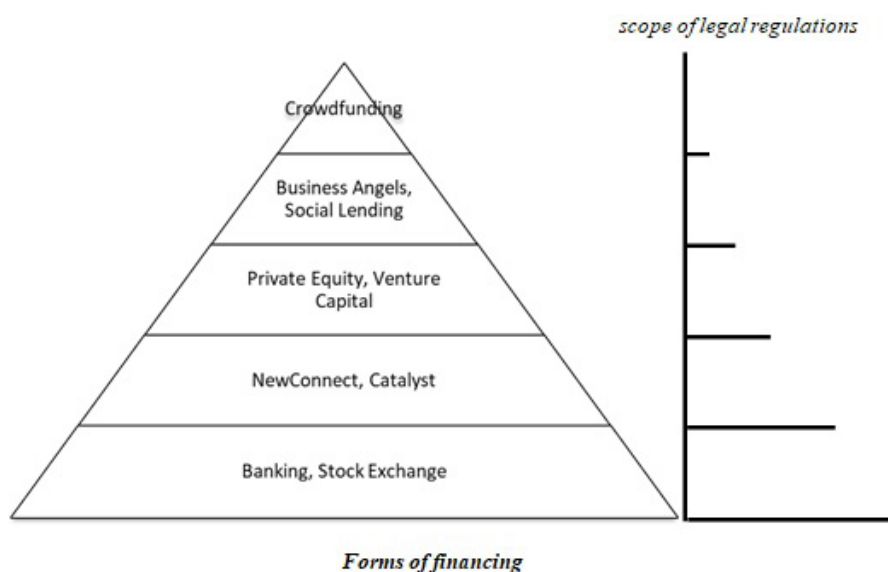
An important advantage of this form of financing is the limited legal regulations on crowdfunding. The fact that free financing is based on the Internet community sets new possibilities for raising funds to start or expand business activity in the digital age (Crowdfunding, 2015; Moritz & Block, 2016).

REGULATORY TSUNAMI VS. INVESTMENT CROWDFUNDING

The issue of obtaining financing for a business remains an important problem of the economy. Today, however, the problem is growing significantly, because many ways of financing considered traditional (loans, share or bond issues) are becoming less and less effective. The reason is the excessive and restrictive legal regulations concerning the functioning of the banking sector and the capital market (including the stock market), which significantly complicate the process of raising capital. In addition, there are associated costs, lapse of time, and the legal risk of final non-compliance with legal requirements. One can even speak of serious legal barriers to entering and staying in the financial market with a view to raising capital for running a business (for example, subsequent CRD, MAR, and MiFID regulations). As a result, the indicated sectors have become almost dysfunctional in relation to the possessed capital and possessed operational capabilities, and many recognized capital market entities in Poland are giving up the status of a listed company (Dziawgo & Dziawgo, 2018). See more: <https://www.gpw.pl/podstawowe-statystyki-gpw>.

Because of the above-mentioned restrictions, attempts have been made for years to facilitate access to financing for smaller business entities based on reduced legal requirements (Diagram 2).

Diagram 2: Regulating Pyramid



Source: Own study

Alternative trading markets are an example of raising money with reduced legal requirements on the capital market. In the case of the Polish capital market, these are Catalyst - for bond issuers, and NewConnect - for issuers of shares. However, even reduced legal requirements still constitute a certain barrier and the costs and risks related to them.

When considering the financing of business activity through the Warsaw Stock Exchange, as well as through Catalyst and NewConnect, it is necessary to point out another serious problem, which is the need to disclose information about the company's operations. These data can be freely used by competitors (Jóźwik, 2018).

A completely different category of alternative financing of small-scale economic projects, including the start-up category, is Private Equity/Venture Capital equity funds, Business Angels, or Social Lending. All the forms of financing indicated above are based on decidedly even more reduced legal requirements (see Freedman, Nutting, 2015).

Private Equity and Venture Capital equity funds really make it possible to reduce legal and capital barriers to financing. However, these are institutional forms of investing in ventures with higher risk. Thus, the institutional form of action enforces the compliance of functioning with certain legal regulations, although they are limited.

The use of the Business Angels (BA) type of financing provides much greater opportunities to reduce legal burdens. It is a non-institutional form of support by affluent and business-savvy individuals of start-up business ventures burdened with high risk. Unfortunately, this form

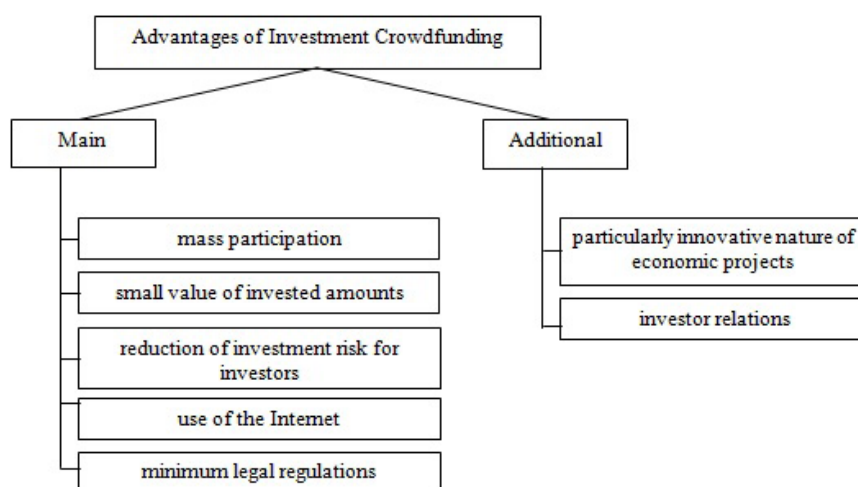
is rarely used and concerns projects of little value.

Social Lending (SL) can be considered another example of financing with a significant reduction of legal requirements. This form may also apply to business activity. However, this method is not widely used in business. The reason is that in general only two entities participate in the loan transaction: the lender and the borrower.

Only Investment Crowdfunding, in comparison with the previously indicated forms, is an interesting, further attempt to finance micro and small economic projects, including start-ups. It should be emphasized that ICF perfectly fits in with the process of conflict between regulations, institutions, and economic freedom. As regards the issue of shares or bonds, ICF is subject only to the general regulations regarding these categories of securities (the Commercial Companies Code, the Bonds Act), but also without the supervision of the Financial Supervision Authority.

At least 5 features of Investment Crowdfunding may indicate its significant development potential, i.e. mass participation, low value of invested amounts and thus the reduction of investment risk for investors, use of the Internet, and legal regulations limited to a minimum. In addition, the possible additional advantages of ICF resulting from a specific, funded project, to which access is provided by ICF, may be considered. These may include, for example, the particularly innovative nature of economic projects or investor relations. For it can be assumed that the initiators of particularly innovative projects will be using innovative methods of financing, one of which is Investment Crowdfunding. In the case of investor relations, however, the added value would consist in the fact that

Diagram 3: Advantages of Investment Crowdfunding



Source: Own study

they will be of an informal and more direct nature owing to the requirements of the internet community (for more about legal requirements see: Gajda, 2017).

THE RISKS OF INVESTMENT CROWDFUNDING FUNCTIONING

When analysing the prospects of development of Investment Crowdfunding, one should not only consider its advantages, but also point to its real limitations and potential risks.

A real limitation is the maximum amount that can be obtained for the financing of a project through Investment Crowdfunding. In Poland, the permissible limit pursuant to the regulations on organized trading market is EUR 1 million (Polish Act on public offering ..., 2005). Although legal regulations in many countries are generally liberalized in favour of ICF, this form of financing remains a solution primarily for micro and small economic projects, and perhaps only in the near future also for medium-sized enterprises (Regulation 2017/1129). It seems that the position of decision makers may be accepted to some extent owing to the safety of the market functioning. However, this issue can be considered open owing to the growing demands of investors and the current and future experience from ICF operations. The examples of raising funds of significant value by Polish initiators presented in item 4 allow us to hope that ICF will be more and more useful in financing larger economic projects.

Another serious problem for the development of Investment Crowdfunding is the potential risks associated with its functioning. One can mention here investors' knowledge and experience, the value of financial resources at their disposal, and the instability of law, also in the context of political risk (Dziawgo, 2013). It is also important to bear in mind the administration's inefficiency in law enforcement.

To illustrate the indicated legal risks, some analogies can be recalled. One of them is the crisis referred to as dot.com and, among the newer ones, the bitcoin cryptocurrency. The short history of the operation of this currency has already provided many examples of different and changing positions of decision makers in individual countries. On the other hand, regarding the failure to enforce the law, using only the example of Poland one can point to Amber Gold, GetBack bonds, or the Polish Financial Supervision Authority scandals. All this may

discourage ICF investors from taking investment risks.

Among the potential risks of the Investment Crowdfunding market, one can furthermore point out some of the risks that can be described as natural risks. They result from the life cycle of a given product or concept. For there are successive stages of their development such as interest, delight, verification, and the mature phase. It seems that now we are already at the stage of delight. Therefore, the ICF market will have to be verified. Depending on the scale of bankruptcies of financed projects or the gained profits, this may be negative or positive verification. The scale of bankruptcies or successes is likely to define the significance and value of the ICF market for the next years of the mature phase.

POLISH CROWDFUNDING MARKET - SELECTED ASPECTS

In Poland, crowdfunding is becoming more and more popular. There are already several dozen crowdfunding platforms in the country. Foreign crowdfunding platforms are also used to implement the projects of Polish initiators. One of the first initiatives using foreign platforms was the financing of the Zortrax 3D printer project in 2013. The amount of USD 179,000 was collected at that time (Sierant, 2014). In 2017, in turn, the amount of EUR 66,000 was raised for the Polish TurtleRover project (Polacy ..., 2017).

However, one of the latest examples, also successful, was the raising by Awaken Realms, in 2018, of PLN 13,000,000 to finance a board game project (Marynowicz, 2018).

As regards Polish crowdfunding platforms, one should mention one of the most popular Polish Investment Crowdfunding platforms, namely the Beesfund platform. There are several examples of its effective use. One of them is the obtaining of funding for the well-known project of the company MC2Innovations (co-founder Anna Streżyńska - the former Minister of Digital Affairs). At the end of 2018, the fundraiser ended in success. Nearly 700,000 Polish zlotys was raised by selling 5,263 company shares to 266 investors. The acquired capital will enable the company to undertake the activity of providing services in the field of the digital transformation of enterprises based on the blockchain (Frączyk, 2018).

However, not all ICF initiatives are successful. This applies to both foreign and Polish ICF markets. When using Investment Crowdfunding, the awareness of the

risk taken is important. On the Polish market, attention is paid also to this aspect of the investment. Beesfund's CEO directly stated that it should be acknowledged that most of the investments using the Beesfund platform will go bankrupt (Ogórek, 2016). Such opinions are repeated both at home and abroad.

Unfortunately, according to the statement of Polish Financial Supervision Authority from 29 March 2019 the activities of Investment Crowdfunding Platform will be limited. To continue collecting capital for investment purposes Crowdfunding Platforms have to obtain a licence adequate for a brokerage house. It means more bureaucracy and less economic freedom. However, the lack of capital in the Polish economy, especially for start-up activities, will press the administration to liberalise the law.

CONCLUSIONS

The presented theoretical considerations and provided examples should be treated with appropriate research caution. However, they make it possible to positively verify the hypothesis put forward in the Introduction. Investment Crowdfunding seems to be a viable alternative to financing micro and small economic projects if compared to the traditional and over-regulated forms of financing. At the same time, its particular usefulness in the financing of business projects in the start-up category should be appreciated.

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