

CROWDFUNDING - A VIABLE ALTERNATIVE TO FINANCE SMALL AND MEDIUM ENTERPRISES

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Abstract

The resumption of economic activity after the lockdown imposed by the need to stop the Covid-19 pandemic is a major imperative for any of the states in the world that have faced this scourge.

Among the most affected corporate organizations were small and medium-sized enterprises (SMEs), whose small financial resources did not allow them to maintain the level of performance recorded before the pandemic.

In order to recover, especially in the context of the economic crisis that is looming at the beginning of 2022, SMEs need even more additional sources of financing and alternative solutions to bank loans would be welcome.

In this context, the crowdfunding mechanisms proposed in recent years by the business environment in developed countries and recently adopted in the European Union by "Regulation (EU) 2020/1503 on European providers of crowdfunding services" offer solutions that have proved viable, and a draft law is being prepared in Romania to regulate the crowdfunding of Romanian enterprises.

Keywords: *crowdfunding; small and medium-sized enterprises; financial management; fundraising platforms; business angels.*

1. The economic conjuncture in the spring of 2022 and the financing of SMEs

The combined effect of the national and global impact of the pandemic has severely degraded the performance, cash flow and solvency of companies.

From large companies to small companies, the entrepreneurial tissue is beginning to feel the effects of the global recession and the slowdown in the national economy.

Survivors of this wave of closures are not exempt from the current market difficulties, and the prevailing uncertainty is particularly detrimental to investment, with most businesses, especially small and medium-sized enterprises (SMEs) reporting a decline in demand for their products and services.

In the European Union¹ for example, the two consecutive years of lockdown - 2020 and 2021 - have slowed down and even decrease the activity in the main sectors of the real economy. Thus, in 2020 compared to 2019, the production of capital goods decreased by 7.1%, consumer goods by 2.4%, energy production by 1.5%, intermediate goods by 0.5 %, and the production of capital goods decreased by 7.1%. In the following year, 2021, the situation improved slightly, but without

recovering from the previous decline: the production of non-durable consumer goods increased by 8.0%, energy production increased by 6.1%, consumer goods by 3.2% and intermediate goods by 2.4%, while the production of capital goods continued to fall by 0.8%.

In the construction sector, the evolution has been similar. In 2021, compared to 2020, civil engineering decreased by 2.1%, while civil engineering increased by 1.7%.

The negative consequences of this evolution were felt in all economic and social fields, along with the negative impact of the pandemic.

Thus, according to European statistics² in 2020, 8.6% of the population of the European Union and more than one in five people were at risk of poverty (21.7%) not being able to afford a meal of meat, fish or a vegetarian equivalent every two days.

It should be noted that Romania registered in 2020 the highest rate of material and social deprivation in the entire European Union, respectively 25.3%.³

But beyond its immediate effects, the crisis has revealed structural defects in the private sector, primarily the significant gap in competitiveness between high-tech sectors - IT, automotive, aeronautics, etc. - and those that have been late to modernize, as in the case of Romania, agriculture - with

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¹ <https://ec.europa.eu/eurostat>, accessed on 28.03.2022.

² <https://ec.europa.eu/eurostat/statistics-explained>, accessed on 28.03.2022.

³ <https://ec.europa.eu/eurostat/databrowser>, accessed on 28.03.2022.

very serious effects to ensure the supply of the population, but also the increase of the current account deficit, caused by the increase of imports of agricultural products and food, unjustified for a country with such a high agricultural potential.

Funding and financial sustainability are two more barriers. First of all, businesses, especially SMEs, have difficulty accessing loan financing because they cannot meet all the eligibility criteria imposed by banks through their methodology to reduce their risk of default. Also, SMEs are often unable to meet their current obligations to repay and / or pay the costs of credit, in the case of small companies there are frequent delays in payment.

From another point of view, the financing of SMEs is difficult. In this regard, although entrepreneurship and SME innovation are the strengths of private sector dynamism, young companies are struggling to raise start-up capital, and the funding structure and access mechanisms are cumbersome, too complex for start-ups to meet. More flexible and simpler conditions would give small businesses, at least in the transition phase from the project to the operational phase, the opportunity to function properly and survive in a competitive market.

An unexpected positive effect of the health crisis, which was at the root of the current economic crisis, is the involvement of banks in resolving the tensions of corporate treasuries by proposing short and very short-term loans that would improve their liquidity management. In this way, insolvency and even the closure of companies that declare themselves unable to pay can be avoided.

In the current unfavorable situation and probably for a longer period of at least two years, these measures are insufficient; which leads to the need for the intervention of public authorities not only in the field of real and social economy, but also of promotion, in collaboration with the private sector, of some simpler and faster financial services, which urgently respond to the needs of SMEs in financial difficulty or in the initial stage of activity.

2. Techniques and tools for financing the activity of SMEs

Financial techniques have diversified greatly in recent years, especially in developed, but also in developing countries - as our country - which have resorted to some of these and implemented an increasingly diverse range of means of accessing new generation financial sources.

The financing of any enterprise corresponds to the stages of its existence:

- first its creation as a distinct entity in the

specific economic landscape;

- then the development of the activity and the gaining of a market segment, which it wants to expand. In order to achieve this goal, the company will have to be able to finance the current activity - at the bottom of the profit and loss account, financing the necessary working capital (NFR), but also to finance the essential investments for the operation of the company, respectively the acquisition of equipment and other heritage items.

In the practice of classical financial management of enterprises, the sources of financing of private entities can be classified into three distinct categories, access, costs - explicit or implicit -, the impact on the competitive market position being decisively influenced by the sources of funds used by the company. These can be classified into three main categories, which have proved to be very heterogeneous and constantly undergoing modernization:

- *self-financing* is a mandatory element to support the development of a company, in the absence of which investors of any color lose confidence in the creditworthiness of the enterprise;

- *the contribution to the own capital from individuals or legal persons* who are involved in the existence of the respective corporation, even if only as owners, if not as managers, constitutes an essential element both in the creation phase of the enterprise and its subsequent evolution. The size of equity depends on several factors, among which the most important are correlated with the company's position on the market, respectively with its attractiveness, determined by profitability, as well as with the element of innovation proposed by the activity sector.

When looking for investors to participate in the creation of a company, individuals and / or corporations willing to invest in the new entity are targeted. These may be private individuals / legal entities, such as:

- those close to you (family, friends, etc.), grouped in the category known as "love money";
- crowdequity, a category of participatory financing, in which some intermediaries (so-called platforms) propose to the general public to invest in the company's own funds, thus becoming shareholders;
- venture capital companies interested in the respective company, from various points of view: the type of activity, the potential importance in the respective geographical area, the improvement of the employment in the locality, etc.

Business angels mainly finances innovative projects, whether technological or otherwise, and / or projects with high growth potential. They not only bring money to strengthen the company's equity, but also their experience, skills and network, which they

make available to managers to help them enter their market.

Venture capital funds are mainly involved in the creation of an innovative company with strong growth prospects or in the development of an existing company. In this case, their purpose is to participate in the capital of the (unlisted) company and to give impetus to its growth through a significant contribution to equity which, due to the leverage effect, will allow them to obtain higher returns and thus attract foreign investors.

- the third category of financing of enterprises is indebtedness, and the forms under which it materializes are more and more diversified, from the classic bank credit to the multiple forms of financing obtained by accessing alternative financing platforms.

Crowdfunding also includes the form of crowdlending, which allows companies to borrow from individuals and / or legal entities in the community through a platform.

There are also several operations that facilitate the financial management of a company, among which leasing and factoring are widely used.

Leasing is generally a solution offered by a bank for the long-term lease of goods, with the option to buy at the end of the period, under conditions that vary according to the chosen formula.

Factoring is also a quick way to raise funds, considered as part of the turnover, by transferring the commercial receivables that the company has on customers, and thanks to the online platforms specialized for this purpose the respective liquidities are obtained almost immediately. The most important disadvantage is the cost of factoring, but it can also offer the management of the company's treasury, which would save valuable time for the company.

3. Participatory financing - benefits and risks

At least two parties are involved in a crowdfunding operation:

- investors - natural or legal persons - who invest a sum, generally not very large, in the project presented on the participatory financing platform;
- the promoter of this project, who appeals to the public to collect the funds necessary for the implementation of the project.

Being an investment, crowdfunding involves risks, mainly the failure to carry out the project, so the loss of the amounts invested, but for investors there are a number of options so that the risks are reduced to zero.

Regarding the type of crowdfunding, there are currently three types of fundraising platforms: donation, loan and investment.

Participatory funding in the form of donations or **Reward Crowdfunding** can take many forms, depending on the request of the fundraiser:

- donations without consideration or reward, which the public makes to support the project, as can be the launch of a music CD, a book, a concert, the establishment of a kindergarten and much more;
- donations with a symbolic reward, such as a gift CD, a printed T-shirt with the respective band, etc.;
- pre-orders for the respective activity, generally with a price / tariff below the market price, etc.

Participatory financing in the form of loan or crowdlending can take the form of:

- interest-free loans;
- loans with interest, without guarantee or guarantee from the debtor, minibon loans.

This type of crowdfunding generally makes it possible to finance expenses that are not taken into account by banks, such as the need for liquidity, which arises from the bottom can have a profit and loss account, to cover the financial needs of working capital or for intangible investment projects.

Unlike crowdfunding, which mainly involves a donation from individuals or legal entities for a cultural or social project, crowdlending offers the possibility of a financial investment with a specified return and for a specified period of time.

One of the most important advantages of crowdlending is that it does not require collateral, or it is very low, which means that project initiators can access financing much more easily than from commercial banks.

They can also use the loans collected to finance the required working capital (NFR) - respectively to balance the operating activity - without proving a sufficiently high turnover, thus being able to carry out new projects with implementation of innovative solutions, research & development works, etc.

The most important disadvantage of such financing is the higher cost than a classic bank loan, but compared to short and very short term loans, the interest rate differences and other costs – in brief debt service - are not very high, although, obviously, they are a measure of the higher risks faced by investors compared to bank depositors.

In all cases, the initiator of a project must choose a participatory financing platform accredited by the national authorities in the field - in the case of Romania, the Financial Supervisory Authority (FSA) - which will fulfill the role of intermediary for fundraising, and for this purpose being specialized in analyzing the creditworthiness of project initiators, as well as the projects themselves.

Given the great diversity of projects and developers, there is a wide range of crowdfunding

platforms, some dedicated to personal projects, others to professional projects specialized in certain fields of activity, and large platforms that have already consolidated their activity and market segment offer services for the promotion of complex projects.

The platforms that offer intermediation for financing the business aim especially at professional projects in fields such as renewable energy, real estate developments, support for the establishment and / or development of SMEs, elaboration of studies and works in R&D, etc.

Crowdfunding platforms are mainly accessed for fundraising for activities initiated by individuals, for various purposes: financing studies, family events - for example weddings, baptisms, anniversaries -, purchasing durable goods or even real estate, etc.

In the case of *participatory financing in the form of shares or Crowdequity* (capital investments), economic agents, natural and/or legal persons, invest in an enterprise by acquiring shares or social parts, thus becoming shareholders. The invested funds allow the creation or development of an enterprise, the remuneration of the shareholders being realized through dividends, which means that it depends on the results obtained by the company in the operating cycle.

Crowdequity is mainly used to create start-ups and businesses and can, like other types of crowdfunding, take many forms:

- the investors participate in the share capital of the corporation, either in the form of shares, or of social parts, depending on the way the company is organized. According to this participation, the investor will be remunerated in the form of dividends or capital gains realized during the sale of securities;
- the investment is materialized by the purchase of bonds issued by the borrowing company, and the remuneration of the investors will consist of earnings resulting from bonds, respectively interest and other gains, in accordance with the issue prospectus;
- the investment is materialized in the form of participation in a concession, the investor's remuneration being the royalty, calculated, according to the contract, as a percentage of the turnover resulting from the activity of the respective project.

Depending on the particularities of each project, its initiators address a crowdfunding platform, which can be a convenient intermediary - both in terms of fundraising and costs - between them and potential investors.

The platforms can be divided into two categories, general or specialized, depending on the methods they apply to raise funds: by donation, loan or capital and the sector of activity of the projects for which they agree to raise funds.

General platforms present an important advantage for project initiators because they can address potential investors who are not, at least initially, interested in the field of activity of the project in question.

On the other hand, both the general and the specialized participatory financing platform require that the projects they promote meet certain eligibility criteria, which include risk and profitability forecasts, implementation and operation deadlines at the projected parameters, etc., such as also the size of the investor community - number, value of participation with funds - but also their rewards / remuneration, if requested.

In the financial markets, especially in the developed countries, a lot of crowdfunding platforms have appeared, the profile publications presenting the most important ones, which exercise their intermediation in a certain geographical area or even globally. For example, Investopedia, the well-known financial site in New York, published at the end of 2021 a list of crowdfunding platforms for small businesses, highlighting the top six best performing US platforms, including the fees and other costs they perceive to the initiators of projects: Indiegogo, SeedInvest Technology, Mightycause, StartEngine, GoFundMe, Patreon, who, although general, have specialized in certain fields.

Although much more shy, crowdfunding has appeared and spread in Romania. Platforms have been created and managed to raise funds from individuals or legal entities. Even though some have been closed (crestemidei.ro, multifinantare.ro - the first crowdfunding platform in Romania, We-are-here.ro), at the beginning of 2022, these were some of the best known⁴:

- PotSiEu.ro, for projects with social impact, initiated by NGOs, associations and foundations;
- Startarium.ro is dedicated exclusively to entrepreneurial initiatives;
- Bursabinelui.ro is a platform developed by BCR and dedicated to NGOs;
- The participatory financing platform developed by Babeş-Bolyai University - Cluj-Napoca, for the ALUMNI graduates association, as well as other activities within the university;
- Sprijina.ro, a general platform that collects funds for personal projects, but also for projects, usually for small businesses, sports, education, animals, environment and travel, etc.
- seedblink.com, an investing platform specialized in sourcing, vetting, financing, and scaling European tech start-ups

⁴ <https://laurentiumihai.ro/crowdfunding-din-romania/>, accessed on 20.03.2022.

4. Participatory financing - regulation and institutional framework

Participatory financing includes several activities: the provision of investment services; public offering of financial securities; banking transactions between investors - platform - project initiators; making payments; consulting; market research etc. Most of these activities are regulated in the Member States of the European Union by national and / or European legislation, and the monitoring of its observance is the responsibility of the authorities of the respective states.

Consequently, the regulatory framework for crowdfunding operations was specific to each state, which made the regulations heterogeneous, preventing the development of a common European crowdfunding market. With the free movement of capital, in the European Union was enacted the Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European providers of crowdfunding, applicable in all Member States from 10 November 2021, for the proper functioning and access of platforms, as well as the protection of investors, but also the stimulation of business development,.

This Regulation lays down uniform requirements for the provision of crowdfunding services as follows:

- organization and operation of crowdfunding service providers;
- authorizing and monitoring the respective providers of crowdfunding services, mainly following the operation of crowdfunding platforms;
- imposing the principle of transparency, the rules on advertising communications, the information addressed to the users of the platforms, as well as the marketing requirements;
- the supervisory institutional framework in the European Union: the European Supervisory Authorities and the European Banking Authority (EBA), established by Regulation (EU) no. 1093/2010 of the European Parliament and of the Council and the European Securities and Markets Authority (ESMA), established by Regulation (EU) no. Regulation (EC) no. 1095/2010 of the European Parliament and of the Council. The Regulation specifies the powers of these authorities with regard to notification obligations, information protection, etc.;
- the regulation also provides for the administrative sanctions that the competent authorities may apply in the event of a breach of European regulations, including the national ones that have taken them over.

Along with Regulation (EU) 2020/1503, directives and regulations on the financing of the European financial market have remained in force, such as Directive 2020/1504 amending Directive 2014/65 /

EU on markets in financial instruments (“MiFID II”); Regulation (EU) 2017/1129 on the prospectus of public offerings of securities or of the admission of securities to trading on a regulated market; Directive 2014/65 / EU on markets in financial instruments; Directive 2011/61 / EU on the management of alternative investment funds; Directive (EU) 2015/2366 on payment services in the internal market, etc.

The provisions of these European regulations and directives are or will be taken over in the national legislation of the Member States. Thus, in Romania, the institution designated for the supervision of participatory financing is the Financial Supervision Authority (ASF). The establishment of a crowdfunding platform requires the authorization of the FSA, which will enter the entity in a special register, specifying its structure and the crowdfunding services it can provide.

5. Conclusions

Participatory financing or crowdfunding is a technique of obtaining the funds needed to carry out an activity from a multitude of people - natural or legal, without traditional intermediaries, using an Internet promotion platform. Crowdfunding is a very powerful tool to create a company or stimulate its development, involving the general public - either individuals, associations or companies, or local public authorities, etc. - in supporting the financing of projects that they consider interesting or important or profitable, etc.

Although the technique of crowdfunding is not new - the first forms can be found even in the 19th century, the classic example is the public funding of the Statue of Liberty platform in the United States - it has become widely used mainly due to the enormous possibilities offered by the Internet, becoming a simple and affordable fundraising tool.

Thanks to the Internet, crowdfunding has become a simple and affordable fundraising tool. The initiator of the project uses a crowdfunding platform as a site through which he makes his project known and asks for funds from the public, at first investors are friends, family members, acquaintances and their area expands as the project becomes more and more better known.

In recent years, especially after the financial crisis in the US mortgage markets since 2007, credit institutions have applied more restrictive methodologies to lending to firms, especially smaller ones, which obviously have a higher credit risk. As a result, many alternatives to bank credit have been developed: crowdfunding, lease back or even automatic factoring, so that SMEs are encouraged to study the financing offers that currently exist on the market before starting their activity.

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