

ALTERNATIVE FUNDING TECHNIQUES. COMPARATIVE ANALYSIS

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Abstract

The main objective of this paper is to highlight the dynamics, diversity and especially the availability of an alternative financial market, developed outside of the traditional banking system, on online trading platforms, a market that can constitute an efficient solution, at the expense of entities open to fast funding, wide ranging, with limited guaranties and minimum procedural and legislative formalities.

For this purpose, we shall analyze briefly the main alternative financing methods, both empirically and qualitatively, in terms of similarities and differences between the two of them, inclusively of the amount that can be employed in this process through different methods.

The current paper aims to be a practical guide meant to support those facing difficulties in obtaining financing for start-ups, implementing or/and developing business and entrepreneurship initiatives, and also a guide for those who want to be informed regarding the latest funding techniques. Another aspect to be considered is the legal framework in which this process takes place, because the regulation for these levers remains constantly behind the development process of new methods.

The classic financiers should also consider reviewing the lending policy as the amounts attracted and accessed through these alternative methods increase exponentially from one year to the other, the volume of sums involved surpassing each time the forecasts, making thus possible the transformations of these paradigms from the financial sector into preponderant financial funding's.

Keywords: *alternative financing, venture capital, entrepreneurship, crowdfunding, peer to peer.*

1. Introduction

Attracting the financial resources needed to start and develop business and entrepreneurship initiatives represented a permanent challenge for the promoters.

If initially accessing the external financial resources was the prestige of financial institutions, we have witnessed unprecedented changes in recent decades.

Drastic reduction in access to classical financial instruments, caused by the global economic-financial global crisis, the decline of trust in consecrated saving, investment and lending mechanisms, as well as innovations in digital technologies have led to the emergence of alternative lending and investment methods.

A first step has been made by venture capitals and Angel Investors who implemented method considered to be unconventional for funding businesses, often start-ups.

Small investments, up to 100.000 euro designed to financially support a business until it starts generating its own income is included in the seed financing category. Business angel investments (the investors investing in start-ups in exchange for part of the business) usually use these seed financing¹.

This type of investment is generally used also for the financial capital offered to scalable start-ups that have great potential for development and which, until the time of the investment have registered spectacular growths. We are referring here to venture capital (private equity). Thus, business angel investments are regulated by Law no. 120/2015, with its subsequent regulations and amendments. The first private network investors in technological startups in Romania was TechAngels (<http://www.techangels.ro>). Also, the Venture Capital funds are represented in Romania also (Digital Catalyst Fund).

An important development has also been recorded in the alternative financing segment, made through the online platforms, outside the traditional banking system. These new unconventional financing sources, known in Romania as participatory financing or multifinancing, will manifest itself mainly in the form of investment of private equity through crowdfunding or peer to peer financing and its characterized by a collective effort of some investors who usually finance, usually online, various projects started by other people or companies.²

Globally, the first multi-funding platform was set up in 2001 by the American company ArtistShare, and the largest multi-funding project was "Star Citizen", a

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¹ <http://akcees.com/cum-finantezi-un-startup>, accessed on 2 september 2017

² Silviu Marian Banila, THE ANALYSIS: *History for multifinancing* 20 Jan. 2014, article available online <http://www.manager.ro/articole/economie-139/analiza-o-istorie-a-multifinantarii-57713.html>, accesat la 6 septembrie 2017

space-based video game for which they gathered in 2014 over \$ 36 million³.

Internationally, we can also mention other popular sites such as Kickstarter, Indiegogo or Crowdfunder, and in Romania, creștemidei.ro or potșieu.ro.

Peer to peer funding, however, is based on "person to person" lending and can be done for both entrepreneurs and individuals.

Among the platforms setup successfully for this purpose, we can mention: Zopa (the first company of its kind, set up in 2005 in the UK), Prosper, Lending Club, Bondora (established in Estonia, this platform facilitated the development of the well-known Skype).

Romania also ranks among the countries with a low degree of assimilation of new trends, with the volume of alternative financing amounting to 1.17 million euros, with the last position among the countries of South Eastern Europe. That is why the present paper has as its main objective the popularization of these new financing levers by highlighting the dynamics, diversity and especially the availability of an alternative financial market, developed outside the traditional banking system, on online trading platforms. Thus, this market can be an effective solution, for entities willing to use fast-paced, large-scale, low-guarantee and minimum procedural and legislative formalities financing. For this purpose, empirical data, published by the Cambridge Center for Alternative Finance in "The European Alternative Finance Benchmarking Report" (2014-2018) was used.

2. The dynamics of the main types of alternative financing

Alternative funding is a branch of financial services with an accelerated growth. If initially they were considered as alternative financing methods crowdfunding and peer-to-peer loans, later on other methods such as invoice trading and reward services were also included in the analysis. The volume of funding involved in these funding mechanisms increases significantly each year, from EUR 8,50 billion in 2013 to 32,77 in 2014, and 130,02 billion in 2015, reaching EUR 261,14 billion in 2016.

Table 1. Evolution of Global Alternative Financing

	Europa	America	Asia	
2013	1,130	3,240	4,130	8,500
2014	2,830	9,650	20,290	32,770
2015	5,430	29,980	94,610	130,020
2016	7,670	31,810	221,660	261,140
Total	17,060	74,680	340,690	

Source: Personal processing based on data published by Cambridge Center for Alternative Finance in The European Alternative Finance Benchmarking Report (2014-2018).

But, given the specificity of national culture as well as the level of different financial education from one area to another, from one country to another, for a complete and correct picture of this financial behavior, the amounts to be traded should be analyzed by geographical regions (Europe, America and Asia along with the Pacific area).

For each of these regions there is a country whose weight is overwhelming. Thus, for Europe, the largest share is held by the United Kingdom, in America the United States of America, and for Asia the largest share is held by China.

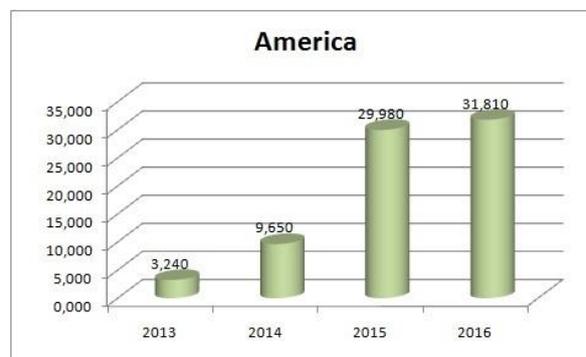
For our area of interest, which is Europe, UK had each year more than 70% of the amounts involved in such funding.

Globally, the area in which these mechanisms have been most used is Asia.

For each area, the graphical analysis reveals interesting aspects of the dynamics of the sums involved in this process.

Thus, America, the region that initiated this process and where alternative funding has the greatest experience, has come to suffer, with an increase of only 6% in 2016 compared to 2015 compared to previous growth rates of about 200%.

Chart 1 Evolution of Alternate Funding in America in 2013-2016



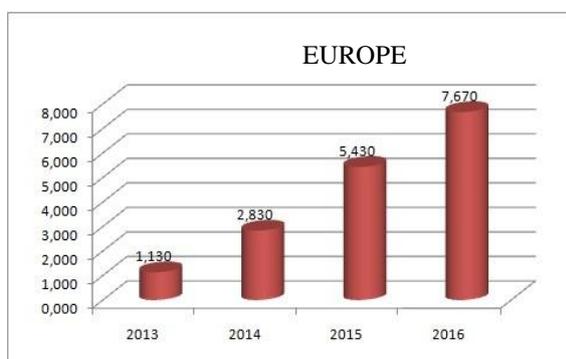
Source: Personal processing based on data published by Cambridge Center for Alternative Finance in The European Alternative Finance Benchmarking Report (2014-2018)

A similar phenomenon, but on a smaller scale can also be observed in Europe (limiting growth to 41% compared to much higher growth rates in previous years). This is due to the saturation of the financial market with such offers, the number of platforms offering such services rising each year, which is not always satisfying in terms of the quality of the services offered, having as proof the fact that a great share of platforms analyzed within the original study in 2015 (regarding the 2013 and 2014) is no longer

³ Silviu Marian Banila, ANALIZA: O istorie a multifinantarii, 20 Ian. 2014, articol disponibil online pe <http://www.manager.ro/articole/economie-139/analiza-o-istorie-a-multifinantarii-57713.html>, accesat la 6 septembrie 2017

working. Another factor for the less accentuated growth is the emergence of cryptocurrencies (completely new technological platforms not regulated by financial markets) and which absorb a large amount of the sums needed for very large startup projects.

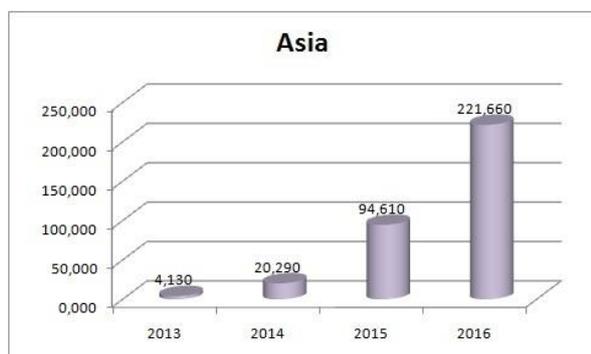
Chart 2. Evolution of the volume of alternative funding in Europe over the period 2013-2016



Source: personal processing based on data published by the Cambridge Center for Alternative Finance in The European Alternative Finance Benchmarking Report (2014-2018)

The Asia-Pacific region has continued to grow further, a trend that can continue in the years to come, as China and South Korea have opted not to allow cryptocurrencies for trade on their territory.

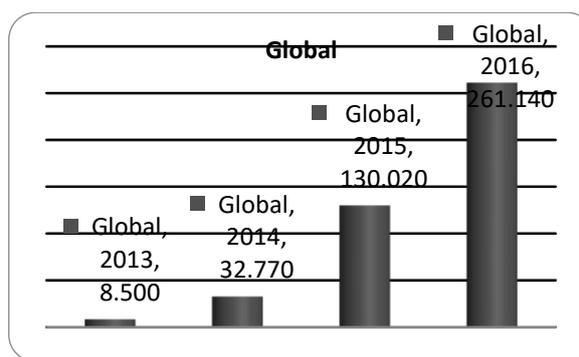
Chart 3. The evolution of the volume of funding by alternative methods in Asia & Pacific during 2013-2016



Source: Personal processing based on data published by Cambridge Center for Alternative Finance in The European Alternative Finance Benchmarking Report (2014-2018)

On a global scale, however, there is a steady increase in the amounts involved in the alternative financing mechanism.

Chart 4. The evolution of the global volume of funding by alternative methods in 2013-2016



Source: personal processing based on data published by the Cambridge Center for Alternative Finance in The European Alternative Finance Benchmarking Report (2014-2018)

The values involved in this process as well as the impressive annual growth rate indicate the imposition of these methods on the financial market, especially for small firms, based mostly on innovative business ideas, namely the startups which most often, the classic and unconventional funding systems (Angel Investors and Venture Capitals) ranks them at too high a risk.

These amounts are accessed through alternative funding methods grouped into three broad categories: crowdfunding, peer-to-peer (direct loans) and invoice trading. We will analyze them in detail, by category, in order of importance in the share of collected amounts.

Thus, **P2P Consumer Lending**, meaning the loans from individuals or legal entities accessed by a natural person, are carried out within web platforms specialized in such services. The financier knows only the project and not the beneficiary of the loan. Most often, this loan returns to the lender with a higher value, the borrower receiving also interest.

P2P Consumer Lending managed to accumulate EUR 696.81 million in 2016, accounting for 33.80% of the market for alternative financing methods, the average amount considered to be defining for this type of financing being **EUR 10,000**.

P2P Business Lending has the same features as P2P Consumer Lending, only this time loans are accessed by legal entities from individuals or businesses in order to fund a business.

In 2016, the accumulated amount was of EUR 349.96 million, representing 17.00% of the total alternative funding for this period, the defining amount for this type of loan being **EUR 100,000**;

Instead, **P2P Property Lending** is covered by risk, being loans from individuals or legal entities guaranteed by a property, which is not the case for the other two options presented above. Otherwise, the features are the same. The amounts accrued in 2016 by this type of funding were 95.15 million Euro, representing 4.6% of the total.

For the **equity-based crowdfunding** case, the necessary amounts are obtained through the sale of shares held by the company but, this mediation is carried out by those web platforms, eliminating thus

other intermediaries, and with diminished commissions. The link between the investor and the creditor is greatly facilitated by the specialized online platform, without which it would be difficult for the two entities to get in touch.

In 2016, the amounts accumulated from this type of financing totaled EUR 218.64 million, or 10.60%, the average amount being accessed through this method being EUR 459,000.

The amounts involved in 2016 for **Real Estate Crowdfunding** alternative financing, meaning loans from natural or legal persons granted for real estate investments, amounted up to 109.45 million Euro, meaning 5.3% of the total.

At the same time, 9.20% of the total amount of alternative funding for 2016, meaning 190.76 million Euro, was covered by **Reward-based Crowdfunding, a mechanism for financing** people, projects or companies in exchange for rewards or products, but not in monetary form).

Invoice Trading, meaning the sale of invoices to be withdrawn at a discount value compared to their nominal value, in order to obtain rapid liquidity, accumulated in 2016 a total of 251.87 million Euro respectively 12.20% of the total alternative financing.

Debt-based investment funds, widely known as **Debt-based Securities**, have been used in the field of unconventional energy. Another feature distinguishing them from other types of alternative funding is the guarantee they provide to creditors as well as the reimbursement system of funding in annual installments and a large number of years. Although the amounts involved are not as high as in other cases (EUR 22.85 million), this type of alternative funding is worth mentioning due to the innovative nature of the technologies in which it is being invested and the way of reimbursement.

In addition to these techniques, there are a number of less useful methods, but their share is less than 1% of the total amount of money circulated.

All of these methods have as their main feature that they are operating on a web platform that links investors and borrowers. The mode of granting credits is much more permissive, depending largely on the creditworthiness of the borrower and on the pertinence of the project he is proposing to finance.

The risks to which the sponsor and the borrower are subject to having two components: the classic one, valid for both classical or unconventional loans and a specific one, determined by the characteristics of this type of credit intermediation. Thus, the borrower bears the risk of being exposed to the innovative ideas of the business he wants to initiate, since the innovative idea needs to be shared, at least in part, to convince potential investors. At the same time, the investor is no longer an expert in financial transactions, having to make a decision largely based on intuition and less on financial experience or good practices. There are few ways to guarantee the investment.

Another relevant aspect in the analysis of this sector is represented by the evolution of the number of web platforms involved in alternative funding mechanisms, especially for our area of interest, which is Europe. Thus, if at the beginning of the 2013 study the number was modest and distributed in only a few countries (UK - 65, Germany - 31, France - 33, Spain - 34, Netherlands - 31) in 2016, meaning a 3-year time span, the number of those benefiting from such platforms increased, the European countries having (with the exception of the former Yugoslavia and Albania) at least one such facility.

But the Eastern European countries have a sad record of 1 to 3 platforms, followed by the Baltic countries with 4 to 6 developed platforms, carrying significant amounts. Estonia, for example, is among the countries with high GDP per capita, ranking second, after the UK. In this country, the unprecedented development of communications infrastructure and Estonian support for web applications of all kinds, including in the public administration sphere, has played an important role.

3. Conclusions

The period following the global financial crisis has created the climate for developing alternative funding mechanisms, against the backdrop of growing distrust in classical or unconventional mechanisms. Also, as a result of this mistrust, surplus money that was usually aimed at savings or pension funds was reoriented to alternative savings / investments. It can be said that, alternative financing methods have been forced to emerge due to the need of both market forces - demand and supply of financing. The existence of new methods of promoting and using web platforms has facilitated and generated this new lending mechanism. It has benefited in particular to startups, characterized by innovative but also resource-poor ideas, as well as small investors, who thus have the opportunity to make advantageous savings.

The phenomenon has intensified, the significant increase in yearly interim amounts, requiring new financial regulations in the United States, Canada and Europe.

Also, in the last report of the University of Cambridge (The 3rd European Alternative Finance Industry Report, 2018, p.38), the increase in the institutionalization level is brought to discussion. In fact, this means increasing involvement of large players on the financial market in alternative funding mechanisms. Nominated are the pension funds, investment funds, banks, Venture Capitals and Angel Investors. Thus, classical funding methods as well as unconventional methods have transformed this competition of alternative methods into a means to reinvest their funds.

The difference consists of the interest they would have had if these amounts were offered in a classic credit for an innovative project and the much lower

profit it would obtain by subscribing those funds within crowdfunding or peer-to-platform -peer.

Startups can therefore benefit from fast alternative funding methods, with few guarantees and less formalities. Lenders can benefit from higher earnings from these funding by replacing banks or investment funds with web platforms whose commissions are most often applied to the borrower.

The phenomenon seems to be a win-win situation for both investors and startups, which explains the explosive evolution of recent years.

As a result, the phenomenon can no longer be ignored by traditional players on the financial market, their lending policy showing a tendency to relax.

The growth limitation from 2016 can be explained through adjusting the banks and Ventures

Capital companies lending policies, on the one hand, and by the emergence of cryptocurrencies, funding mechanisms for innovative, large-scale financial projects, not yet regulated (China and South Korea forbidding them as lending mechanisms) but extremely advantageous and at the same time risky both for startups and for investors.

All the information presented above as well as the prospects for market evolution, open the way for new research directions on this topic, especially since, for the time being, the complexity of the analysis methods is based on the limited database, given that the Cambridge Center for Alternatives Finance, the global benchmarking institution in this field, publishes annual reports from 2015, the time frame covered so far being only between 2012-2016.

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