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**EQUITY-BASED CROWDFUNDING:
THE ISSUER'S PERSPECTIVE.**

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*Grazie ad ogni singola persona
che ho incrociato durante il mio cammino.*

*Se ne avessi persa anche solo una
non sarei dove mi trovo adesso.*

S.L.F.

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SINTESI

Con il seguente elaborato, ci si prefigge lo scopo di andare ad individuare una serie di regole e principi che, applicati alle legislazioni correnti, favoriscano l'utilizzo dell' Equity-Based Crowdfunding da parte delle imprese.

Per fare questo, l'analisi inizia citando brevemente qualche utilizzo storico di *crowdfunding* e descrivendo il principio che sta alla base di questo strumento: il *crowdsourcing*, ovvero la possibilità di utilizzare le *idee* provenienti dalla folla con lo scopo di sviluppare o pubblicizzare nuovi prodotti o servizi (HOWE 2006). A sua volta, esso si basa su un altro concetto, quello di "intelligenza della folla", sviluppato da SUROWIECKI nel 2005, secondo il quale un gruppo di individui (la *folla*) riesce a risolvere un certo numero di problemi meglio di quanto farebbero singolarmente i soggetti che la compongono.

L'analisi procede con l'elenco e la descrizione dei modelli di crowdfunding più utilizzati (donation, reward, lending, royalty e real estate) per soffermarsi più a lungo sull'oggetto di questa tesi che è, come anticipato, l'equity crowdfunding, e cioè quel meccanismo tramite il quale un'impresa, tramite l'utilizzo di un portale *online*, offre al pubblico proprie quote o azioni, in cambio un contributo monetario. In questo modo, la *folla* acquisisce una partecipazione all'interno dell'impresa, portando alla creazione di una vera e propria "folla di investitori".

Ogni offerta viene lanciata tramite una campagna, la quale, specialmente nel reward crowdfunding, può assumere due forme tipiche: All-Or-Nothing (AON), tramite la quale il promotore riceverà effettivamente la somma inviata dalla *folla* solo al raggiungimento di un determinato obiettivo; Keep-It-All (KIA), grazie alla quale il promotore "prende tutto", non essendo rilevante il fatto che l'obiettivo prefissato venga raggiunto o meno. La differenza sostanziale fra le due sta nel fatto che le campagne del primo tipo infondono più fiducia nel potenziale finanziatore, inducendolo maggiormente a partecipare. Quelle del secondo tipo, invece, dovrebbero essere utilizzate solo per progetti "scalabili", ovvero che possono comunque dar vita al prodotto promesso, qualsiasi ammontare venga raccolto, poiché, se così non fosse, non attirerebbe abbastanza la fiducia e la partecipazione dei finanziatori. In questa sezione vengono poi esaminate le implicazioni inerenti l'utilizzo di questi due modelli nell'equity crowdfunding.

La discussione procede elencando i benefici che le imprese ed il pubblico possono ricavare dall'utilizzo di questo strumento. Fra questi meritano di essere riportati quelli derivanti dalla nascita di comunità attorno ad ogni progetto ed alla loro partecipazione. A tali vantaggi si aggiunge la caratteristica principale del crowdfunding, ovvero la sua capacità di essere uno strumento di

finanziamento per la società molto meno costoso ed impegnativo rispetto ad altre forme quali il prestito bancario o l'apporto dato da società di *venture capital*. Gli svantaggi maggiori derivano invece: per l'imprenditore, dalla pubblica esposizione della sua idea e del suo progetto e dal rischio che la propria idea possa essere copiata o che un eventuale fallimento o comportamento scorretto possa restare nella memoria della folla; per l'investitore, dall'alto rischio di truffa o di fallimento dell'impresa, nonché nella difficoltà che questo potrebbe incontrare nel caso in cui volesse rivendere la partecipazione acquisita.

Questo primo capitolo si conclude riportando i dati di mercato relativi all'utilizzo del crowdfunding in Europa. La prima posizione della classifica è occupata dal Regno Unito, in cui il quantitativo raccolto tramite questo strumento risulta essere quindici volte superiore a quello che è possibile trovare in Francia, seconda classificata, seguita immediatamente dalla Germania. Fra gli stati considerati, l'ultima posizione è occupata dall'Italia, che conta un ammontare raccolto ben dieci volte inferiore a quello francese, nonostante sia stata il primo stato europeo ad introdurre una regolamentazione di questo strumento.

Il secondo capitolo si apre con una disamina delle direttive europee che si applicano o potrebbero applicarsi allo strumento in esame. In base alla prospettiva adottata, la più importante fra queste è la Direttiva 2003/71/CE (Direttiva Prospetto). Tale Direttiva influenza particolarmente l'utilizzo a livello europeo dell'*equity crowdfunding* a causa della possibilità attribuita a ciascuno Stato Membro di scegliere arbitrariamente la soglia di esenzione dalle regole previste dalla stessa fra le cifre di €100,000 e €5 milioni di euro. Le altre direttive si applicano solo in alcuni casi specifici, specialmente agli investitori o ai portali.

La trattazione prosegue con l'analisi della legislazione adottata dai più importanti Stati Membri per regolamentare l'utilizzo di questo strumento. In un tentativo di evidenziare qui solo i profili più utili alla prospettiva dell'emittente, la legislazione italiana si caratterizza per: (i) l'introduzione di limitazioni soggettive sull'utilizzo di questo strumento (principalmente Startup e PMI innovative); (ii) obbligare determinate categorie di investitori(definiti "*professionali*") a partecipare ad ogni offerta affinché questa possa considerarsi legalmente completata; (iii) nell'impostare come soglia di esenzione la somma più elevata consentita dalla Direttiva sopra citata (€5 milioni); (iv) nel prevedere un meccanismo di autocertificazione degli investitori, i quali sono obbligati a rispondere correttamente ad un questionario, attestante la comprensione del rischio che stanno affrontando, prima di poter avere accesso all'investimento.

La regolamentazione inglese, invece, oltre a prevedere anche questa un sistema di autocertificazione e la soglia di esenzione più alta consentita dalla Direttiva sopracitata, prevede, inoltre, un meccanismo di agevolazione fiscale molto vantaggioso che sostiene l'investitore specialmente nel momento in cui l'impresa in cui aveva investito fallisce.

La legislazione francese contiene una dettagliata ed agevole disciplina dei portali ed un discreto meccanismo di esenzione fiscale per gli investitori, fissando una soglia di esenzione molto bassa. L'ultimo stato europeo analizzato è, poi, la Germania. La sua disciplina è peculiare poiché, mentre l'offerta di azioni è limitata dalla soglia di esenzione di €100.000, permette l'utilizzo di un meccanismo di "partecipazione ai profitti" (*Profit Participation Loan*) fino ad un offerta dal valore di €2,500,000.

Tale capitolo si conclude con uno sguardo alla disciplina americana, nella quale deve essere evidenziata la presenza di un sistema proporzionale con riguardo al quantitativo (e quindi al costo) di pubblicazione di informazioni che la società emittente deve effettuare prima dell'offerta.

L'ultimo capitolo si apre con la definizione dei sei principi che dovrebbe seguire una legislazione attenta alle istanze dell'emittente. Questi sono: (i) la rimozione di limitazioni territoriali; (ii) l'abolizione di restrizioni sull'utilizzo di questo strumento, legate al tipo di business, alle dimensioni della società o al tempo passato dalla sua costituzione; (iii) la riduzione delle informazioni da pubblicare così da ridurre i relativi costi; (iv) lo sviluppo del mercato secondario di questi strumenti; (v) un corretto impiego degli aiuti statali, specialmente tramite l'introduzione di agevolazioni fiscali; (vi) l'eliminazione o l'ampliamento di limiti massimi relativi sia alla singola offerta che ad ogni investimento.

La tesi procede con la ricerca dei principi appena elencati nelle disposizioni analizzate nel secondo capitolo. Le disposizioni che li rispettavano sono state classificate come "buone", quelle che non li rispettavano, come "cattive". In base alla prospettiva adottata, appartengono al primo gruppo le disposizioni: (i) che prevedono la soglia di esenzione più alta prevista dalla direttiva; (ii) che richiedono all'emittente poche e semplici informazioni; (iii) che introducono un sistema proporzionale di pubblicazione di informazioni richieste ai fini dell'offerta; (iv) che adottano un sistema di autocertificazione dell'investitore; (v) che promuovono l'investimento tramite vantaggi fiscali.

Nel secondo gruppo, invece, sono state inserite le disposizioni che: (i) limitano soggettivamente l'utilizzo di questo strumento; (ii) obbligano specifiche categorie di soggetti ad investire; (iii) impongono un limite sull'ammontare che può essere investito da ogni singolo soggetto; (iv) comprimono il mercato secondario di questo strumento.

La tesi si conclude suggerendo ai futuri legislatori(l'Unione Europea o i singoli Stati Membri) che intendano regolare questo strumento intervenendo sulle regolamentazioni attuali o introducendone di nuove, di prendere come esempio le “buone” regole classificate prima. Questo perché, grazie all’analisi dei dati di mercato effettuata nel primo capitolo, si può vedere come vi sia una corrispondenza fra risultati e la classificazione da noi adottata. Basti osservare come il paese che ha il maggior numero di “buone” regole (il Regno Unito) abbia ottenuto dei risultati incredibili. Dove invece, alle regole “buone” sono state affiancate anche quelle “cattive”(l’Italia), l’utilizzo di questo strumento è ancora lontano dal raggiungere i risultati desiderati.

EXECUTIVE SUMMARY

This dissertation aims at highlighting the principles that an equity crowdfunding regulation should follow to enhance its use for the issuers. First of all, it starts by mentioning some historical facts related to its use. Thereafter, it describes the fundamental mechanism of this instrument, that is *crowdsourcing*. This has been described as the possibility to use “*the power of crowds for generating and assessing new ideas as well as for developing and marketing new products and services*”(HOWE 2006). This is based on another important concept known as “Wisdom of the Crowd”(SUROWIECKI 2005). According to it, a group's aggregate answers has been found better than the answer given by any of the individuals within the group.

Furthermore, the most famous crowdfunding model has been described (donation, reward, lending, royalty and real estate), to study more in depth the one at the center of this dissertation, that is equity based crowdfunding. This mechanism lets the investors effectively become partners of the undertaking they are giving money to, using an online portal where the issuers previously presented his project.

Each offer starts with a campaign on the crowdfunding platform. When defining the sum the promoter wants to collect, most platforms let the creators decide between two schemes: Keep-It-All (KIA) or All-Or-Nothing (AON). In AON model, the entrepreneur receives the money collected from the crowd only if he reaches the fundraising goal at the end of the campaign. In KIA campaigns, instead, although there is the fixation of a goal, the platform lets the promoter take all the money received at the end of the campaign. The application of this two model brings a risk-return trade-off at the entrepreneurial level: selecting the KIA represents less risks but also lower returns and expected rate of success; AON involves more risks taken by the campaign creator but higher chances of reaching the funding goal. In addition, the implication coming from the application of these two models in equity crowdfunding has been shown.

Moreover, the dissertation reports crowdfunding advantages and disadvantages. In the list of the advantages, it has been highlighted how crowdfunding is not only a financing tool - less costly than the other available for SMEs - or a way to acquire a product or a financial return. Indeed, there are also other advantages such as the one generated by community participation, such as risk reduction, market validation and marketing, that need to be taken in consideration. In regards to the disadvantages, these are mostly caused, on the one hand, by the public exposition of the entrepreneur and his idea. On the other, because of the high risks that the investment in SMEs and startups involves.

The first chapter ends reporting the market data regarding the use of equity crowdfunding in Europe. From those data, the following rank can be created. The UK occupies the first position, reaching

incredible results, that is to say, 15 times French ones which occupies the second position. Germany follows immediately, while Italy achieved only results 10 times smaller than Germany and France, notwithstanding the fact that it was the first state to regulate crowdfunding.

The second Chapter starts analyzing the European Directives that could trigger the use of equity crowdfunding. From the adopted perspective, the Prospectus Directive is the most important because of the territorial limitations resulting from the rules contained in it. Indeed, this Directive does not contain an “adequate” exemption for foreign operations and, in addition, each Member State may decide to set the threshold between €100,000 and €5 million. Thanks to this faculty, each Member State has adopted different conditions to be exempted from prospectus requirements. Therefore, in relation to the same amount of shares offered, issuers can find the full prospectus regime in some Member States while in others there is the complete exemption. Others Directives apply only in some specific cases, specially to portals and investors.

Furthermore, the dissertation analyses the equity crowdfunding regulation of each Member State. In order to look for the ones regarding the adopted perspective, Italian legislation is important because: (i) it is not open to “every-issuer” but requires companies to meet certain conditions to have access to this financing instrument; (ii) it forces “professional investors” to subscribe at least the 5% of the offered capital for the success of the campaign; (iii) it provides one of the highest threshold exemptions from prospectus requirements, letting issuer raise up to €5 million in a 12-months period; (iv) it introduced a self-certification mechanism, that is a simple questionnaire that each investor needs to fill with correct answers, before they could access on-line offers.

The UK regulation provides also the same Italian self-certification process and the high threshold exemption, but, in addition, introduced a mechanism of tax relief that helps investors if the company in which they invested fails.

French and Germany regulations are more moderate. The former should be specially highlighted for the detailed discipline dedicated to crowdfunding portals. The latter for the introduction of a different investment schemes called Profit Participation Loan. Indeed, in Germany, while the offer of share is limited by a really low threshold (€100,000), using this instrument let issuers offer up to €2,500,000.

Last, a comparative sight is given to USA legislation that need to be quoted because of the introduction of a disclosure mechanism proportionate to the amount of money the issuer seeks through the funding portal.

The last Chapter introduces six principles that equity crowdfunding legislations should follow from the Issuer's Perspective. These are: (i) the removal of any kind of territorial limitation; (ii) the abolition of business, time and size restrictions; (iii) restricted disclosure costs; (iv) the development of secondary market for this instrument; (v) the introduction of state aids to protect investors; (vi) the removal of limits in the amount that could be given or collected.

Those principles has been researched in the regulations listed in the second Chapter. The ones that respected them has been considered "good" rules. The others has been classified as "bad". The ones that can be mentioned in the first group are the rules providing: (i) the highest exemption threshold from the Prospectus Directive; (ii) simple or proportionate disclosure requirements; (iii) self-certification process for investors; (iv) tax reliefs.

On the other hand, the rule that can be considered in the second group are the ones that: (i) introduced limitation on "who" can use equity crowdfunding; (ii) force the participation of specific investors; (iii) provide cap on investment participation; (iv) restricted the secondary market for those instrument.

The dissertation ends suggesting that when a lawmaker will look for a crowdfunding regulation, it will find the answer to its doubts simply by looking for the results that they would like to achieve. Indeed, it has been highlighted that the ones classified as "good rules" are present for the major part in the UK and Italy, while the "bad ones" can mostly be found only in Italy. In other countries (Germany and France), conversely, the regulation analyzed can be defined as "moderate" because their rules were classified as neither good nor bad.

CHAPTER I - Introduction to Equity Crowdfunding

1. History and Origins

The word “crowdfunding” was created less than 10 years ago, but the essence of what this idea represents dates back to almost one and a half century before. The first relevant experience was indeed initiated in 1885 in New York, when the Statue of Liberty arrived in the Big Apple from France. The majestic sculpture was in fact unfinished and funds were needed to bring it to completion. From the idea of the famous journalist Joseph Pulitzer, a funding campaign was started on New York’s “*World*” newspaper, setting \$100,000¹ as the project’s goal and promising that anybody who donated, regardless of the amount, would have their name published on the newspaper. After only 5 months, the campaign succeeded and the first model of Reward-based Crowdfunding had a chance to shine. At the basis of this accomplishment there was the reliance on the civic spirit of people and the moral recognition they would get if they contributed to this public venture: their “*reward*” for helping the community was the element of being publicly recognized as donors.

What happened in New York in the 1885 was only one the first historical example of “crowdsourcing”. This term was coined by HOWE in 2006 and describes an “*organization leveraging the power of crowds for generating and assessing new ideas as well as for developing and marketing new products and services.*”² Crowdfunding is a particular form of crowdsourcing in which the crowd participate mainly giving money for the development of ideas and projects.

According to NASRABADI A. G. (2015), the potentials of this financing method are intricately linked with the interaction of financial, technological and social aspects. As shown above, the collection of money from lots of people is not a real innovation. The real novelty lies in the use of the Internet and in the advent of Web 2.0 to gather people from all around the world in stable communities. Each individual supplies a small amount of money and his knowledge to the promoter of that project. This is

¹ PIATTELLI U. (2013) *Il crowdfunding in Italia – Una regolamentazione all'avanguardia o un'occasione mancata?* Torino: G.Giappichelli Editore, p.3-4

² WILLFORT R. and WEBER C. (2016) *The Crowdpower 2.0 Concept: An Integrated Approach to Innovation That Goes Beyond Crowdfunding.*- In BRÜNTJE D. & GADJA O. (eds). *Crowdfunding in Europe - State of the Art in Theory and Practice.* FGF Studies in Small Business and Entrepreneurship,. Brussels: Springer International Publishing, p.214.

also demonstrated by the fact that sometimes³ the financial aspect plays only a secondary role in this environment.⁴

2. Classifications

Several crowdfunding models were designed in the last decade, each of them following a different pattern, on the basis of which money is gathered. Some of them have a “*Do ut des*” structure, so that investors get something in return for their participation, others are aimed at building something bigger together, getting investors involved in the project itself.

Among the others, equity-based crowdfunding is the model that this dissertation is going to analyze. Notwithstanding this, a brief description of the other schemes will be reported because some implications in equity crowdfunding can be understood only by reference to them. Reward-based crowdfunding is above all the only one that would be mentioned elsewhere apart from the following description.⁵

2.1 Reward model

The reward-based crowdfunding⁶ is the archetypical design of this genre of investment: both individual and corporate entrepreneurs who need money to develop an idea or start a new business can use this instrument without any fear or risk of surrendering their economic independence. They are not going to interact with big entities, eager to take over the project and intruding on their future decision-making process. The public will be their main counterpart in the venture, both helping with the project-financing and giving them a first reaction and evaluation of the idea they are developing.

The creation of an intermediary between the promoters and the investors went hand-in-hand with the birth of crowdfunding. Online platforms like “Kickstarter”⁷ or “Indiegogo”⁸ are the virtual portals that allow organizers to present a project in an appealing way in order to gather supporters, willing to participate in the endeavor. The homepage of the project would usually involve a presentation video and a thorough description of the idea and the people behind it, together with a pyramidal list of

³ As will be highlighted in the paragraphs below, reference is made to the use of crowdfunding by bigger companies.

⁴ See WILLFORT R. and WEBER C. (2016) *supra* note 2, p. 205.

⁵ The reason of this choice is based on the observation that most aspects of equity crowdfunding are also present in reward crowdfunding but not vice versa. Therefore, the latter will be used to explain better some equity crowdfunding principles.

⁶ See PIATTELLI U. (2013) *supra* note 1, p. 11.

⁷ For more information see the website at www.Kickstarter.com

⁸ For more information see the website at www.Indiegogo.com

“rewards” associated with the invested amount. These rewards, or “perks” as they are commonly defined, would vary in quality and quantity in relation to the given amount.⁹ Those will usually range from a simple “thank you” from the authors at the minimum offer level to an active collaboration on the project when contributing with a huge donation. The latter spots are often restricted to a close number of people, which in most cases will become the sponsors of the project.

2.2 Donation model

The donation-based crowdfunding¹⁰ was the original herald of the phenomenon born in the late ‘80s of the XIX century. It would usually involve a charity project aimed at providing structures, goods and services either for the disadvantaged social classes or for the benefit and security of the entire community. This funding mechanism helps bringing the development of the public endeavor to a quicker completion, relying on the citizens’ generosity. This type of campaign, often referred to as “social” or “civic” crowdfunding, does not entail remuneration of the donors, aside from the moral reward they would get from their good deed.

2.3 Lending model

The lending crowdfunding¹¹ model is deeply diverse from the ones described above both for its structure and its aim. It is basically a peer-to-peer loan without any traditional financial intermediary between the lender and the borrower. Through the access to an online portal, the borrowers request a loan and promote their investment project: the platform has then to validate it and to deal with security and financial solvency checks of those future debtors. Lenders will then see their investment automatically diversified by the portal among several different borrowers so that their risk is reduced. The aim of a lender is of course that of getting a financial return from the capital he invested onto the marketplace, but at the same time, he helps enterprises starting and improving their businesses without having them recurring to banks or other traditional institutions.

2.4 Equity model

The equity-based crowdfunding (also referred to crowdfunding¹², investment-based crowdfunding¹³, securities crowdfunding¹⁴) is the most relevant model for the purpose of this research¹⁵. It will be

⁹ For a complete analysis of the possible rewards see Paragraph 4

¹⁰ See PIATTELLI U. (2013) *supra* note 1 p. 10.

¹¹ *Id* p. 13.

¹² This terms is used by KLÖHN and HORNUF, (2012) in KLÖHN, L. and HORNUF, L. (2012) *Crowdfunding in Deutschland: Markt, Rechtslage und Regulierungsperspektiven*, Journal of Banking Law and Banking 24, 237- 266 and by HORNUF and SCHWIENBACHER, (2014) in HORNUF, L. and SCHWIENBACHER, A. (2014) *Crowdfunding – Angel Investing for the Masses?*, working paper. Available at: <http://ssrn.com/abstract=2401515>

presented here with a brief description, while all the other relevant aspects are going to be studied more in depth in the following chapters of this dissertation.

This scheme is a type of fundraising that lets the investors effectively become partners of the undertaking they are giving money to. Through the use of online portals, issuers present their businesses and investors with definite requirements may contribute with money, sum that will *de facto* represent their share of capital conferred to the issuers' companies. Nevertheless, the newcomer investor is not considered as a fully-fledged partner, since he has some limitations as far as voting rights and annulment clauses are concerned.

The use of the platform reduces the transaction costs that were an impediment against the offering of shares of small companies to the general public.¹⁶ Therefore, equity crowdfunding became a viable alternative to traditional financing ways for companies located in countries where the solicitation of the general public without costly prospectus requirement is permitted.¹⁷

The study of this innovative financing method is worth for its potential to fill the “SMEs financing gap” and help those companies move up the “funding escalator”¹⁸. For this reason, as will be explained in Chapter II, regulators around the world started understanding the economic potential of equity crowdfunding and started their national regulation.¹⁹

As will be clarified below, there are two main issues concerning equity crowdfunding regulation: combining low costs for early stage enterprise with high investor's protection. Cutting this Gordian knot with the adequate regulation will let this instrument *unleash all his potential*.

¹³ The Financial Conduct Authority (FCA) and the European Security and Market Authority used this term in “FCA Consultation Paper CP13/13 ‘The FCA’s regulatory approach to crowdfunding (and similar activities)’” and “European Securities and Markets Authority ‘Opinion Investment-based crowdfunding’.”

¹⁴ KNIGHT, LEO and OHMER (2012) used this term in KNIGHT, T.B., LEO, H. and OHMER, A. (2012) *A Very Quiet evolution: A Primer on Securities Crowdfunding and Title III of the JOBS Act*, 2 Michigan Journal of Private Equity & Venture Capital Law, 135-153.

¹⁵ See PIATTELLI U. (2013) *supra* note 1 p. 14.

¹⁶ HORNUF, L., and SCHWIENBACHER A. (2015b). *Should securities regulation promote crowdinvesting?* Discussion Papers in Economics 2014-27. Available at <https://epub.ub.uni-muenchen.de/20975/>, p.3

¹⁷ *Id.* The specific application will be analyzed in Chapter II

¹⁸ According to European Commission Communication (2014), crowdfunding can be followed by other forms of financing such as bank loan, venture capital or an Initial Public Offering.

¹⁹ See HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 16 p. 7.

2.5 Royalty model

The royalty-based crowdfunding is a more complex variation of the reward-based model. The distinctive factor is that the reward has the shape of a royalty, *id est* the participation to the profits of a business activity, so any kind of share or dividend that is paid, based on the revenues of the undertaking. That pattern is similar to the institute of the joint venture.

2.6 Real Estate model

Real estate investment-based crowdfunding is a recent clever deviation from the scheme of the classic lending crowdfunding. This branch of business is another way to diversify one's portfolio: accredited investors have here the opportunity to start businesses between each other buying real estate together via online portals. Through the use of joint capital, they are able not only to acquire a property, but also to manage it, renew it, rent it or sell it in order to make profit.

3. All-Or-Nothing and Keep-It-All campaigns.

Before starting the crowdfunding campaign, the promoter sets the amount of money that he needs in order to develop the presented project. When defining this sum, most platforms let the creators decide between two schemes: Keep-It-All (KIA) or All-Or-Nothing (AON).²⁰

Both are two typical models of reward crowdfunding campaigns. Notwithstanding this, understanding their characteristics is useful to study some interesting implications in equity crowdfunding. For this reason, the description of these two model will be reported and, only after, those consequences will be analyzed.

3.1 KIA and AON in reward crowdfunding.

The sum of money that the promoter/issuer asks the public and that he wants to get before the expiring of the campaign is the *funding goal*. In reward crowdfunding this is an important reference point that is set together with the time duration of the campaign²¹, directly on the platform when the project webpage is designed.

The difference between AON and KIA is based on what happens when the funding goal fixed by the entrepreneur is reached or not. In AON model, the entrepreneur receives the money collected from the crowd only if he reaches the fundraising goal at the end of the campaign. Otherwise, every single bidders will have the pledged money back.

In KIA campaigns, instead, although there is the fixation of a goal, the platform lets the promoter take all the money received at the end of the campaign.²² This happen whether or not he reaches the fundraising goal, having bidders giving the entrepreneur their money in any case.

On the basis of this structure, it seems that KIA is the more advantageous model for entrepreneurs because it lets them gain something even if their idea is not supported by many backers and does not reach the predetermined goal. Actually, this is not so true because of different social implications that

²⁰ The most completed analysis of this two models has been provided by CUMMING D. J., LEBOEUF G. and SCHWIENBACHER, A. (2015) in regards to reward campaign. For a deep analysis of the implication in Equity and Lending campaigns see HAKENES H. and SCHLEGEL F. (2014) on this theme.

²¹ Usually platforms let campaign creators decide a period of time between 30 and 90 days.

²² CUMMING D. J. and LEBOEUF G. and SCHWIENBACHER, A. (2015) *Crowdfunding Models: Keep-It-All vs. All-Or-Nothing* Available at SSRN: <http://ssrn.com/abstract=2447567> or <http://dx.doi.org/10.2139/ssrn.2447567> p. 3

are behind this two different models.²³ Each model finds application only when determined conditions have been set out considering the central role played by risk allocation.

In the AON model the entrepreneur sends a strong message to the potential backers: he will not undertake the project if an insufficient sum is raised.²⁴ As a consequence, backers see the risk they bear reduced. They have a higher chance that the project they give money to will see the light, because only *well-funded* projects will be developed. On the other hand, AON campaigns are riskier for entrepreneurial firms. Indeed, the risk is *all* borne by the campaign creators. From this precondition they certainly gain more confidence from the public, more willing to pledge money.

There is a trade-off between risk and trust that determines an increase of campaigns success rate. This is also true because being this kind of campaign less risky for backers, they generate higher attraction. An important role is played by the creation of a community. People, indeed, are willing to participate even if they can only vaguely assess the project's fate. They count on the positive opinions of other people, to reinforce their own and feel safer in receiving the perks that they were promised in exchange for their money. "*This multitude of vague hunches accumulates to relatively precise aggregate information*"²⁵

On the other hand, KIA model reduced the risk for creators, because at the end of the day they will always get something. Therefore, this time backers bear the risk that a company will undertake an underfunded project. For this reason, they are more reluctant in giving the campaign creator their money, because the possibility that they will not receive their perks is higher.²⁶ The fact that KIA model inspires less trust in money givers is the price the promoters pay for having less risk.

In order to avoid crowd diffidence, it is necessary to present a project with some determined characteristics if the entrepreneur wants to use the KIA model. As shown on the home page of Indiegogo²⁷, this model should be selected by companies only if they are positive they will be able to fulfill their obligation with the public, notwithstanding the amount of money that they will receive. This means that KIA is suitable only for "scalable projects" in which bidders could still gain some results if only a percentage of the fundraising goal is achieved. Those projects should have a lower

²³ *Id.*

²⁴ *Id.* p. 4.

²⁵ HAKENES H. and SCHLEGEL F. (2014), *Exploiting the Financial Wisdom of the Crowd -- Crowdfunding as a Tool to Aggregate Vague Information* (August 1, 2014). Available at SSRN: <http://ssrn.com/abstract=2475025> or <http://dx.doi.org/10.2139/ssrn.2475025>, p 29

²⁶ See CUMMING D. J. , LEBOEUF G. and SCHWIENBACHER, A. (2015) *supra* note 22 p. 4.

²⁷ For further information see the website of Indiegogo, in particular <https://support.indiegogo.com/hc/en-us/articles/205138007-Choose-Your-Funding-Type-Can-I-Keep-My-Money->

incidence of fixed costs, because they would increase the chance of developing the project on a smaller scale. Without those characteristics, the crowd will not give anything to the campaign creator (CUMMING, LEBOEUF and SCHWIENBACHER, 2015).

On the contrary, in all the other cases, AON campaigns are the only solution that creators should take in consideration. Investors will not trust the entrepreneur enough if those conditions are not respected.

Therefore, there is a risk-return tradeoff at the entrepreneurial level: selecting the KIA represents less risks but also lower returns and expected rate of success; AON involves more risks taken by the campaign creator but higher chances of reaching the funding goal.²⁸

Research data supports these theoretical assumptions. The study conducted by CUMMING, LEBOEUF and SCHWIENBACHER (2015) was made on the famous reward-based platform Indiegogo, the first one that offered the possibility to choose between KIA or AON models.²⁹ The research shows that the success rate of the KIA campaigns is only 17% against the 34% of the AON ones.³⁰ In addition, creators choosing the AON model campaigns obtained twice the number of backers of KIA campaigns. How remarked by CUMMING, LEBOEUF and SCHWIENBACHER (2015), these data do not imply that AON is superior to KIA in every aspects. Both have some characteristics that make them suitable for different purposes as the ones listed above.

3.2 Implication for equity crowdfunding

The application of the models just studied brings some consequences to equity crowdfunding. Those generates from the concept of *funding limit*. It can be defined as the maximum amount of money the entrepreneur can accept at the end of the crowdfunding campaign.

In reward crowdfunding, instead, a *funding limit* does not exist, because there is no reason to refuse pledged funds. Here, users are moved by consumption-based decisions because there is a reward for each correspondent given sum. Equity crowdfunding deals with investment decisions, so issuers establish a limit on their company's portion offered onto the market.

Therefore, before starting an equity crowdfunding campaign, the company needs to summon the general meeting to deliberate a capital increase regarding the shares offered on the platform. It is that decision that sets a limit on the number of shares that the company is going to issue.

²⁸ See CUMMING D. J., LEBOEUF G. and SCHWIENBACHER, A. (2015) *supra* note 22 p.4.

²⁹ *Id.*

³⁰ *Id* p. 5.

For this reason, equity crowdfunding campaigns generally follow the AON model. Indeed, the company will have little interest in issuing a low amount of shares to gain few money and have few investors. In most cases, this is also because the administrative costs to manage the entrance of new investors will overcome their investment in the company. In other cases, the reason to stop the issuing of shares is also linked to disclosure and other requirements that are proportionated to the amount of shares offered, depending on the legislation concerned.³¹

In order to introduce this limit, the general meeting deliberates a second capital increase, but this time conditioned to the first. In other words, each company's general meeting usually deliberate on two conditional capital increases. The meeting defines the *funding goal* with the first, that is to say a capital increase of an established amount of money, subordinated to the condition that this sum is effectively collected. The second one is, instead, subordinated to the first and it is proportionated to the difference between the amount collected at the end of the campaign and the *funding goal*.

Notwithstanding these premises, a campaign based on the KIA model can still be created. In order to do so, it is sufficient that the general meeting sets a funding goal so low that it could be satisfied with minimum subscription. In this way, the first condition established in the general meeting can immediately be satisfied, letting the new backers became shareholder of the company at their first investment. As it will be shown in the last chapter³², when a company takes such a decision, problems arise in relation to the information disclosed.

³¹ For instance, according to HORNUF L., SCHWIENBACHER A.(2015a) generally in Germany the funding limit set at €100,000 because above this sum company will not enjoy any more the prospectus exemption. This issue will be discussed more in deep in Chapter II, Paragraph 1.5.1. - HORNUF L., SCHWIENBACHER A.(2015a), *The Emergence of Crowdfunding in Europe: With an in-depth analysis of the German market*. Available at <http://ssrn.com/abstract=2481994> p. 6

³² See Chapter III, Paragraph 4.2.5.

4. Crowdfunding Benefits

In the following paragraphs, the most relevant advantages³³ related to the use of crowdfunding will be discussed. The aim is to highlight that, from the creator's perspective, crowdfunding is not only a financing tool, while from the bidder's view, it is not only a way to acquire a product or a financial return.³⁴ Instead, also other advantages need to be taken in consideration, especially the one generated by community participation. As it will be highlighted in the paragraphs below, indeed, community involvement is the characteristic determining the success of crowdfunding.

4.1 Advantages for Backers

Depending on the model taken in consideration, a single member of the crowd can be defined as a bidder or as an investor. The former of these two terms is used to refer to participants of reward crowdfunding campaigns. The latter, instead, indicates money givers of equity crowdfunding campaigns.

There are three main advantages that they can extract from participating to a crowdfunding campaign.

4.1.1 Immediate Return

The first reason that moves investors/bidders to participate in a crowdfunding campaign is obtaining a direct and immediate *return*. Generally, from reward crowdfunding, bidders get perks or products, while from equity investors acquire the subscribed number of shares of the company.

With regards to the latter, dealing with startups' shares, those investment opportunities may bring incredible returns.³⁵ However, those extraordinary rewards are compensated by the high risk of losing all the money invested.³⁶

Reward crowdfunding, instead, gives bidders the possibility not only to receive a symbolic “*thank you*” from the company³⁷, but, in most cases, on the basis of the pledged amount of money, it also

³³ NASRABADI A. G. (2015) *Equity Crowdfunding: Beyond Financial Innovation*. In BRÜNTJE D. & GADJA O. (eds). *Crowdfunding in Europe - State of the Art in Theory and Practice*. FGF Studies in Small Business and Entrepreneurship. Brussels: Springer International Publishing.

³⁴ *Id.*

³⁵ For instance, investing in Uber granted a return two thousand times bigger than the first amount invested. The report is available here <http://fortune.com/2014/06/05/meet-the-uber-rich/> [Accessed 26th January 2016] - GRIFFITH E. (2014) Meet the Uber Rich. *Fortune.com*. [Online] Available at: <http://fortune.com/2014/06/05/meet-the-uber-rich/>

³⁶ For the complete description of the risk related to crowdfunding investment see Paragraph 5.2 of this Chapter.

³⁷ Usually, the campaign creator gives bidders the possibility to see their name shown in the company website for few dollars. Common perks are also t-shirts, magnets or mugs.

gives the possibility to acquire early access to the new products, sometimes in limited editions or even to its prototype for collection purposes. In rare cases, campaign creators offer to meet some bidders, giving them the opportunity to have dinner together. As is evident, the emotional and affective components play here an important role.

4.1.2 Community Participation

Investors or bidders have the possibility to freely surf the Internet looking for projects they are interested in. This element favors the creation of a community around each project. Communities are open to anyone, and consist of heterogeneous individuals³⁸. Here, the knowledge of the single member amplifies within the crowd, creating what was defined as “Wisdom of the Crowd” (SUROWIECKI, 2005).³⁹

According to DE CARVALHO et al. (2014), the simple pleasure of being part of a community is an advantage that attracts bidders in crowdfunding participation. Indeed, they have the possibility to participate in the creation of the products of their dreams, gaining also the consciousness of being of support for projects or ideas.⁴⁰ In addition, according to AGRAWAL et al. (2013), other times, a crowdfunding campaign can be also a good occasion to formalize friendship or family relations into contracts.⁴¹

4.1.3 Risk Reduction

The above mentioned “wisdom” has also an important role in the reduction the of bidders’ personal risk, bringing lots of advantages to fund seekers too.⁴² Generally, startup failures are caused by the lack of specific know-how or shortage of capital⁴³. Communities born around each project has the possibility to satisfy both these needs, in this way reducing the risk of failure for company. The first of these two issues can be solved by community participation because each campaign captivates people that are expert in that specific field, attracted because the projects deals with something that they can understand and help to develop. The community supplies to the second problem with their personal

³⁸ See WILLFORT R. and WEBER C. (2016) *supra* note 2 p. 215.

³⁹ “*The wisdom of the crowd*” (or intelligence of the crowd) is a sociological theory according to which a large group's aggregated answers to questions involving quantity estimation, general world knowledge, and spatial reasoning has generally been found to be as good as, and often better than, the answer given by any of the individuals within the group.[Wikipedia]

⁴⁰ DE CARVALHO L. F., IMBRIZI F.G., TURRI S. N. & MACCARI E. A. (2014) *Equity-based crowdfunding as an alternative for funding of startups: trends in Brazilian context*, III SINGEP e II S2IS. Available at <http://www.singep.org.br/3singep/resultado/251.pdf> , p. 6

⁴¹ AGRAWAL, A. K. , CATALINI, C. and GOLDFARB, A. (2013). *Some simple economics of crowdfunding*. NBER working paper series.[Online] NBER, Working Paper 19133. Available from: <http://www.nber.org/papers/w19133> p. 16

⁴² See NASRABADI A. G. (2015) *supra* note 33.

⁴³ See WILLFORT R. and WEBER C. (2016) *supra* note 2.

investment. Indeed, crowdfunding favors the collection of small amounts of money from lots of people.⁴⁴ The final result is a higher chance for investors and bidders to receive a financial return or the requested product.

4.2 Advantages for Entrepreneurs

4.2.1 Financial Benefits

The first advantage granted by the use of crowdfunding is the access to lower cost of capital.⁴⁵ This is true for at least three reasons. First, the creator can easily find people with more willingness to fund his project. The Internet, indeed, reduces territorial limitations and favors the possibility for people to look for something that they want, no matter in which part of the world it is produced.⁴⁶

In addition, crowdfunding gives the possibility to bundle the sale of equity or the pre-sale of products with other valued goods, such as discounts for future shareholders or the possibility to be the first to have a prototype of the product. In this way, the interest in potential bidders is increased. This is also possible thanks to the presence of a “particular slice” of the crowd that highly values the possibility to have the “first” access to that kind of innovation. They are the so called “early adopters”, that is to say, people that assume the risk of buying that product only to be the first to have it.

Finally, crowdfunding represents a more competitive and accessible form of financing with respect to the ones supplied by venture capital of business angel thanks also to the “Lottery Effect”⁴⁷. This assumption came from the Prospectus Theory elaborated by KAHNEMAN and TVERSKY in 1979.⁴⁸ In accordance to this theory, when people have the possibility to lose little sums of money to obtain a small chance of gaining bigger ones, they behave as risk seekers and decide to bet. The application on crowdfunding are interesting.⁴⁹ The investment in startups involves a high risk but can as well grant high economic returns. For this reason, retail investors may decide to invest little amount of money, notwithstanding the high probability to lose it. Conversely, in those case, venture capitalists behave as risk averse, since they are fewer than retail investors and usually invest higher amount of money

⁴⁴ See WILLFORT R. and WEBER C. (2016) *supra* note 2.

⁴⁵ See AGRAWAL, A. K. , CATALINI, C. and GOLDFARB, A. (2013) *supra* note 41 p. 10.

⁴⁶ *Id* p. 12

⁴⁷ HELM (2007) “There is a chance to make big money” in Harms 2007:3.

⁴⁸ “*Prospect theory is a behavioral economic theory that describes the way people choose between probabilistic alternatives that involve risk, where the probabilities of outcomes are known. The theory states that people make decisions based on the potential value of losses and gains rather than the final outcome*” Wikipedia

⁴⁹ BIFFI A.(2013) *Equity crowdfunding: un modello di analisi del comportamento di imprenditori e investitori*. p 87

looking for more certain economic returns. At the end of the day, according also to this theory, it is more probable that common people may support startups than venture capitalists.

The final result is that, compared with others financing instruments, crowdfunding results faster and easier.⁵⁰ For this characteristic it can also have a positive effect in enhancing competition on the supply of early stage capital market.

4.2.2 Community Participation

As anticipated above, community participation brings several advantages also to campaign creators. *Marketing* is the first advantage that can be reported. Each campaign has a community that follows creator's updates. Most times they became real "evangelist investors"⁵¹ ready to spread the word within their network so helping fund seekers reaching their goal. They are encouraged to help the success of the company because they have a direct interest in the success of the campaign. This can vary from shares and revenues, to products or other direct returns.

The participants of the community are also the first and probably the *future consumers* of the campaign creator. Therefore, a successful campaign is important for the fund seeker in the long term run, because he will gain not only the money, but also his first clients. This is the second advantage that community participation brings to company.⁵²

The third one and maybe the most important is *market validation*. Crowdfunding, indeed, gives the possibility to test the potential success of a product. According to MARTIN (2012)⁵³, the community provides with feedback and responses to the entrepreneur during the campaign that can be used to drive the future product to be successful on the market.⁵⁴

Moreover, allowing the "pre-sale" of a product on the market avoids huge investments in a future failure of that product.⁵⁵ Here, a failure can be a chance to learn by the errors committed, thanks to the advice given by the community. AGRAWAL et al. (2013) report that crowd's suggestions are often taken in high consideration⁵⁶. Due to this mechanism, big companies started to use crowdfunding to

⁵⁰ See DE CARVALHO L. F., IMBRIZI F.G., TURRI S. N. & MACCARI E. A. (2014) *supra* note 40 P. 5

⁵¹ See NASRABADI A. G. (2015) *supra* note 33 p. 208

⁵² *Id* p. 209

⁵³ MARTIN, T. A. (2012). *The JOBS act of 2012: Balancing fundamental securities law principles with the demands of the crowd*. Available at SSRN: <http://ssrn.com/abstract=2040953> or <http://dx.doi.org/10.2139/ssrn.2040953>

⁵⁴ See NASRABADI A. G. (2015) *supra* note 33 p. 208

⁵⁵ *Id* p.205

⁵⁶ This was the case for the Pebble watch as reported in AGRAWAL, A. K. , CATALINI, C. and GOLDFARB, A. (2013). *Some simple economics of crowdfunding*. NBER working paper series.[Online] NBER, Working Paper 19133. Available from: <http://www.nber.org/papers/w19133> p. 13

test their products too.⁵⁷ The company gains undeniably a pre-market analysis at zero cost.⁵⁸ Finally, co-creation and market validation have an important role in reducing the risk of failure.⁵⁹

Benefits coming from the community participation are also more evident in equity crowdfunding. In this case, the entrepreneur gains the possibility to expand company's team.⁶⁰ Usually, those that decide to take the risk of investing in that project are also expert in the issuer's business. According to NASRABADI A. G. (2015), with that "expert crowd" the issuers can fulfill an experience gap in certain fields.

Finally, the crowd is also a *stimulator of innovation* because it is composed by a variety of people coming from different cultures. FLEMING (2004) develops the concept of "*cross-pollination of idea*"⁶¹, that is to say, the bolstering of high innovation thanks to the contribution of authors of different cultures, ethnicities, type of knowledge and point of view.⁶²

4.2.3 Control over the Company

Contrary to other form of financing, such as venture capital, in crowdfunding entrepreneurs do not need to give investors control rights.⁶³ According to VALANCIENE L., JELEVICIUTE S. (2013), they will maintain the right to make company decisions themselves. While this is absolutely true for reward crowdfunding, in the equity form things are a bit different. However, thanks to the relation between equity issuer's and investor's numbers, the entrepreneur will always maintain the majority control, if compared with the other form of financing listed above.

⁵⁷ More information in Chapter III, Paragraph 1.2.

⁵⁸ See NASRABADI A. G. (2015) *supra* note 33

⁵⁹ *Id* p. 203

⁶⁰ *Id* p. 206

⁶¹ FLEMING, L. (2004). *Perfecting cross-pollination*. Harvard Business Review. Retrieved from <https://hbr.org/2004/09/perfecting-cross-pollination> . On this argument see also HEWLETT, S. A., MARSHALL, M., & SHERBIN, L. (2013). *How diversity can drive innovation*. Harvard Business Review. Retrieved from <https://hbr.org/2013/12/how-diversity-can-drive-innovation>

⁶² See NASRABADI A. G. (2015) *supra* note 33

⁶³ See VALANCIENE L., JELEVICIUTE S. (2013) *Valuation of crowdfunding: benefits and drawbacks*. In ECONOMICS AND MANAGEMENT: 2013. 18 (1) [Online] Available at: <http://dx.doi.org/10.5755/j01.em.18.1.3713>

5. Crowdfunding Drawbacks

If the use of the Internet brings several advantages to entrepreneurs, its use takes also a number of disadvantages relating the public exposition of the company and his project for two main reasons. First of all, the community is so diverse that it is a good place in which lots of “enemy” can hide. In addition, the Internet provides the community with strong collective memory that would make difficult for it to forget and forgive who betrayed its trust.

For backers, the biggest disadvantages are linked to the nature of the money seekers. They are for the greatest part startups, and so really instable company, making investing in them exposed to the risk of failure and illiquidity. In addition, a big danger is also represented by the potential higher risk of fraud.

However, as reported above, crowdfunding gives the possibility to reduce those potential damages. It should be remarked that the Internet and the communities are powerful instruments to prevent the issuers from a commercial failure or to make entrepreneurs restrains from bad behaving.

5.1 Disadvantages for Entrepreneurs

5.1.1 Administrative Duties

Starting a crowdfunding campaign means an increase of administrative costs.⁶⁴ This is a point that should not be underestimated, especially for small of medium-sized enterprises composed usually by small teams. The first kind regards the management of the campaign itself, that is to say, all the actions to do before, during and after the campaign. For instance, maintaining the relation with the crowd and looking for its support are some of them. Moreover, as reported by AGRAWAL et al. (2013), the simple actions of sending rewards, updates and answer questions of the community are really time consuming.⁶⁵

For equity crowdfunding, other kinds of costs need to be considered, such as the ones that derives from modifications to company's statutes and legal advices. In addition, other costs belong to the modification of the previous shareholder relations. Before starting such a campaign, startups are usually composed by 4-8 members. After a successful campaign, the number can became really bigger. According to KITCHENS & TORRENCE (2012), having a large basis of retail investors is a challenge especially for communications duties.⁶⁶

⁶⁴ See VALANCIENE L., JEGELEVICIUTE S.(2013) *supra* note 63 p. 43.

⁶⁵ AGRAWAL, et al. (2013) report that in most cases the team became so overloaded with activities relating the managing of the campaigns that they have little time to run the company. See AGRAWAL, et al. (2013) *supra* note 41 p. 17.

⁶⁶ KITCHENS & TORRENCE (2012) *The JOBS Act – crowdfunding and beyond*. Economic Development Journal, 4(11), p.42-47.

5.1.2 Risks from Public Exposition

The two major drawbacks deriving from the public exposition of the project and of the entrepreneur are the theft of ideas and the harm of reputation.⁶⁷ According to some authors, crowdfunding entails the risk that better-funded companies may steal the project shown on the platform (SULLIVAN and MA, 2012, BECHTER et al., 2011 and GALWIN, 2012). In those cases, there are only few expensive legal ways that could be taken in consideration by the creator of the campaign. In order to avoid this risk, some platforms offer legal instruments to fix this issue.

Another risk linked with information disclosure regards the relation with potential suppliers and the related loss of bargaining power.⁶⁸ Those risks are accentuated in equity crowdfunding since the company is also requested the disclosure of future plans and strategies.⁶⁹

Finally, another danger not to underestimate is the harm to creator's reputation. Indeed, in some cases, the failure of a crowdfunding campaign could damage the future possibilities to produce that product, especially when the creator does not maintain a fair conduct during the campaign or in the relations with the community.

5.2 Disadvantages for Backers

The most important disadvantages for investors and bidders are the risks of fraud, failure and, for equity crowdfunding only, also market illiquidity. All those damages involve the possibility of losing all their money without receiving anything in exchange.

5.2.1 Fraud

On the one hand, the Internet offers a good ground for committing fraud thanks to the possibility for campaign creators to reach a really high number of people. According to AGRAWAL et al. (2013), "*it is relatively easy to use false information and craft fraudulent pages*". Those facts make crowdfunding an appealing target for professional criminals. Moreover, because each single investment is usually small and thanks to the high possibility to free-ride on investment decision of others, individuals will not find incentives in making due diligence.⁷⁰

⁶⁷ See AGRAWAL, et al. (2013) *supra* note 41 p. 17

⁶⁸ *Id.*

⁶⁹ *Id* p. 18.

⁷⁰ See AGRAWAL, et al. (2013) *supra* note 41 p. 20

On the other hand, disclosure requirements and the mentioned “wisdom” participate in the reduction of those risks. The Internet has a really good ability in maintaining transparency. If someone tries to prepare a fake project in one of these big platforms than it is difficult that he could escape. The whole community, spreading the word of the fraudulent action, will not let him do something similar again.

For those reasons there were little cases of fraud in proportion with the number of campaigns concluded with success.⁷¹ In this number, in most cases all the investors received their money back and the creator has been punished. For instance, in Hanfree's Case the creator, Seth Quest, was literally punished by the legal system and the community. Not only he went bankrupt after the lawsuits for a claim of only 70\$, but, as reported, he had also real difficulties in finding a new job because of his bad reputation.⁷²

5.2.2 Failure

In other cases, although the managers of the company do not act badly or do not try to cheat investors, it happens that the company simply fails. The reasons could be several and diverse and they are common to normal startups. Most of the times, the process goes far beyond creator's expectations, especially when creators have little experience in building a product and dealing with suppliers and other logistics.⁷³

However, thanks to the intelligence of the crowd, the number of startups that fail after concluding a successful crowdfunding campaign are fewer. Data confirm this assumption. A research made by AltFi and reported by the Financial Times⁷⁴, states that “only” the 20% on the companies using equity crowdfunding failed. This is a big result, considering that the actual rate of failure for startups is between 80% and 90% after the first two years from their incorporation.

5.2.3 Illiquidity

A typical risk of equity crowdfunding is illiquidity. This means that, after buying shares in a company, the buyer is unable to easily re-sell them to have his money back. One of the reason is the fact that the

⁷¹ Actually, cases of fraud are still really few. For further information see CORNER and LUZAR (2014) *Crowdfunding Fraud: How Big is the Threat?* Crowdfundinsider.com. [Online] Available at <http://www.crowdfundinsider.com/2014/03/34255-crowdfunding-fraud-big-threat/>

⁷² For further information about the whole story see: MARKOWITZ E. (2013) *When Kickstarter Investors Want Their Money Back.* Inc.com [Online] Available at <http://www.inc.com/eric-markowitz/when-kickstarter-investors-want-their-money-back.html>

⁷³ See AGRAWAL, et al. (2013) *supra* note 41 p. 19

⁷⁴ BARRETT C. and ROVNICK N. (2015) One in five UK crowdfunding investments fail. *Financial Times* [Online] Available at: <http://www.ft.com/intl/cms/s/0/90eff1cc8e0011e58be43506bf20cc2b> [Accessed: 26th January 2015]

secondary market of such instruments is still underdeveloped⁷⁵. Fortunately, lots of platforms are trying to favor the growth of this market, often dealing themselves with the creation of fundamental infrastructures.

⁷⁵ In Chapter III some of the reasons for such underdevelopment will be exposed. For further information see Chapter III, Paragraph 1.4.

6. Data from the European Crowdfunding Market

The first part of this dissertation will end with some market data⁷⁶ about the use of crowdfunding in Europe, in order to highlight the importance of this financing instrument and at reporting the effects of each regulation in the referring market, in order to see if the outcomes will suggest to better regulate this instrument, or if the regulation of some Member State could be taken as an example for its good performance on the market.

The total European crowdfunding market reached €2.9 billion in 2014, showing 144% growth from the previous year.⁷⁷ In the USA, the same growth rate has been reported, although the total market is three times bigger, reaching \$9.4 billion in the same year.⁷⁸ The reason of this huge difference is probably the lack of a Capital Market Union (CMU).⁷⁹

By December 2014, 510 live crowdfunding platform have been identified in Europe. In this number, the report⁸⁰ includes 155 reward-based platforms, and 117 equity platforms. The problem caused by the lack of a CMU can be highlighted by the fact that among all this platforms just 49 of them successfully funded “foreign projects”. This means that nowadays platforms practicing cross-border operations are still uncommon.

Some researchers⁸¹ had estimated that in 2015 crowdfunding market would have reached the volume of €7 billion, managing to double the current size.

6.1 Italy

Notwithstanding the possibility to study real-time data relating to equity crowdfunding⁸², Italy does not occupy a really important position among the major European countries that will be considered in this dissertation. Equity crowdfunding raised only €3,376,767 on a total of only 12 successful campaign of the 34 published.⁸³ The total offer size was near to €11 million and although the average collected of

⁷⁶ The data reported refers to the period 2013-2014.

⁷⁷ WARDROP R., ZHANG B., RAU R. and GRAY M. (2015) *Moving Mainstream - The European Alternative Finance Benchmarking Report*. University of Cambridge and EY.

⁷⁸ MASSOLUTION (2015)

⁷⁹ More information about this issue will be reported in Chapter III, Paragraph 1.1. [Accessed: 8th February 2016]

⁸⁰ EUROPEAN COMMISSION (2015) *Crowdfunding: Mapping EU markets and events study*. Available at: http://ec.europa.eu/finance/general-policy/crowdfunding/index_en.htm

⁸¹ See WARDROP R., ZHANG B., RAU R. and GRAY M. (2015) *supra* note 77.

⁸² Data provided by Osservatorio sul Crowdfunding – Politecnico di Milano. Available at: <http://www.fianzaaziendale.polimi.it/equitycf/equitycf.html> [Accessed: 8th February 2016]

⁸³ Data provided by Osservatorio sul Crowdfunding – Politecnico di Milano. Available at: <http://www.fianzaaziendale.polimi.it/equitycf/equitycf.html> [Accessed: 8th February 2016]

€281,397 is quite high in relation to the European average of €113,000⁸⁴, the data cannot be compared because of the so small number of Italian crowdfunding campaigns. Finally in Italy there are 42 crowdfunding platforms representing the 8.2% of European platforms total number.⁸⁵

6.2 France

In France the total amount raised by equity crowdfunding campaign in 2014 was €18.9 million and it represents a good slice of the total crowdfunding market of €253 million. This market had a 94 % increase from the data of 2013. According to the research conducted by WARDROP, ZHANG, RAU and GRAY (2015), only the 33% of the interviewed people think that the existing regulations were excessive and too strict, while the 42% though the rules were appropriate.⁸⁶ These data make France the second European country for crowdfunding market size and the third under the equity model.

Moreover, this country maintains the second position in relation to the number of active platform. These are 77, representing the 15.1% of the European total number in 2014.⁸⁷

6.3 Germany

In Germany, crowdfunding totally raised €236 million, with a growth of 113% from 2013 to 2014. In 2014 the slice of equity crowdfunding was €29.8 million, measuring an increase of 174% respect to year 2013. Those results made Germany the second on this market immediately after the UK. However, the research highlighted that the public was not so happy about the existing regulation. The 60% thought it was too strict and excessive.⁸⁸ For this reason, German equity crowdfunding users promoted the creation of a peculiar model, as it will be highlighted more in deep in the following Chapter.

In relation to the number of active platforms, Germany is the third with 65 active portals that represent the 12% of the European total.⁸⁹

⁸⁴ The research has been made by Statista - The Statistic Portal. Available at: <http://www.statista.com/statistics/413491/web-entrepreneurs-crowdfunding-funds-raised-europe/>

⁸⁵ See EUROPEAN COMMISSION (2015) *supra* note 80.

⁸⁶ See WARDROP R., ZHANG B., RAU R. and GRAY M. (2015) *supra* note 77.

⁸⁷ See EUROPEAN COMMISSION (2015) *supra* note 80.

⁸⁸ See WARDROP R., ZHANG B., RAU R. and GRAY M. (2015) *supra* note 77.

⁸⁹ See EUROPEAN COMMISSION (2015) *supra* note 80.

6.4 UK

With a total crowdfunding market size of €2.3 billion, UK leads the European crowdfunding market for the collected amount of money. Here, a relatively big slice of the cake is also represented by equity crowdfunding. The total is near to €111 million collected in 2014, with an incredible growth of the 420% with respect to the previous year.⁹⁰

The UK can also count 143 platforms that focus primarily or just onto the UK market. This is also the 28% of European total number of live platforms.⁹¹ In order to clarify the importance of the UK market, it should be sufficient to underline how the 80% of the successful European projects came from only 5 UK platforms.⁹²

⁹⁰ See WARDROP R., ZHANG B., RAU R. and GRAY M. (2015) *supra* note 77.

⁹¹ See EUROPEAN COMMISSION (2015) *supra* note 80.

⁹² *Id.*

CHAPTER II - Crowdfunding

Legislation

Introduction to Chapter II

The aim of this Chapter will be to see how this instrument has been handled by the major legal systems, with the final purpose, in the next chapter, to look for the best legislative combination to favor its functioning from an issuer's perspective.

The focus of our analysis will be the European Union because one of the aim of this dissertation is the suggestion of the best law combination for a possible harmonization. Notwithstanding this purpose, the overseas situation will be analyzed, looking for some lessons to learn from USA experiences and regulations.

1. Europe

1.1 General

1.1.1. Equity Crowdfunding and EU Directives

In relation to the established financial sector, Equity Crowdfunding could be considered as an alternative or complementary financing method for early stage companies.

In order to talk about Equity Crowdfunding in Europe, it is not possible to consider immediately the law of the single Member State, because, operating in the financial sector, Equity Crowdfunding is going to be influenced or "triggered" by numerous European Directives. To this day, indeed, a complete European crowdfunding regulation is yet to be implemented.

For these reasons, talking about Equity Crowdfunding in Europe means first of all analyzing the European Directives that have relations with it, in order to see how Equity Crowdfunding could be limited or enhanced. After that, it will be possible to go more in depth and see how each Member State regulates this instrument, within the limits imposed by the European Union.⁹³

⁹³ EUROPEAN COMMISSION (2013), *Crowdfunding Innovative ventures in Europe - The financial ecosystem and regulatory landscape*. DG Communications Networks. Available <https://ec.europa.eu/digital-agenda/en/news/crowdfunding-innovative-ventures-europe-financial-ecosystem-and-regulatory-landscape-smart>

1.1.1.1 Prospectus Directive.

Only the campaign creator who issues shares after a successful crowdfunding campaign⁹⁴ could be subject to the Prospectus Directive - Directive 2003/71/EC *on the prospectus to be published when securities are offered to the public or admitted to trading*.

This Directive regulates the *soliciting of investment* and *the act of public offering* with the main purpose of harmonizing the prospectus that companies shall present when they attempt to offer securities to the public in the European Union. A prospectus is a document disclosing all the necessary information⁹⁵ regarding the issuer and its offer, which are necessary in order to evaluate the investment and the connected risks.

Complying with this directive is a very expensive procedure. It represents a cost that a company cannot afford during its early stage activity period. To reduce this burden, the Directive provides that any Member State could introduce in their national law some exemptions⁹⁶.

For instance, Member States can increase the threshold up to €5 million in a 12-month period but they have also to provide that the offer is presented to less than 150 natural persons. To do so, each Member State needs to promulgate a particular legislation to define the threshold.

⁹⁴ GABISON G. A. (2015a) *Equity Crowdfunding: All Regulated But Not Equal*, DePaul Business & Commercial Law Journal 13. Available at: http://works.bepress.com/garry_gabison/5 p. 30

⁹⁵ “*The prospectus shall contain all information which [...] is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities*”[Article 5.1, Directive 2003/71/EC]

⁹⁶ “1. *Member States shall not allow any offer of securities to be made to the public within their territories without prior publication of a prospectus.*

2. *The obligation to publish a prospectus shall not apply to the following types of offer:*

(a) *an offer of securities addressed solely to qualified investors; and/or*

(b) *an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors; and/or*

(c) *an offer of securities addressed to investors who acquire securities for a total consideration of at least €100,000 per investor, for each separate offer; and/or*

(d) *an offer of securities whose denomination per unit amounts to at least €100,000; and/or*

(e) *an offer of securities with a total consideration in the Union of less than €100,000, which shall be calculated over a period of 12 months.*

However, any subsequent resale of securities which were previously the subject of one or more of the types of offer mentioned in this paragraph shall be regarded as a separate offer and the definition set out in Article 2(1)(d) shall apply for the purpose of deciding whether that resale is an offer of securities to the public. The placement of securities through financial intermediaries shall be subject to publication of a prospectus if none of the conditions (a) to (e) are met for the final placement.

3. *Member States shall ensure that any admission of securities to trading on a regulated market situated or operating within their territories is subject to the publication of a prospectus.*”[Article 3, Directive 2003/71/EC].

Furthermore, in order to let the public expand, it is necessary to reduce the offer to €100,000, still in a 12-months period. In this way, it is possible to use the second exemption provided by the directive. In addition, this threshold has a “*cross-border value*”, so operations in other Member States are exempted as well from the duty provided for⁹⁷.

Finally, another exemption provided for by the Directive is to address only “qualified investors”, that is to say, professional traders or high net worth individuals who fulfill some criteria provided in the Directive⁹⁸. How the exemption from the prospectus is the major cause of territorial limitation of crowdfunding within the European Union will be discussed in the next Chapter.

1.1.1.2 MiFID

The nature of equity crowdfunding is based on the offering of shares to the public. This means that Directive 2004/39/EU *on markets in financial instruments*, generally known as *MiFID*, could be easily triggered.⁹⁹ The Directive's two main objectives are the harmonization of financial markets and the protection of investors. To do so it establishes a minimum set of rules which those firms operating with reception, transmission and execution of transferable stock market transactions shall respect.

In such a case, this Directive affects the sphere of equity crowdfunding platforms when they *help the trading of securities*¹⁰⁰. They need to respect a set of rules under the control of a Regulatory Agency established by each Member State. The Regulatory Agency is entitled to grant, upon request of the platforms, a license to operate in the home country, or a passport to operate abroad.

To be more specific, the operations which could trigger this Directive are: the management of a secondary market for shares; investments advice; placing of financial instrument; execution of order on behalf of clients; receipt and transmission of orders in relation to financial instruments; operating a multilateral (or organized) trading facility; services related to underwritings.¹⁰¹

Given that each platform chooses a different business model, not all equity crowdfunding operations fall under the scope of the Directive. In addition, each State implementing MiFID by its own legislation provides different exemptions. The most common exemption regards the trading of stakes

⁹⁷ See EUROPEAN COMMISSION (2013) *supra* note 93.

⁹⁸ “A qualified investor must fulfill two of three following criteria: (a) the investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, 10 per quarter over the previous four quarters; (b) the size of the investor's securities portfolio exceeds EUR 0,5 million; (c) the investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment.” [Article 2.2, Directive 2003/71/EC].

⁹⁹ See GABISON G. A. (2015a) *supra* note 94

¹⁰⁰ See GABISON G. A. (2015a) *supra* note 94 p. 22

¹⁰¹ See EUROPEAN COMMISSION (2013) *supra* note 93 p. 34.

in private company¹⁰². The great part of the companies using Equity Crowdfunding are at their early stage development so they are unlikely to be already public. Others, instead, decide to provide a threshold under which the operation, although included in the ones listed above, is still exempted from MiFID costly requirements.¹⁰³

1.1.1.4 Directive on Payment Services

Platforms could also decide to collect, hold and then transfer the money received from the investors. All these actions trigger multiple directives. The first is the Directive 2007/64/EC on Payment Services¹⁰⁴.

The Directive aims at “*make cross-border payments as easy, efficient and secure as 'national' payments within a Member State*” and “*improve competition by opening up payment markets to new entrants*”¹⁰⁵. To do so, it establishes a harmonized set of rules applicable to all payment service in Europe.

Therefore, when platforms collect and then transfer money to fundraisers, they could be qualified as financial institutions. This means that the costs in terms of registration and compliance with the home Member State financial institution regulations are on them. In such cases, this compliance means also being in charge of holding sufficient capital and other safeguards measures.¹⁰⁶

1.1.1.3 Capital Requirement Directive

The platform could be subject to Directive 2013/36/EU¹⁰⁷ on *Capital Requirement* in two scenarios: being it a credit institution¹⁰⁸ or an investment firm.

¹⁰² *Id* p.33.

¹⁰³ SANNAJUST A., ROUX F., and CHAIBI A. (2014) Crowdfunding in France: A New Revolution? *The Journal of Applied Business Research*, vol. 30 n.6.

¹⁰⁴ Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on Payment Services in the Internal Market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.

¹⁰⁵ See the website of the European Commission dedicated to the Directive on Payment Services at: http://ec.europa.eu/finance/payments/framework/index_en.htm

¹⁰⁶ See GABISON G. A. (2015a) *supra* note 94 p. 23

¹⁰⁷ Directive 2013/36/EU, of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

¹⁰⁸ Institution “*that take deposits or other repayable funds from the public and to grant credits for its own account*”[Art. 9, Directive 2007/64/EC]

Equity Crowdfunding Portals could be considered credit institutions if they decide to operate the direct collection of funds and to grant credit for their own account.¹⁰⁹ In this respect, the purpose of the Directive is to enhance risk management of credit institutions. For this reason, it imposes a minimum capital requirement to be respected with other different obligations such as reporting, public disclosure and prudential requirements.¹¹⁰

On the other hand, if platforms operate simply as intermediaries between fund-seekers and investors, they could be subjected to this Directive as *investment firms*¹¹¹. This happens when they provide “*the reception and transmission of orders in relation to one or more financial instruments*”¹¹². In such a case, portals should also comply with capital and licensing requirements.

1.1.1.5 The Undertakings for Collective Investment in Transferable Securities Directive (UCITS), the Alternative Investment Fund Manager Directive (AIFMD) and other Directives.

Sometimes platforms decide to establish a company to hold the equity in the investee after a successful campaign¹¹³. In other cases, portals could decide to poll their clients' fund and decide where to invest. In more general terms, when a platform decides to manage the fund collected, it could be considered as an *investment firm* and be subject to four other different Directives (apart the ones mentioned above) depending on the kind of investment that it decides to process¹¹⁴.

The Directive on Undertakings for Collective Investment in Transferable Securities (UCITS)¹¹⁵ could be triggered when the platform takes the resemblance of an open-ended fund that invests in publicly traded companies¹¹⁶.

The Alternative Investment Fund Manager Directive (AIFMD)¹¹⁷, instead, operates for platforms that resemble hedge funds and all the other kind of funds¹¹⁸ which are not subject to the UCITS Directive.

¹⁰⁹ According also to Commission Regulation 575/2013, art. 4, of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms, a credit institution can be defined as “*an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.*”

¹¹⁰ See GABISON G. A. (2015a) *supra* note 94 p. 24

¹¹¹ The activity of an investment firms are: “(1) *Reception and transmission of orders in relation to one or more financial instruments.* (2) *Execution of orders on behalf of clients[...]* (5) *Investment advice.* (6) *Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis.* (7) *Placing of financial instruments without a firm commitment basis.*” [Annex I § A, Directive 2004/39/EC].

¹¹² See GABISON G. A. (2015a) *supra* note 94 p. 24

¹¹³ See EUROPEAN COMMISSION (2013) *supra* note 93.

¹¹⁴ See GABISON G. A. (2015a) *supra* note 94 p. 25

¹¹⁵ Directive 2009/65/EC, of the European Parliament and of the Council of 13 July 2009 on the coordination of Laws, Regulations and Administrative Provisions relating to Undertakings for Collective Investment in Transferable Securities (UCITS).

¹¹⁶ See GABISON G. A. (2015a) *supra* note 94 p. 26

The aim of this Directive is to introduce a harmonized set of rules to reduce the risk associated with the above-mentioned funds. For this reason, it fixes a heavy burden of rules such as capital requirements or enumeration policies. In addition, also managers of the funds are subject to authorization requirements.¹¹⁹

Finally, the Regulations on European Venture Capital¹²⁰ and European Social Entrepreneurship Funds¹²¹ need to be taken in consideration for platforms which are also venture capital funds in private companies or in a company with a social scope.

1.1.1.6 Other Directives

The Directive on Distance Marketing of Financial Services¹²² shall be taken in consideration when platforms *advise* investors. According to the Directive¹²³, the platform must provide the investors *ex-ante* with specific and clear information about the supplier, the financial service provided, the contract, and methods of redress¹²⁴

Finally¹²⁵, other Directives that generally need to be taken in consideration are the Directive on Consumers Rights¹²⁶, which aims at achieving a real business-to-consumer internal market and could be triggered when shares are offered to retail investors and the Anti-Money Laundering Directive¹²⁷.

¹¹⁷ Directive 2011/61/EU, of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

¹¹⁸ According to the Directive, AIFs are *collective investment undertakings which raise capital from a number of investor and which invest in accordance to a defined policy in the interest and for the benefits of his investors*.

¹¹⁹ See GABISON G. A. (2015a) *supra* note 94 p. 27

¹²⁰ Commission Regulation 345/2013, of the European Parliament and of the Council of 17 April 2013 on European Venture Capital Funds.

¹²¹ Commission Regulation 346/2013, of the European Parliament and of the Council of 17 April 2013 on European Social Entrepreneurship Funds.

¹²² Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the Distance Marketing of Consumer Financial Services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC.

¹²³ See GABISON G. A. (2015a) *supra* note 94 p. 25

¹²⁴ Article 3, Directive 2002/65/EC

¹²⁵ See EUROPEAN COMMISSION (2013) *supra* note 93.

¹²⁶ Directive 2011/83/EC of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council Text with EEA relevance.

¹²⁷ Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

1.1.2 Problem of non-harmonization and relation with state law.

The existence of different legislations means also the possibility of arbitrage or concentration of companies and platforms in the States with the more favorable legislation¹²⁸. In particular, considering the peculiar nature of Equity Crowdfunding, combining investors' protection and high-risk investment in early stage company, it is not crystal if a Member State should practice a race to the top or to the bottom, to attract more companies through its legislation.

Now, what is important to underline is that, from the Issuer's Perspective, these Directives are like "traps" imposing costs on Equity Crowdfunding operators. Because of the mentioned Equity Crowdfunding nature and the need for it to be used in a development phase of the company, operators should move trying not to trigger any of these. Obviously, Equity Crowdfunding, as an instrument to favor companies' development and the related market, will not expand and develop until all these traps and their costs will be removed or until a "fast track" for this instrument will not be realized.

The European Union gives the possibility to each Member State to adapt the content of Directives to their national framework. Therefore, each State has an active role in adjusting the "traps": they could decide to relax them or even to introduce tighter strings. For this reason, it could be useful to analyze and then compare the most relevant national approaches to select, in the next Chapter, the rules favoring the better and safer development of such an instrument.

¹²⁸ See EUROPEAN COMMISSION (2013) *supra* note 93.

1.2. Italy

1.2.1 General Framework

On 17 December 2012 with Law n. 221/2012¹²⁹, Italy was the first European state explicitly regulating Equity Crowdfunding. On 26 June 2013, the Italian Securities and Exchange Commission (*Commissione Nazionale per la Società e la Borsa*, known as CONSOB) implemented European Directives with Regulation n. 18592 of 26 June 2013¹³⁰. Finally, updates and innovations to the discipline arrived on March 2015, with Legislative Decree n. 3/2015 converted into law n. 33/2015¹³¹.

Being it the first state regulating Equity Crowdfunding, Italy has also been the first that limited it. Italian Legislation presents two main drawbacks: the first regards the issuer, that is to say “who can use Equity Crowdfunding as a financial instrument”; the second regard the investors, or “who is forced to invest” for the legislative success of the campaign. In the following paragraphs, it will be showed how these limitations work.

1.2.2 National Law Regulation

1.2.2.1 Regulation for the Issuer

In Italy, Equity Based Crowdfunding is not open to “every-issuer”. Italian regulation requires companies to meet certain conditions to have access to this financing instrument. Only when those are matched, they can be enrolled in a special section of the Company Register. In this way, Italian regulation introduced two new legal statuses: Innovative Startup (ISU)¹³² and Innovative Small and Medium-size Enterprises (ISME)¹³³. Both of them could be acquired by private¹³⁴, public¹³⁵ or cooperative companies.

¹²⁹ Articles from 25 to 30 are dedicated to on “innovative startup”.

¹³⁰ Consob Regulation 26-06-2013, n. 18592, ‘*Raccolta di capitali di rischio da parte di start-up innovative tramite portali on-line*’

¹³¹ Law n.33/2015 “*Misure urgenti per il sistema bancario e gli investimenti*” also known as “Investment Compact”.

¹³² The definition is given by Art. 25, comma 2, Law Decree 179/2012

¹³³ The definition is given by Art 4, comma 1, Law Decree 3/2015

¹³⁴ Limited Liability Company (*Società a Responsabilità Limitata, SRL*), also in the simplified form (*Società a Responsabilità Limitata Semplificata, SRLS*).

¹³⁵ *Società per Azioni, SPA*.

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It should be underlined that these are not two new legal forms, but sort of “titles” that even an *already set-up* enterprise could acquire when it satisfies the conditions set forth below and asks for the enrollment in the special section of the Company Register.

The definition of ISU was introduced in 2012 with the first crowdfunding regulation. To be registered as an ISU, a company should fulfill the following conditions. It shall:

1. Have an innovative purpose¹³⁶;
2. Satisfy at least *one* of the three following requirements¹³⁷:
 - a. At least 15% of the major between the company's expenses and net turnover shall be used for research and development activities (R&D);¹³⁸
 - b. At least 33% of the total employees shall be holder of PhD or researcher, or at least 66% shall be holder of a Master's degree;¹³⁹
 - c. Hold, possess or be licensee of high tech patent rights linked with the main purpose of the company.¹⁴⁰

In addition¹⁴¹, the company shall have been set up no more than 5 years before filing for an ISU status, and it may benefit from the status for no longer than 4 years. The creation of the company should not be the result of mergers, divisions or as a transfer of a company branch. It shall not be listed nor shall it have shares significantly spread among investors. Finally, the company should not pay dividends and it has to maintain a net turnover for two fiscal year lower than 5 million euros.

To wider the kinds of businesses that could have access to crowdfunding, Law Decree n.3 of 2015 introduced a second status. A company is considered as an ISME when it satisfies at least *two* of three requirements that are similar to the ones provided for the ISU status. Those are¹⁴²:

- a. At least 3% of the major between the company's expenses and net turnover should be used for research and development activities (R&D) ;

¹³⁶ According to Art. 25 of d.l. n. 179/2012: «*whose exclusive or predominant purpose is the development, the production and trading of innovative, valuable high tech products or services*»; but also after d.l. n. 33/2015 which «*supports the national travel industry through software or technology development*».

¹³⁷ ITALIAN MINISTRY OF ECONOMIC DEVELOPMENT - MINISTER'S TECHNICAL SECRETARIAT, DG FOR INDUSTRIAL POLICY, COMPETITIVENESS AND SMES (2015), *Executive Summary of the new Italian legislation on innovative SMEs*. Available at http://www.mise.gov.it/images/stories/documenti/Executive_Summary_of%20Italy_Startup_Act%2026_05_2015.pdf

¹³⁸ Art 25, para. 2, let. H, n. 1, d.l. n. 179/2012

¹³⁹ Art 25, para. 2, let. H, n. 2, d.l. n. 179/2012

¹⁴⁰ Art 25, para. 2, let. H, n. 3, d.l. n. 179/2012

¹⁴¹ DE LUCA N. (2015), slide on *Equity Based Crowdfunding*, LUISS Summer School on European & Comparative Company Law: Capital Markets.

¹⁴² See ITALIAN MINISTRY OF ECONOMIC DEVELOPMENT (2015) *supra* note 137.

- b. A least 20% of the total employees is holder of PhD or researcher, or at least 33% is holder of a Master's degree.
- c. Hold, possess or be licensee of an high tech patent rights linked with the main purpose of the company¹⁴³

Moreover¹⁴⁴, the company should not be listed in a regulated market and its last annual account shall have been audited by a recognized accountant or accounting firm. The company shall not be an ISU and it shall respect the requisites provided by the EU regulation in the definition of Small and Medium-size Enterprise¹⁴⁵. Finally, the company needs to have its registered office in Italy or in another European country, but, in the latter case, it shall have at least a branch in Italy. The company shall not distribute dividends.

In order to complete the description, it should be underlined that Italian regulation associates with these two kinds of companies not only the possibility to use Equity Crowdfunding, but also a lot of other advantages such as tax relief, reduction of duties for the subscription in the business register, flexible remuneration and flexible management system.¹⁴⁶ All these benefits are the reason why there are so many conditions to fulfill and the discipline is so stringent. On the other hand, some obscure points in this legislation still exist. One of them is, for instance, the correct definition of the term “innovative”.

1.2.2.2 Regulation for the Investors

The second limitation introduced by Italian Equity Crowdfunding regulation regards those who *must* invest in each campaign to determine its success. Indeed, each campaign is correctly completed only if “*professional investors*”¹⁴⁷ subscribe at least the 5% of the offered capital. Fortunately, the definition of professional investor is wide and the regulator is working to enlarge it further. It currently includes bank foundations, investment companies, financial institutions for innovation and development, innovative startup incubators and insurance companies.

¹⁴³ Art. 4, d.l. 3/2015

¹⁴⁴ See DE LUCA N. (2015) *supra* note 141.

¹⁴⁵ According to the EU Recommendation 2003/361/EC, Small and Medium-Size Company are undertakings with less than 250 employees and a total net turnover of less than €50 million or total balance sheet of €43 million. Further information at http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm.

¹⁴⁶ See ITALIAN MINISTRY OF ECONOMIC DEVELOPMENT (2015) *supra* note 137. For more information about these advantages see <http://www.sviluppoeconomico.gov.it/index.php/it/impresa/piccole-e-medie-imprese/pmi-innovative>.

¹⁴⁷ The complete definition is given by TUF art. 6, commas 2-quinquies (private professional investors) and 2-sexies (public professional investors).

On the other side, differently from other European countries, investors do not suffer other kinds of limitations: retail and professional investors can invest as much as they want.¹⁴⁸

One of the obstacles that they meet is the completion of the “path for informed investment”¹⁴⁹ before they buy shares through the portal. Apart from the emphatic name, this is a simple questionnaire that each investor needs to fill with correct answers, before he could access on-line offers. In this way, he can demonstrate his full understanding of the risks related to the investment.

The regulation also grants a right to withdrawal from the investment. Investors could exercise it within the 7 days after the adhesion or within 7 days when major changes occur in the situation of the startup or in the offer conditions. A similar right needs to be provided also in the Article of Incorporation of the startup offering its shares in a crowdfunding portal. This is granted providing a “tag-along clause” in favor of the investor if the majority of shares is sold within 3 years after the offer or before the ISU status expires¹⁵⁰. In this way, investors are protected against future and sudden changes in the property structure.

1.2.2.3 Regulation of the Platforms

Also for Italian regulation, platforms have a central role. To exercise their activity, they need to be enrolled in a public register held by CONSOB. The legislator provides the existence of two kinds of platforms:

1. “*De Iure Platforms*”, that is to say, investment companies or banks that can be enrolled in the CONSOB Register just giving an advanced notice. This means that, according to Italian law, this kind of companies already hold all the requisites to manage this activity.
2. “*Special Website Managers (SWMs)*”¹⁵¹, which are mainly designated companies that have to meet the requirements provided by TUF¹⁵² and decide to carry out the business of online funding portals.

As far as the second kind of platform is concerned, a particular discipline cares for investor's protection. For this reasons, any company that decides to pursue this kind of business needs to have the platform management as its exclusive purpose and its managers shall have some honorable and

¹⁴⁸ GABISON G. A. (2015b) *Understanding Crowdfunding and its Regulations*. European Commission.

¹⁴⁹ CONSOB (2014), *Investor Education – Important things to know before investing in innovative start-ups through a portal*, p. 9. Available at <http://www.consob.it/mainen/consob/publications/start-ups.pdf>

¹⁵⁰ See DE LUCA N. (2015) *supra* note 141.

¹⁵¹ Definition of De Luca in DE LUCA N. (2015) *supra* note 141.

¹⁵² Art. 50-Quinquies

professional requirements. In addition¹⁵³, SWMs cannot hold sums of money or financial instrument belonging to third parties and they need a bank or a financial company to transmit the orders regarding the underwriting of the shares offered.

The regulation provides other duties for funding portals. They have to publish all the information regarding the offer in clear, non-misleading form and without omissions, in a way that could lead investors to fully understand the nature of the investment and the risks associated to it. There is also a list of information that shall be published.¹⁵⁴ All this duties are complementary with the disclosure obligations requested to the issuers.

1.2.3 Implementation of EU Directives

1.2.3.1 *Prospectus Directive*.

Italy provides one of the highest threshold exemptions from prospectus requirements, letting issuer raise up to €5 million in a 12-months period. Issuers are so exempted from the costly disclosure duties provided by the Directive. However, some requirements still exist. The most important among these is the *simplified informative document*, a 5 pages-paper that needs to be published in the funding portal but does not need to be revised or submitted to the CONSOB.¹⁵⁵

1.2.3.2 *MiFID*

As seen above, only banks or investment companies can handle the proceedings of the offers. In doing so, they have to comply with MiFID regulation. Italian law provides two exceptions to this rule. They regard investments that do not exceed a specific amount. In order to obtain the exemption, in relation

¹⁵³ PIATTELLI U. (2014) The Italian legal framework of Equity-based Crowdfunding. *Osborneclark.com* [Online] Available at <http://www.osborneclarke.com/connectedinsights/publications/theitalianlegalframeworkofequitybasedcrowdfunding/> [Accessed: 10th January 2016]

¹⁵⁴ In particular this information are:

- *corporate details on the funding portal company (shareholders and managers) and on the activity of the portal, such as costs to be borne by the investors, measures applied to reduce fraud risks, measures undertaken to manage conflicts of interest and aggregate data of the offers carried out through the portal;*
- *warnings about the risks associated with investment in financial instruments issued by innovative start-ups, such as the risk of loss of the entire investment, risk of illiquidity, prohibition of distribution of profits, tax treatment of the investments (with reference to cases where the benefits may be disappplied) and typical content of a business plan; and*
- *with reference to each single offer of financial instruments by a given issuer company, the offer itself, the details on the bank or investment company which treat and process the orders and the frequency of updates on the subscription campaign. Id*

¹⁵⁵ Attachment 3, Consob Regulation 26-06-2013, n. 18592.

to the single investment, natural individuals cannot invest more than €500 while for legal entity the threshold becomes of €5,000. The exemption is also granted when the overall investment during the year is below €1,000 for individuals and under €10,000 for legal entities.¹⁵⁶

1.2.3.3 Others Directives.

Payment Services Directive does not find application directly because platforms cannot hold a sum of money if they are not banks or investment undertakings. The same principle is valid for AIFM Directive.

¹⁵⁶ AIEC – ASSOCIAZIONE EQUITY CROWDFUNDING ITALIA (2015) I 5 punti di AIEC. *EquityCrowdfundingItalia.org* [Online] Available at: <http://www.equitycrowdfundingitalia.org/> [Accessed: 26th January 2015].

1.3. France.

1.3.1 General Framework

The French Equity Crowdfunding regulation was adopted on 30 May 2014 and detailed in Ordinance no. 2014-559. The specific provisions were adopted by Decree no. 2014-1053 dated 16 September 2014, and the entire regulatory framework became applicable on 1 October 2014.¹⁵⁷

Before the introduction of this new set of rules, the old regulation introduced limits in line with the default regime of the Prospectus Directive. The first exemptions regarded issuing of no more than €100,000 and for no more than 150 investors¹⁵⁸. Moreover, in order to seek more than €100,000 and less than €1 million, the amount raised did not exceed 50 percent of the existing equity capital of the firm.¹⁵⁹

1.3.2 Implementation of EU Directives

To favor the development of the Equity Crowdfunding market, also the French Regulator used the power granted by the European Union to provide wider exemptions when it was possible.

1.3.2.1 Prospectus Directive

The possibility given by the Prospectus Directive has been used to increase the threshold of the amount that could be collected in 12 months. This threshold went up from €100,000 to €1 million. However, in order to do so, the Regulator imposed the use of an Equity Model Crowdfunding Platform accredited by the French Financial Market Authority (*Autorité des Marchés Financiers - AMF*). Obviously, because of the Directive's aim to furnish adequate information to the investors, the issuer is required to provide “*simple, clear and balanced information*”. The result is a smaller burden for him, in respect to the costly information that he shall provide according to the text of the Directive. The important thing is that this “*mini-prospectus*” will reach his purpose, that is to say, to make the risk of investment understood by the investor.

¹⁵⁷ ASCHENBECK-FLORANGE T. and NAGEL T. (2014) Germany, In: GADJA O. (ed.) *Review of Crowdfunding Regulation*. European Crowdfunding Network. Available at <http://eurocrowd.org/wp-content/blogs.dir/sites/85/2014/12/ECN-Review-of-Crowdfunding-Regulation-2014.pdf>

¹⁵⁸ ROOT A. (2014) French Crowdfunding Regulation: An Overview. *Crowdsourcing.org* [Online]. Available at <http://www.crowdsourcing.org/editorial/french-crowdfunding-regulation-an-overview/30712> [Accessed: 25th January 2015]

¹⁵⁹ See HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 16 p. 14.

1.3.2.2 AIFMD Directive

The Directive has been transposed into French Law by Ordinance no. 2013-676 and Decree no. 2013-687. As described before, AIFMD Directive is not always involved in Equity Crowdfunding. This is even truer in accordance with the French definition of Alternative Investment Fund. For French Law, an AIF is a collective investment company raising capital from a number of backers in order to invest into the fund according to a defined policy. Most platforms under French Law regulation regime are prevented from collecting the fund of the campaign.

However, according to AFM, if platforms create holdings companies to regroup shareholders funding the same project (for instance, aiming at simplifying the relationship with the project holder or with a potential purchaser in an exit perspective), they shall be subjected to the AIFMD regime. However, to verify so, a case-by-case analysis shall be made, having regards to the investment policy and the purpose of the platform¹⁶⁰.

1.3.3 National Law Regulation

1.3.3.1 Regulation for the Issuer

French Regulator grants the use of Equity crowdfunding to all kind of companies.¹⁶¹

When the same conditions established for the exemption from the Prospectus Directive are respected, also some exemptions from the French public offer regulation could be granted. The most notable is the possibility given to the SAS (*Société par actions simplifiée*)¹⁶² to make public offering through an Equity Model Platform¹⁶³.

In regards to information requirements, the sole condition imposed to the issuer is to provide simplified documents and adequate information to the investors. These documents need to be verified by the AMF. The issuer is also required to give investors voting rights and information about the company and about the money they are going to receive. Moreover, he shall advertise the danger of the investment¹⁶⁴.

¹⁶⁰ OLIVE C. and HUCHON E. (2014), France. In: GADJA O. (ed.) *Review of Crowdfunding Regulation*. European Crowdfunding Network. Available at <http://eurocrowd.org/wp-content/blogs.dir/sites/85/2014/12/ECN-Review-of-Crowdfunding-Regulation-2014.pdf>

¹⁶¹ See ALLEGRENI (2015a) La grande crescita dell'Equity Crowdfunding in Francia, as published at www.crowdfundingbuzz.it [Online]. Available at <http://www.crowdfundingbuzz.it/lagrandecrescitadellequitycrowdfundinginfranciailquadroeconomicoeregolamentare/>

¹⁶² "The more flexible type of limited liability company by shares that may be set up in France". See OLIVE C. and HUCHON E. (2014) *supra* note 160 p. 96.

¹⁶³ See OLIVE C. and HUCHON E. (2014) *supra* note 160.

¹⁶⁴ See ROOT A. (2014) *supra* note 158.

1.3.3.2 Regulation for Investors

French system does not impose particular ties to investors such as investments thresholds.¹⁶⁵ They are only required to complete a test to assure that they understood the risk that they incur.

1.3.3.3 Regulation of Platforms

A peculiarity of the French crowdfunding framework is the accurate legislations about crowdfunding portals. The starting point of this process is the creation on new legal status for Equity Crowdfunding Platforms: the *Conseiller en Investissements Participatifs* (CIP, crowdfunding investment advisor). This is an optional and cheap instrument the crowdfunding platform may choose to operate with. For this reason, compared to its “siblings”¹⁶⁶, it suffers some limitations.

To reduce setup costs, no minimum capital requirement and no license is necessary to create the platform under CIP regime. On the other hand, CIPs cannot receive the money or the securities collected with the campaign. In addition, they need to establish their place of business in France and not benefit from a European Passport in relation to their activities. The investment on this platform is only limited to *ordinary shares* or *fixed interest bonds*, while offering shares without voting right or other kinds of securities (such as convertible bonds or warrant) is excluded.

Platforms operate under AMF supervisions and need to be filed in the “register for intermediaries in banking operations and payments services” (ORIAS).

Another requirement to set up a CIP is the membership of an accredited AMF association. These associations are in charge of controlling the professional capacity of their members and of screening the portal before its application for the registration. The control is made according to a “good behavior” code to assure that members have given moral guarantees to be approved by the AMF. In addition, they have to respect some reporting obligations towards the AMF. The failure to comply with this obligation may result in the revocation of the accreditation. In alternative to the membership of an accredited AMF association, the platform could decide to be subject to specific control procedures, all in accordance with the AMF General Regulation. As to 30 September 2014 no association was

¹⁶⁵ See GABISON G. A. (2015b) *supra* note 148.

¹⁶⁶ This is a reference to *Intermédiaires en Financement Participatif* (IFP) status, the one dedicated to lending crowdfunding, and to *Prestataire en Services d'Investissement* (PSI) or credit institution, that are preexistent but also more costly legal model that could be used for crowdfunding. In regards to the last two, the choice depends on the services that the platform want to offer (investment advise or offer securities in other country), to their clients and investors. See OLIVE C. and HUCHON E. (2014) *supra* note 160.

accredited by the AMF. For this reason, the AFM itself manages the registration and analyzes the platform before they can register with the ORIAS.¹⁶⁷

Moreover, the regulation provides that platforms shall subscribe certain insurance policies in respect to a minimum capital requirement (mandatory from 1st July 2016) and comply with the good conduct rules set forth in the Ordinance and the AMF General Regulations. These regulations ensure that clients understand the risks connected to the investment through a right set of information.

French Regulator wanted CIPs dedicated only to Equity Crowdfunding. A different legal form is indeed provided to platforms dedicated to other kinds of crowdfunding. For example, lending crowdfunding has its dedicated Platform Model. Those are known as *Intermédiaires en Financement Participatif* (IFP, crowdfunding intermediaries).

It shall be stressed that Crowdfunding in French does not need any intermediary agent: the platform itself is the intermediary. It creates the MIFID requested Client Profile, but there is no need to sign by hand because all the procedure is made on the internet. No exemption is provided from this duty.¹⁶⁸

Platforms can no longer take shares in companies they promote. In this way, they can no more advertise the use of proxy vote, because in France mandates of representation at the shareholders general meeting cannot be given to third parties¹⁶⁹.

Finally, all the platforms shall expose a logo showing the approval by the French authorities. This label aims at ensuring trust to the public and investors.¹⁷⁰

¹⁶⁷ See OLIVE C. and HUCHON E. (2014) *supra* note 160. 94

¹⁶⁸ See ALLEGRENI (2015a) *supra* note 161.

¹⁶⁹ See OLIVE C. and HUCHON E. (2014) *supra* note 160.

¹⁷⁰ *Id.*

1.4 United Kingdom.

1.4.1 General Framework

The United Kingdom equity crowdfunding market is the widest in Europe. Initially there was lobbying to regulate it by means of dedicated rules. The Financial Conduct Authority (hereinafter FCA), instead, acknowledged the possibility to use equity crowdfunding as a valid business model under the existing regime with only little amendments.¹⁷¹

The use of exemption to avoid becoming subject to regulation and monitoring in UK is no more a common practice as in other countries.¹⁷² FCA, indeed, has signaled its disapproval of platforms making use of it.¹⁷³ In addition, for the English common law, using the letter of the law and not its spirit is a risky operation because of the increasing intervention and judgmental approach to protect investor, especially in a period of financial crisis.

1.4.3 National Law Regulation

1.4.3.1 Regulation for the Issuer

The offering of securities through a platform is considered as a financial promotion under UK Law, that is to say, an invitation or inducement to engage in investment activities.

All financial promotions addressing a retail investment audience must be communicated and receive the approval of a FCA-authorized firm. In this case, the financial promotion needs to comply with “Chapter 4 of the FCA's Conduct of Business Sourcebook” to ensure that they are clear, fair and non-misleading. Another way is to use some exceptions from the financial promotion regime such as the *existing shareholder exemption* in which the platform creates a shareholder relationship with all investors and a parent/subsidiary relationship with the issuer.¹⁷⁴

¹⁷¹ BLAIR D. and PRINGLETON A. (2014a) United Kingdom, In: GADJA O. (ed.) *Review of Crowdfunding Regulation*. European Crowdfunding Network. Available at <http://eurocrowd.org/wp-content/blogs.dir/sites/85/2014/12/ECN-Review-of-Crowdfunding-Regulation-2014.pdf>.

¹⁷² Reference is made to the German use of Profit Participation Loan to avoid the limit of €100,000 for offering of security. For further information see Chapter II, Paragraph 1.5.1.

¹⁷³ See BLAIR D. and PRINGLETON A. (2014a) *supra* note 171.

¹⁷⁴ See BLAIR D. and PRINGLETON A. (2014a) *supra* note 171.

Last, the Company Act 2006¹⁷⁵ prohibited the offer of shares in a private limited company to the public¹⁷⁶. For this reason, issuers need now to create a public company or to involve the platform¹⁷⁷.

1.4.3.2 Regulation for the Platforms

Platforms need to be authorized by the FCA according to the Financial and Services Markets Act (FSMA). They have to comply with the FCA's business code of conduct. Authorization is expensive in terms of time and money. Experts estimate that the procedures will cost around £150,000 plus six to nine months of compliance work before filing and other six months after the filing.¹⁷⁸ This could be a problem if associated with the low value transaction linked with crowdfunding. However, it should be noted that this expensive procedure did not stop English Equity Crowdfunding Market from blooming.

1.4.3.3 Regulation for Investors

The main scope of the regulation is to protect investors, because, as BLAIR and PRINGLETON (2014b) reported, “*crowdfunding combines indiscriminate online marketing with speculative start-up investment opportunities*”¹⁷⁹.

To ensure their protection, only certain investors can receive direct offers from issuers or platforms. These are retail consumers who take regulated advice¹⁸⁰, investors who certify themselves as high net worth or sophisticated investors and those who confirm that will invest no more than the 10% of their net asset a 12 months period. This last category shall confirm in writing this fact.¹⁸¹

The proper protection of consumers is also granted through FCA supervision of the market. In particular, this includes monitoring platforms website and reviewing monthly management information. The scope is to verify if platform discloses all the relevant information so potential

¹⁷⁵ Section 755, Company Act 2006

¹⁷⁶ See BLAIR D. and PRINGLETON A. (2014a) *supra* note 171.

¹⁷⁷ BLAIR D. and PRINGLETON A. (2014b). The regulation of crowdfunding in the UK. [Osborneclarke.com/](http://www.osborneclarke.com/). Available at <http://www.osborneclarke.com/connected-insights/publications/regulation-crowdfunding-uk/>

¹⁷⁸ See GABISON G. A. (2015a) *supra* note 94

¹⁷⁹ See BLAIR D. and PRINGLETON A. (2014b) *supra* note 177

¹⁸⁰ “Advice relating to a particular investment given to a person in their capacity as an investor or potential investor (or their agent) and relates to the merits of them buying, selling, subscribing for, or underwriting (or exercising rights to acquire, dispose of, or underwrite) the investment”. For further information see FCA (2015) *Finalized Guidance on FG15/1: Retail investment advice: Clarifying the boundaries and exploring the barriers to market development*. p. 2. Available at: <http://www.fca.org.uk/static/documents/finalised-guidance/fg15-01.pdf>

¹⁸¹ FCA (2015b) *A review of the regulatory regime for crowdfunding and the promotion of non-readily realisable securities by other media*. Available at <https://www.fca.org.uk/your-fca/documents/crowdfunding-review>

investors could make informed decisions. FCA also monitors financial promotion and takes action against firms that do not respect its standards¹⁸².

The English Government enhanced a policy to improve the use of crowdfunding through some mechanisms of tax relief. The first of these instruments is the Enterprise Investment Scheme, a relatively old instrument, introduced in 1994. It aims at encouraging the financing of company not listed in stock exchange which investment is more risky. To do so, it provides the following benefits:

1. 30% income tax relief for the present or the past tax year, for a maximum amount of £1 million;
2. 100% Inheritance tax relief if the shares are held for more than 2 years;
3. 50% Capital Gains Tax Re-Investment Relief;
4. Tax Relief from Investment Losses;

In 2012, to encourage start-up financing, the UK Government enacted an “update” of the previous scheme. The result is a startup tailored instrument: the Seed Enterprise Investment Scheme. The guidance principles are quite the same as those of the EIS but with a higher tax relief. The rules are the following:

1. Investor can have a 50% relief for income tax on the cost of shares for a maximum amount of £100,000 in a Year.
2. No capital gain tax on profit from shares held for at least three years. This time will not expire if the shares are sold and the capital gain reinvested into qualifying SEIS shares. This rule is valid under the threshold of £100,000 per year.
3. 100% inheritance tax relief.

In order to receive the benefits of this instrument, the investor shall not be an employee of the company before the shares, which have been issued or held, are over the 30% of the company. At the same time, any issuer who wants to be eligible for these benefits should follow some rules. First, it shall not raise more than £150,000 through SEIS and shall not have more than 25 employees. His assets cannot be worth more than £200,000 before the SEIS, and should not have been incorporated for longer than 2 years prior to the issuing of shares. Finally, the company needs to operate in a business comprised in the SEIS/EIS permitted list.

¹⁸² *Id.*

1.4.2 Implementation of EU Directives

1.4.2.1 Prospectus Directive

The Prospectus Directive was implemented in the UK through the Prospectus Regulations 2005 (SI 2005/1433), amending the Financial Services and Markets Act 2000 (FSMA) and introducing amendments to the FCA Handbook, such as the introduction of the Prospectus Rules.

Therefore, as in other countries, the publication of a Prospectus is required under UK Law, in particular, according to the FSMA. The UK Lawmaker decided to use the prospectus exemption as wide as permitted by the Directive. For this reason, issuers are exempted if they collect less than £5 million in a 12 months period from no more than 150 non-qualified investors¹⁸³.

1.4.2.2 AIFMD

The AIFM Directive needs to be taken in consideration as regards some platforms that fall also under the FCA regulation of Collective Investment Schemes (CIS). In this field, there is often an overlap of legislation between the Directive and the UK existing regime for CISs, because most of them will constitute an alternative investment fund. This is a more burdensome legislation and, for this reason, issuers and platforms usually avoid this kind of schemes.

The application of these rules is possible when the platform does not help the creation of a common issuer/shareholder relationship. Instead, there is the pooling of investor's contribution or of their income prior to the distribution and there is no involvement of shareholders in the day-to-day management of the company. This leads to the creation and the management of an AIF.

As showed before, the AIFMD impose a heavy regulation burden on fund operator falling within the scope of the Directive. However, in the UK the impact of this regulation is reduced in comparison with other European countries, because of the existence of a "*light-tough regime*" for funds with total assets under €100 million. In this case, not only the registration requirements are reduced, but the regime also allows marketing of AIF to retail investors in the UK, provided that the AIF is also a regulated CIS¹⁸⁴.

1.4.2.3 Others Relevant Directives

Payment Service Regulation 2012 (implementing in the UK the Payment Service Directive) should be taken in consideration for platforms operating "credit transfer" or "money remittance". Platforms conducting payment services will require a separate FCA authorization. However, for this kind of

¹⁸³See GABISON G. A. (2015a) *supra* note 94 p. 30

¹⁸⁴See BLAIR D. and PRINGLETON A. (2014a) *supra* note 171.

operations the Payment Service Regulation 2012 provides the exemption for “commercial agents” because platforms operate on behalf of issuers and investors.

1.5 Germany

1.5.1 General Framework

Before the recent regulation, crowdfunding took place in Germany thanks to the exemption provided in the Prospectus Directive and in the German Investment Act that excluded issuers offering securities (for a total amount lower than €100,000 per year) from the prospectus requirement. To avoid this limit and because the transfer of quotas of limited liability company in Germany involves costly notary¹⁸⁵, the usage of Profit Participating Loan (*partiarische Darlehen*)¹⁸⁶ slowly started spreading. Those kind of operations, indeed, were not considered as investment products (*Vermögensanlagen*) under German Law and so there was no need for the publishing of a prospectus.¹⁸⁷

1.5.2 National Law Regulation

1.5.2.1 Regulation for the Issuer

The situation smoothly changed after the promulgation of the “*Small Investor Protection Act*” on 23 April 2015. This act amended §1 para. 2 of the German Investment Act including in the definition of investment products also profit-participating loans, subordinate loans and similar forms of financing.¹⁸⁸

In order to save crowdfunding, it introduced in the Investment Act the §2a, now providing an exemption from the prospectus requirement (§6 Investment Act) for issuers that seek funds using the forms listed above (profit-participation loan and similar). Three conditions have to be fulfilled for it to benefit of the exemption:

- (1) the maximum amount of the aggregate value of the investment to enjoy this exemption is €2.5 million;
- (2) using of participating loan and similar subjects for the first time to gain a prospectus requirement exemption;
- (3) the usage of the internet and the platform by means of investment consulting or investment brokerage;

¹⁸⁵ See HORNUF L., SCHWIENBACHER A. (2015a) *supra* note 31 p. 4.

¹⁸⁶ According to KLÖHN L., HORNUF L. and SCHILLING T. (2015) profit participating loan can be defined as “loan (i) for which the interest rate depends on profit or revenue of the borrower, (ii) which give the lender no right in management of the borrower, (iii) through which the lender has no exposure to losses of the borrower, and (iv) which rank below other debts in insolvency proceedings”. KLÖHN L., HORNUF L. and SCHILLING T. (2015) The Regulation of Crowdfunding in the Draft Small Investor Protection Act: Content, Consequences, Critique, Suggestions. Working paper. Available at: <http://ssrn.com/abstract=2595773>

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

(4) the investment of the issuer must not being offered publicly.

Issuers exempted from the prospectus shall therefore produce an information document called “Investment Information Sheet” (*Vermögensinformationsblatt – VIB*). The issuer shall send this document to the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – hereinafter “BaFin”*). Its function is to give the “essential information” about the investment opportunity.¹⁸⁹

The German legislator gives particular attention to advertising possibilities. This provision requires notices and warnings that have to be published with the advertisement and that are the same contained in the Information Sheet. Before, this kind of investment could be advertised only in communications about economics matters. Now, if the advertisement contains adequate warning about the risks of crowdfunding, others channels like social media and Internet could be used.¹⁹⁰ Moreover, the Small Investor Protection Act prescribes that for advertisements that do not include an interest rate, an explicit notice have to be added explicating that the return is not granted. The warning notice has to be introduced in all kind of advertisements, even the smallest.¹⁹¹ Finally, *BaFin* has the power to ban certain type of advertising that could bring about wrongful practices.¹⁹²

Finally, in contrast with other country legislation, Germany does not introduce resale restriction, in this way it does not foster the secondary market for this instrument.¹⁹³

1.5.2.2 Regulation for the Platforms

In accordance to the German Banking Act (*Kreditwesengesetz*), providing *financial services* in Germany requires a written license from the *BaFin*. Within the meaning of financial service¹⁹⁴ are also included operations with “financial instruments”, and, after the recent reform, operations regarding “investment products” such as Profit Participating Loans. To sum up, whenever a crowdfunding

¹⁸⁹ *Id.* p. 8

¹⁹⁰ TORDERA I. (2015). Germany Adopts Crowdfunding Rules. [Eurocrowd.org/](http://eurocrowd.org/) [Online] Available at: <http://eurocrowd.org/2015/04/28/germany-adopts-crowdfunding-rules/> [Accessed: 25th January 2015]

¹⁹¹ In the ones short than 210 words, the word “warning” has to be introduced with a reference to a longer description. See KLÖHN L., HORNUF L. and SCHILLING T. (2015) *supra* note 186 p. 9.

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ ASCHENBECK-FLORANGE and NAGEL (2014) defines “*Financial service*” as “*the purchase and sale of financial instruments or their documentation (investment broking), the purchase and sale of financial instruments in the name of and for the account of others (contract broking) and the placement of financial instruments without commitment to take up those instruments (placement of financial instruments).*” See *supra* note 157.

platform facilitates the offering of securities, investment products, or shares in collective investment undertakings (*Investmentvermögen*), the platform requires a license provided by BaFin.¹⁹⁵

Therefore, when securities are offered, no exemption is available from the license requirements. Contrariwise, exemptions are provided when the platform offers other investment products such as Profit Participating Loans. In this case, if some requirements are met, the operator needs only a license under the German Trade, Commerce and Industry Regulation Act (*Gewerbeordnung*). Therefore, the platform shall:

1. conduct only investment broking and contract broking;
2. offer only investment product or shares in collective undertakings;
3. acquire the ownership or the possession of funds or shares of customers.

In German Law, crowdfunding platforms remain almost unregulated under other aspects¹⁹⁶. The single new rule establishes a legal obligation for the platform to monitor the subscription limits that are going to be listed in the next paragraph. In order to do so, the platform needs to be an investment service enterprise according to the German Securities Trading Act or be subject to the monitoring of the general trading authority, although on this specific point the situation is still not completely clear.¹⁹⁷

1.5.2.3 Regulation for the Investors

The first instrument¹⁹⁸ that the German Law used to protect investors is through an obligation on the issuer to insert in the Investment Information Sheet the warning notice “*The purchase of this investment is associated with significant risks and can result in a total loss of the money invested*”¹⁹⁹. Investors must confirm the understanding of the information sheet with a signature on it. In case of use solely of “distance communication”, there is no need of the physical presence of the investor, although a method that permits the clear identification of the investor needs to be used²⁰⁰.

In addition, German regulation presents subscription limits for investors²⁰¹. From this point of view, the Regulator limits only the amount that a single investor can invest for the same fund seeker (*single*

¹⁹⁵ See ASCHENBECK-FLORANGE and NAGEL (2014) *supra* note 157.

¹⁹⁶ See KLÖHN L., HORNUF L. and SCHILLING T. (2015) *supra* note 186 p.8 footnote 28.

¹⁹⁷ *Id* footnote n. 29, in which a legislative intervention on this point is foreseen.

¹⁹⁸ *Id.*

¹⁹⁹ The German wording are the following: “Der Erwerb dieser Vermögensanlage ist mit erheblichen Risiken verbunden und kann zum vollständigen Verlust des eingesetzten Vermögens führen“. The wording of the warning notice has been slightly ratcheted up during the legislative process, compare the indefinite article in the Draft Act. *Id.*

²⁰⁰ In this case, according to German law, the investor should declare “*name, address, the number of his or her identity card or another adequate piece of identification, and the e-mail address or telephone number to reveal his or her identity*” BT - Drs. 18/4 708, p. 66.

²⁰¹ See KLÖHN L., HORNUF L. and SCHILLING T. (2015) *supra* note 186 p. 9

investment) and does not establish an aggregate one. The limit depends on the “freely available assets and monthly net income”. Investors have a limit of €10,000 only if they can demonstrate that they can bear the loss, providing a statement that the amount of freely available assets is, at least, €100,000. If the investor possesses and states to have a lower amount, the limit is set to the double of his monthly net income, but always below €10,000. In other cases, such as when the investor wants to avoid the statement, the cap is of €1,000²⁰². This limitation applies only to investors who are not legal entities.

1.5.3 Implementation of EU Directives

1.5.3.1 Prospectus Directive.

The Germany Securities Prospectus Act (*Wertpapierprospektgesetz – WpPG*) transposed the Prospectus Directive into law with effect from 1 July 2005. The German Lawmaker did not use the power given by the Directive to extend the threshold of €100,000 regarding the issuing of securities. As highlighted above, the Small Investor Protection Act, amended the Investment Act, including in group of the financing instruments that requires a prospectus also Profit Participating Loans, providing for those an exemption when the conditions listed above are fulfilled. As mentioned above, thanks to this crowdfunding exemption, Profit Participating Loans and similar instruments can be used up to the threshold of €2.5 million.

1.5.3.2 AIFMD

AIFMD applies when there is an Alternative Investment Fund managed by an alternative investment fund manager. According to the Capital Investment Act, an AIF includes collective investment undertakings, which raise capital from a number of investors, in order to invest this amount following a defined policy. The AIF shall not be an operating company conducting business outside the financial sector. BaFin clarified that undertakings are “*operating companies*” when they operate the facility or production themselves in their day-to-day businesses.

Platforms usually do not fall under the definition of AIFs because they do not raise capital from investor for their own business and do not “manage” the collected sum. They merely arrange investment into projects or companies. Only if platform creates a “pooling vehicle”²⁰³ it will be subject to the German AIFMD. This could happen when a company prefers to collect fund by one major

²⁰² See TORDERA I. (2015) *supra* note 190.

²⁰³ A pooling vehicle is a “*company founded to concentrate a large number of investors*”. See ASCHENBECK-FLORANGE and NAGEL (2014) *supra* note 157.

investor instead of a large number of small retail investor. To avoid this regulation, the creation of a pooling agreement between investors could be possible.

1.5.3.3 Payment Service Directive

BaFin decided that operators of internet platform are not covered by the exemption of commercial agents²⁰⁴ when they provide *money remittance services* according to the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*).²⁰⁵

²⁰⁴ According to Payment Service Directive, the Directive does not apply for “*Payment transactions from the payer to the payee through a commercial agent authorized to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee*”. For more detail on the commercial agent exemption and his different application across Eu Member State see ASCHENBECK-FLORANGE T. (2015) Revision of the Payment Services Directive: quasi-banking regulation for e-commerce platforms? [Osborneclarke.com](http://www.osborneclarke.com/connected-insights/publications/revision-payment-services-directive-quasi-banking-regulation-e-commerce-platforms/) Available at <http://www.osborneclarke.com/connected-insights/publications/revision-payment-services-directive-quasi-banking-regulation-e-commerce-platforms/>

²⁰⁵ See ASCHENBECK-FLORANGE and NAGEL (2014) *supra* note 157 p. 111.

2. USA

2.1 General

The USA was the first country to formally regulate crowdfunding with the Jumpstart Our Business Startups Act (*JOBS Act*) signed into law on 5 April 2012. In particular, Title III of the Act is entirely dedicated to Equity Crowdfunding.

Before the implementation of this title, some exemptions from the SEC's regular regime existed. The most famous was the so-called "Regulation A", a provision of federal law that permitted to raise up to \$5 million in a public offering²⁰⁶. Unfortunately, it was not incisive enough for launching equity crowdfunding. There were at least two main reasons²⁰⁷: first, it was not applicable to the "crowd" but only to accredited investors "*who can fend for themselves*"²⁰⁸; second, the \$5 million exemption from the SEC's regime did not avoid state-by-state registration. In this way, crowdfunding resulted personally and geographically limited or expensive because it involved compliance with each state "Blue Sky's Law"²⁰⁹.

The final rule implementing Title III where enacted only on 30 October 2015 by the Securities and Exchange Commission (SEC). The new rules will be active in 180 days after the publication in the Federal Register²¹⁰.

Before the implementation of Title III, only the provision of Title II were applicable. Title II opened crowdfunding to a wider public, removing the historical ban (provided in the Security Act of 1933) on investment solicitation in regards to private placement. Until the promulgation of the JOBS Act, platforms used to permit access to offers only to pre-qualified accredited investors through a password-access system. However, Title II did not open crowdfunding to retail investor.

²⁰⁶ Implementing Title IV of the JOBS Act, Regulation A has been replaced with the so-called Regulation A+. Now it let company to raise up to \$50 million in 12-months. There is no public restriction so anyone can invest with a limitation of the 10% of the greater of their annual income or net worth. Finally also state compliance obligation has been removed. For further information *see* ALMÉRICO K. (2015) SEC: Startups Can Now Raise \$50 Million in 'Mini IPO'. *Entrepreneur.com*. [Online] 25th March. Available at: <http://www.entrepreneur.com/article/244278>

²⁰⁷ For more information about Old Regulation A+ *see* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 16

²⁰⁸ *Id* p. 8.

²⁰⁹ "A blue sky law is a state law in the United States that regulates the offering and sale of securities to protect the public from fraud. Though the specific provisions of these laws vary among states, they all require the registration of all securities offerings and sales, as well as of stockbrokers and brokerage firms." [Wikipedia]

²¹⁰ SEC press release available on its official website at: <http://www.sec.gov/news/pressrelease/2015-249.html>

SEC ultimate regulation of last October finally permits retail (non-accredited) investors to buy shares of company through equity crowdfunding platforms. Before that, the Security Act provided an exemption only for particular investors, resembled in the group of the three “F”s: Family, Friends and Fools²¹¹.

Last, the Act pre-empts state law. Single states cannot add anything to this regulation. They only retain the right to enforce frauds or other violations of the state law, while no enforcement is permitted concerning violation of registration rules.²¹²

2.2 Regulation for the Issuer

Title III of the JOBS Act permits the fund seeker to raise up to \$1 million in a 12-month period. To do so, the offering shall be made via a “broker-dealer” or a “funding portal” relationship. The use of this instrument is not available to non-USA companies. Obviously, foreign fund seekers can always set up a new company in the United State for this purpose.

Regulation of Title III regards two main obligations for the issuers: information disclosure and advertising limitations. In relation to the first one, issuers shall provide investors with the necessary information to appreciate risks and rewards of an investment. In addition, the platform has an active role in this process because it has to provide potential investors and SEC with the information given by the issuer 21 days prior securities are ready to be offered through the portal²¹³.

Prospectus requirements are not as expensive as the ones requested for the regular proceedings. Fund seeker needs to show the risk and the potential requirements of investing in those securities. According to this principle, issuers are then exempted from giving all the costly and necessary information provided in a prospectus. Notwithstanding this, some less costly disclosure requirements still exist.²¹⁴

What is necessary to fulfill this obligation could be summarized in 4 conditions: (i) personal detail and names of directors, officers and substantial investor²¹⁵; (ii) description of the current and the future business plan; (iii) disclosure of certain related party transactions; (iv) description of the financial conditions of the issuer.

²¹¹With the terms “fools” are usually indicated business angels or other early adopters that believe at first sight in the startup’s business idea. See SCHWARTZ, A., (2013) Crowdfunding Securities, Notre Dame Law Review, Vol. 88, 1457; U of Colorado Law Legal Studies Research Paper No. 13-9. Available at SSRN: <http://ssrn.com/abstract=2279175>

²¹² *Id.*

²¹³ ELLENOFF S. D., ADLER J., SELENGUT D. and DEDENATO M. (2014), USA. In: GADJA O. (ed.) *Review of Crowdfunding Regulation*. European Crowdfunding Network. Available at <http://eurocrowd.org/wp-content/blogs.dir/sites/85/2014/12/ECN-Review-of-Crowdfunding-Regulation-2014.pdf>

²¹⁴ See SCHWARTZ A. (2013) *supra* note 211.

²¹⁵ That is investor owners of more than 20% of the company. ALDERMAM P. (2015). Australia to follow USA moving forward with equity crowdfunding regulations. *Lexology.com* .[Online] Available at: <http://www.lexology.com/library/detail.aspx?g=732990db-405e-4d5f-a107-e35d45c7f660> [Accessed: 26th January 2015]

These specifications are proportioned to the amount of money the issuer seeks. In particular, when the offering is:

1. Equal or below \$100,000, the issuer shall provide the most recent income tax returns and financial statements which need to be certified by the principal issuer officers.
2. Between \$100,000 and \$500,000, a financial statement must be provided and reviewed by a public account.
3. More than \$500,000, an audited financial statement is necessary.²¹⁶

Issuers are also required to disclose other information regarding the campaign²¹⁷ and to publish periodical updates. The disclosure operations keep on going also after the campaign is ended. Issuer shall annually file with the SEC and make available for investors financial statements and reports of the result of the operations.

The regulation provides also some advertising limits. Although the major ban of investment solicitation was removed in Title II of the JOBS Act. Some restrictions for the protection of investors still exist. The general rule is that platform and issuer cannot advertise some specific campaign. All the advertising and solicitation should pass through the funding portal.²¹⁸

In addition, the issuer have to respect the requirements of the portal in respect to investors' education and in relation to the risky investment that they are facing.

2.3 Regulation for the Investors

The JOBS Act realizes investor protection limiting the maximum amount of money that each individual can invest. This limitation is based on the investor's annual income. On the contrary, the maximum number of investors that each issuer could attract through the crowdfunding campaign is not restricted²¹⁹.

It is possible to define three categories of investors: investors with an annual income lower than \$100,000, investors with an annual income higher than \$100,000 and finally those who do not want to disclose their annual income. The first group can invest no more than 5% of their greater income, and

²¹⁶ A company's financial statements which have been prepared and certified by a Certified Public Accountant (the auditor).

²¹⁷ (1)Price of the securities issued; (2)Target capital; (3)Deadline for reaching the target; (4)Possibility to accept money above the target.

²¹⁸ See ELLENOFF S. D., ADLER J., SELENGUT D. and DEDENATO M. (2014) *supra* note 213.

²¹⁹ See SCHWARTZ A.(2013) *supra* note 211.

so, at best \$2,000. The second one can invest up to the 10% of their annual income. Finally, investors belonging to the last category are limited to \$2,000²²⁰.

The act limits also the secondary market of these securities²²¹, providing that investors are restricted from transferring their securities for one year. This rule is not valid in case of transfer to: (i) the issuer, (ii) accredited investors, (iii) offering registered with the SEC and (iv) investor's family member. Because of the reduced number of shares issued and these transfer limitation, some authors think that no secondary market will develop in crowdfunding.²²²

What is more, investor protection is guaranteed explicitly authorizing civil action against the company, his officers and directors²²³ and imposing on those the obligation of annual reports of the results of the operations.²²⁴

2.4 Regulation for the Platforms

As seen above, intermediaries could take the legal form of broker-dealer or of funding portal²²⁵. The last one is a new classification of intermediary created by the JOBS Act. In this way, these portals are now subject to the new SEC regulation. This procedure is also simpler than the one provided for the former, although it provides more limitations.

One of these is the prohibition of offering investment advice. At the same time, they are in charge of investor education. This means that platforms have to provide educational materials without making recommendations or giving investment advice.

Investor education is also realized forcing them to answer to a questionnaire in order to demonstrate their consciousness in relation to the risk that they are facing before they could access the portal and buy companies' shares. When they do so, the platform has to adopt a mechanism to grant investor the possibility to withdraw their investment. In general terms, the issuer cannot receive the proceeds of the offering until the target amount is reached or exceeded.

²²⁰ See ALDERMAM P. (2015) *supra* note 215.

²²¹ See ELLENOFF S. D., ADLER J., SELENGUT D. and DEDENATO M. (2014) *supra* note 213.

²²² See SCHWARTZ A. (2013) *supra* note 211.

²²³ *Id.*

²²⁴ *Id.*

²²⁵ "A funding portal is defined as a crowdfunding intermediary that does not: (i) offer investment advice or recommendations; (ii) solicit purchases, sales, or offers to buy securities offered or displayed on its website or portal; (iii) compensate employees, agents, or others persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (iv) hold, manage, possess, or otherwise handle investor funds or securities; or (v) engage in such other activities as the SEC, by rule, determines appropriate" SEC (2012) Jumpstart Our Business Startups Act Frequently Asked Questions About Crowdfunding Intermediaries. *Sec.gov* Available at <https://www.sec.gov/divisions/marketreg/tmjjobsact-crowdfundingintermediariesfaq.htm>

They also need to take the necessary disclosure measures to reduce the risk of frauds. Concerning their relations with the issuers, portals have an important role in information disclosure. Indeed, they need to publish the information given by the issuer and provide for a “chat room facility” so that the “crowd” can discuss about the issuer’s offer. Finally, they shall facilitate offers and sales of crowdfunding facilities²²⁶ but they are prevented from purchasing shares in the campaigns they are promoting.

²²⁶ See ALDERMAM P. (2015) *supra* note 215.

CHAPTER III – The Issuer's Perspective

1. The Issuer's Perspective

In the previous chapter, European and USA legislation has been analyzed and examined. In the last part of this dissertation, the first purpose is to catalogue the good and the bad aspects of these regulations. In this way, some suggestion for a possible harmonization could finally be formulated.

In doing so, the final goal is to define the best advantages from an Issuer's Perspective. This means the definition of some principles and the analysis of the regulations that maximize the benefits that a company could extract from Equity Crowdfunding.

However, the adoption of this point of view does not imply a complete ignorance of investors' circumstances. The Investor's and the Issuers' perspectives are complementary. Only when investors are adequately protected, they can trust this instrument, and so use it more, with clear benefits for companies.

Therefore, although the investors' requests will be considered, they will not have a central position in the following analysis. Their point of view shall be subordinated in order to give the best possible consideration of issuers' needs.

It has been shown²²⁷ that the risk of fraud is the biggest enemy in the development of Equity Crowdfunding.²²⁸ For this reason, a crowdfunding regulation should pursue two complementary aims. On the one hand, the creation of enough confidence in investors through adequate protection; on the other, it should make the access to crowdfunding not unduly burdensome for investors and potential issuers.²²⁹ Adopting the Issuer's Perspective means preferring the second of those two aspects, without ignoring the other.

²²⁷ The reason has been examined in Chapter I in the paragraph dedicated to crowdfunding's disadvantages for bidders/investors. For further details see Paragraph 5.2.1.

²²⁸ This opinion is also shared by NAJJARIAN (2013), who criticizes crowdfunding since he describes it as an easy way to steal money from the internet without any regulation and investor protection, compared to regulated capital and stock market. NAJJARIAN, I. P. DE N. (2013). O CROWDFUNDING E A OFERTA PUBLICA DE VALORES. FMU Direito - Revista Eletrônica, 26(37). Available at <http://revistaseletronicas.fmu.br/index.php/RMDIR/article/view/244>

²²⁹ The interdependence results from the fact that to reduce investment risks, the implementation of some rules to protect investors is necessary. This means more costs for them and for companies.

For the reasons noted above, the following are the principles that an equity crowdfunding regulation under the adopted perspective should aim at settling.

1.1 Removing territorial limitations.

Equity Crowdfunding was born thanks to the Internet. The latter is the “infrastructure” that permits crowdfunding to work, becoming the place in which the crowd gathers and collects money for a project. The Internet has no boundaries and is not territorially limited. Therefore, the removal of territorial boundaries should be the first principle to adopt under the Issuer’s Perspective, because it will let issuers reach a bigger crowd. In this way, this innovative financing instrument will “*unleash all its potential*”.²³⁰

The main innovation of equity crowdfunding is represented by the use of the Internet as the solution to fill the “SMEs financing gap”.²³¹ It facilitates the meeting of people that have money to invest with people who need it to develop their entrepreneurial idea.²³² Therefore, the web creates the connection and solves an intermediary problem that neither banks nor venture capitalists can solve in its stead.

The application of the principle introduced should be stronger in the European Union in which the will to constitute an internal market based on the *four freedoms* exists.²³³ One of these freedoms is precisely the *free flow of capital*. However, as stated by the European Commission (2015), “*Despite the progress that has been made over the past 50 years, Europe's capital markets are still relatively underdeveloped and fragmented*”.²³⁴

To overcome these problems, the European Union is working on the creation of a Capital Market Union. One of the main aims of its creation is the release of more investments that could be channeled

²³⁰ This expression is quoted from the European Commission’s Communication on crowdfunding of 27th March 2014. EUROPEAN COMMISSION (2014) *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, “Unleashing the potential of Crowdfunding in the European Union”*. Brussels. Available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2014:172:FIN>

²³¹ OECD (Organization for Economic Co-operation and Development) recognizes the need to “*broaden the range of financing instruments available to SMEs and entrepreneurs*” and included crowdfunding in the list of those instruments. OECD (2015) *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments*.

²³² BRADFORD, S. C. (2012) Crowdfunding and the federal securities laws. *Columbia Business Law Review*. [Online] SSRN, Vol 1:1 p. 1-150. Available from: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1916184 [Accessed: 10th January 2015] p 101

²³³ “*The internal Market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties*”[Article 26(2) TFEU].

²³⁴ EUROPEAN COMMISSION (2015) *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, “Action Plan on Building a Capital Markets Union”*. Brussels. p. 3

to all the companies, “including SMEs”.²³⁵ Moreover, the increase of competition and financial integration to enhance cross-border operations and risk sharing is a point that has been taken into consideration.²³⁶

Territorial limitations directly affect equity crowdfunding. The problem is that, in concrete cases, the procedure that a platform should follow for requesting a passport to operate in a different country is very expensive if compared with the economic resources that they have.²³⁷ The result is that companies are not allowed to publicize their offers on other platforms and in other Member States.

Territorial limitations result from the rules contained in the Prospectus Directive. The problem is that this Directive does not contain an “adequate” exemption for foreign operations and, in addition, each Member State may decide to set the threshold between €100,000 and €5 million. Thanks to this faculty, each Member State has adopted different conditions for exemption from prospectus requirements.²³⁸ Therefore, in relation to the same amount of shares offered, issuers can find the full prospectus regime in some Member States while in others there is complete exemption. The direct result is a territorial limitation caused by the duty of compliance with 28 different prospectus provisions.²³⁹

Fortunately, the European Commission is working on a solution to this problem. It has recognized the Prospectus Directive as a barrier for smaller company in raising equity finance²⁴⁰ and it promises to solve this²⁴¹ although it will be a long-term project.²⁴²

²³⁵ *Id* p. 3.

²³⁶ This will is more clearly expressed in Communication of 30th September 2015 where the Commission states “*The Commission will take forward measures to remove the barriers which stand between investors' money and investment opportunities, and overcome the obstacles which prevent businesses from reaching investors. The system for channeling those funds will be made as efficient as possible, both nationally and across borders.*” *Id*.

²³⁷ According to this Communication, only 38% of the platforms operate cross-border and 27% cite the high cost of getting an authorization in another Member State as a reason for carrying on only domestic operations. – EUROPEAN COMMISSION (2014) *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, "Unleashing the potential of Crowdfunding in the European Union"*. Brussels. p. 8.

²³⁸ HOOGHMSTRA S.N. and DE BUYSERE K. (2015). *The Perfect Regulation of Crowdfunding: What Should the European Regulator Do?* In BRÜNTJE D. & GADJA O. (eds). *Crowdfunding in Europe - State of the Art in Theory and Practice*. FGF Studies in Small Business and Entrepreneurship. Brussels: Springer International Publishing. p. 138.

²³⁹ For instance, as reported by HOOGHMSTRA S.N. and DE BUYSERE K. (2015): in Germany, Estonia and Lithuania the threshold is set to €100,000; in Norway it is €1,000,000 while in Finland reach €1,500,000; the Netherland and Sweden have adopted a €2,500,000 threshold, while Spain, Italy, the UK and Denmark set the maximum of €5,000,000.

²⁴⁰ See EUROPEAN COMMISSION (2015) *supra* note 234 p. 5.

²⁴¹ “*The direction to take is clear: to build a single market for capital from the bottom up, identifying barriers and knocking them down one by one, creating a sense of momentum, and sparking a growing confidence for investing in Europe's future. The free flow of capital was one of the fundamental principles on which the EU was built. More than 50 years on from the Treaty of Rome, let us seize this opportunity to turn that vision into reality.*” *Id* p. 6

In addition, another source of territorial limitations is represented by the other rules of company law of each Member State. As pointed out by HOOGHMSTRA and DE BUYSERE (2015)²⁴³, these kinds of limitations could be categorized as “*public offer limitation*” and “*other substantial formalities*”. These laws²⁴⁴ makes prospectus exemptions useless, thus *eroding* the benefits that this regulation introduced. The European Commission has also tackled these problems²⁴⁵, promising to identify and removing these obstacles entirely.

Past experiences demonstrate the importance of this issue, as it was reported in the previous chapter. A similar situation was one of the reasons for the failure in the USA of the old Regulation A.²⁴⁶ There too, issuers considered compliance with the Blue Sky Laws of each state excessively expensive, meaning the aforementioned regulation was under-used.

1.2 Abolishing business, size and time restrictions.

The second principle of an equity crowdfunding regulation following the Issuer’s Perspective consists in the removal of business, size and time restrictions. All kind of companies should use it if they expect to obtain some benefits, without regard to their field of activity²⁴⁷, the time passed from their incorporation²⁴⁸, or the number of their employees²⁴⁹. Indeed, as mentioned in the first Chapter, the advantages of equity crowdfunding are not only limited to the nature of its financing method²⁵⁰, but there are many other benefits that companies could acquire through its use. Support from the community/crowd and marketing advantages are the most relevant.

²⁴² “*This Action Plan sets out the building blocks for putting a well-functioning and integrated Capital Markets Union, encompassing all Member States, into place by 2019*”. *Id.*

²⁴³ See HOOGHMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 238 p. 139

²⁴⁴ HOOGHMSTRA and DE BUYSERE (2015) report that, an example of the first group can be found in UK legislation. This left untouched national company regulation, so issuers that want to use crowdfunding need to set up an “expensive” public limited liability company. The second group includes Italian or German legislation that requires the presence of a notary for activities such as shareholders resolution or subscription, in this way, bringing the operation “offline” and requiring the expensive presence of all the potential shareholders in the same place. – *Id.*

²⁴⁵ “*Despite progress in recent decades to develop a single market for capital, there are still many obstacles that stand in the way of cross-border investment. These range from obstacles that have origins in national law, such as insolvency, tax and securities law, to obstacles arising from a fragmented market infrastructure*”. See EUROPEAN COMMISSION (2015) *supra* note 234 p. 5.

²⁴⁶ Now replaced by Regulation A+ as it was described in footnote 206 of the previous chapter.

²⁴⁷ For instance, innovative or not, with a clear reference to Italian regulation analyzed in Chapter I.

²⁴⁸ This is another reference to Italian legislation in which a company loses its status of ISU after four years, without the possibility of acquiring in future other types of status giving access to crowdfunding (ISU or I-SME).

²⁴⁹ This reference is made to the Italian Law and its definition of I-SME as seen in the previous Chapter.

²⁵⁰ For a complete list of the other benefits obtainable see NASRABADI A. G. (2015) *supra* note 33 p. 2013. Most of them has been reported in Chapter I, Paragraph 4

For instance, the use of crowdfunding by big companies²⁵¹ in 2015 was so successful that one on the biggest crowdfunding platforms in the world, Indiegogo, launched the “Enterprise Crowdfunding” in 2016, a new crowdfunding model with the explicit purpose of “*validate product market fit, source innovation and sponsor innovation*”²⁵². This demonstrates that there are notable advantages²⁵³ that a company going public in the traditional way does not gain directly.

Moreover, buying shares in bigger companies entails fewer risks than becoming a startup's shareholder. Although they might view this instrument as useless for their purposes and choose some other kind of crowdfunding²⁵⁴, this is not a good reason *a priori* to keep them out of it. For all these reasons, limits should not be imposed on the size of the tenderer, but merely based on the size of the offers²⁵⁵ or of the bidders²⁵⁶.

Finally, legislation imposing time limits on the use of equity crowdfunding should also be avoided. This is because, the early period is not uniform for all startups. It is possible to imagine slower companies that could take more time to reach the “right moment” for a crowdfunding campaign. The reasons could be several: no formation of a good team as yet, technological developmental problems or technological precocity. In this way, legislation that limits the use of this instrument after some years from the startup's creation goes directly against the issuer's needs, without letting it benefit from the advantages provided above.

1.3 Restricted disclosure costs.

The third principle of the desired regulation analyzed in this chapter is the reduction of disclosure costs for the use of this financing instrument. The major users of Equity Crowdfunding are early stage companies and generally, they are unable to afford costly prospectus requirements.

²⁵¹ In this list there are Hasbro, General Electric, Harman, Philips, Westinghouse and ShockTop. More information at CLIFFORD C. (2016) Indiegogo Launches a New Product to Court Big Businesses. *Entrepreneur*. [Online] 6th January 2016. Available at: <http://www.entrepreneur.com/article/254730> [Accessed: 20th January 2016]

²⁵² For detailed information see the website of Indiegogo at <https://learn.indiegogo.com/usecase-enterprise/>

²⁵³ As described in detail in Chapter I, reference is made to the strong connection with a community that is there, waiting for news and ready to be questioned. Those factors could be used in various ways: feedback, beta testing of new products and more. Through equity crowdfunding, the company gains *the wisdom of the crowd*.

²⁵⁴ For example, Hasbro, “an American multinational toy and board game company, one of the largest toy makers in the world(Wikipedia)”, with share traded on NASDAQ, decided in 2015 to use Indiegogo to launch new products and to receive feedback from the crowd. The result was \$ 28.012 dollars raise in four campaigns. A small gain in terms of money, but a larger one in marketing and the future sales of that products.

²⁵⁵ See BRADFORD, S. C. (2012) *supra* note 232 p. 132.

²⁵⁶ For a discussion about the pertinence of an investment cap see Paragraph 3.3

HORNUF and SCHWIENBACHER (2014) demonstrate that “*firms raise inefficiently low amounts of money when the exemptions are restrictive*”²⁵⁷ and they continue by saying that strong investor protection is not beneficial for small firms. Therefore, too few exemptions can discourage entrepreneurial initiatives.²⁵⁸ Thus, according to BRADFORD (2012), excessive disclosure requirements “*make no economic sense*” for small offerings such as the ones that crowdfunding facilitates.²⁵⁹

A similar problem regards the access costs to this instrument. A regulation that promotes crowdfunding should also reduce the compliance costs that companies must afford before gaining the opportunity to use it.²⁶⁰ In most cases, indeed, the disclosure costs exceed the benefits, or at least, represent a high barrier to the use of this instrument. At the end of the day, the use of equity crowdfunding should be profitable for issuers. If the costs of using it are higher than the benefits, this instrument becomes useless.

The advantage determining the success of crowdfunding is the fact that the Internet reduces the transaction costs²⁶¹ that were, previously, an impediment to the possibility of small companies offering shares to the public.²⁶²

This is also possible because crowdsourcing has modernized the existing relation of the classic forms of financing. Traditionally, retail investors are advised by other people and decide to invest only based on the characteristic of the investment and on the possible financial returns. They care less about the business model of the company. On the contrary, crowdfunding²⁶³ gives people the chance to surf the internet looking for ideas to finance. Here, investors know more about the business in which the company operates, and sometimes they can advise the issuer, participating actively in the community born via the platform. Often investors decide to give money to the company, not *only* because they want a financial return. They are attracted by the idea because they think that it is something that they

²⁵⁷ See HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 16.

²⁵⁸ See HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 16 p. 5.

²⁵⁹ See BRADFORD, S. C. (2012) *supra* note 232 p.144.

²⁶⁰ See HOOGHIEMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 238 p. 164

²⁶¹ See HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 16 p. 2.

²⁶² As reported by HORNUF and SCHWIENBACHER (2015b) at p. 5 the initial costs of a typical IPO is near \$1,000,000. According to other authors (COLLINS and PIERRAKIS, 2012), mere compliance costs with prospectus regulation are between £20,000 and £100,000.

²⁶³ That is to say the German term for equity-based crowdfunding. A complete list of the various European synonyms has been provided in the first chapter.

understand and they could contribute to. Participation and advice favor the creation of a strong bond between the company and the community.²⁶⁴

Given these premises, rules imposing high costs for investors' protection can be relaxed. This is possible because in these conditions a full prospectus becomes less important.²⁶⁵ The internet and the "Wisdom of the Crowd" may supply some instances linked with protection and information disclosure, reducing the costs and the risks linked with the use of this instrument.²⁶⁶

1.4 Secondary market.

The fourth principle consists in the promotion of the secondary market for financial instruments acquired through equity crowdfunding. In order to do so, legislative ties impeding the sale of shares before a fixed period should be completely avoided.²⁶⁷ Generally, those are introduced directly by company laws or by other rules.²⁶⁸

HEMINWAY and HOFFMAN (2011) argue that secondary market restrictions are necessary because resale investors will not have access to the information available to the first buyer²⁶⁹, thus involving higher risks of fraud. In the next paragraphs, the solution to this problem will be set forth.²⁷⁰ Now, it is enough to report that according to BRADFORD (2012), given the small amount of money invested, secondary markets are not likely to sprout outside the platforms where shares were traded for the first time²⁷¹.

²⁶⁴ NASRABADI (2015) explain the different relations between company and investors that crowdfunding introduced. The "Wisdom of the Crowd" (SUROWIECKI, 2005) means investors possess new information and are ready to help the issuer. See NASRABADI A. G. (2015) *supra* note 33 p. 203

²⁶⁵ On this point BRADFORD (2012) p. 142 suggests that, in order to reduce these costs, standardized information should also be avoided, letting issuers evaluate the information displayed on the basis of investors' needs and characteristics.

²⁶⁶ "The need for publication of the prospectus is less in the case of crowdfunding and crowdinvesting because the crowd evaluates the project and the issuer on the basis of the information made available to it and shares its views on the website of the portal. The wisdom of the crowd reduces the need of investors for information on an individual basis and contributes to capital market efficiency." See KLÖHN L., HORNUF L. and SCHILLING T. (2015) *supra* note 186 p. 13.

²⁶⁷ HOPKINS J. & HOPKINS K. (2013) Not All That Glitters Is Gold - Limitations on Equity Crowdfunding Regulations. *Duq. Bus. L.J.* 16(1) p. 16

²⁶⁸ An example of the direct introduction of this prohibition is the USA JOBS Act, while an example of indirect restraint can be found in UK tax law. For more detailed information see Chapter Two.

²⁶⁹ HEMINWAY J. M. and HOFFMAN S. R., (2011). Proceed at Your Peril: Crowdfunding and the Securities Act of 1933, 78 *TENN. L. REV.* 879, 892-906

²⁷⁰ As discussed in Paragraph 3.4, in order to avoid that, platforms also dealing with secondary markets of this instrument should require and save those data. In this way, the information could always be available. - BRADFORD, S. C. (2012)

²⁷¹ See BRADFORD, S. C. (2012) *supra* note 232.

The development of trades between retail and professional investors is necessary to reduce the risk connected to the acquisition of shares in small and medium-size enterprises. As noted before²⁷², illiquidity is one of the biggest enemies of equity crowdfunding.

1.5 State intervention.

The next principle is that each State should directly intervene to protect investors, in a way that does not impose costs on companies. For instance, most startup businesses deal with innovative technologies. Innovation is one of the factors that makes investment in startups riskier. In order to solve this problem, the solution is the introduction of state aid that helps investors only when they receive patrimonial damage.²⁷³

States will in exchange have various benefits from this form of intervention. Indeed, this will be a way to promote and favor the spreading of innovation or to favor the concentration of companies and platforms in their territory.²⁷⁴

1.6 Amount limits.

Providing potentially no limits to the amount of money that could be collected or invested on a crowdfunding platform is the last principle of the desirable regulation discussed in this dissertation. This is a key point of each state’s equity crowdfunding regulation and regards the amount of money that could be sought or given being exempted from the prospectus obligation and other costly requirements.²⁷⁵

As has been highlighted in the previous paragraphs, each State has a certain freedom in establishing this limit. Following the issuer’s perspective, limiting too much *a priori* the amount that could be raised by each issuer would have only negative effects.²⁷⁶ This is true with regard both to the

²⁷² Reference is made to Chapter I, Paragraph 5.2.3.

²⁷³ Reference is made, for instance, to tax relief that could be enjoyed only when the startup fail such as provides the UK investment schemes that has been reported in Chapter II. However, as it will be exposed in the next paragraphs, state intervention should be very prudent. In some cases, ill-considered prescriptions could be more dangerous than beneficial. For instance, in order to be enjoyed, French tax relief requires that investors maintain possession of shares for at least five years.

²⁷⁴ This is what is due to happen in the UK. Most foreign companies decide to set up the company here to have access to the UK’s crowdfunding platform. For instance, this is the case with Primo, a company founded by an Italian team, who used Crowdcube to raise £279,000.

²⁷⁵ For instance, an example of those requirements is MIFID “profiling”. Because of the perspective adopted, this dissertation deals more with obstacle nearer issuers (such as Prospectus Directive disclosure requirements) than duties such the aforementioned regarding more the Investor’s Perspective.

²⁷⁶ See HOPKINS J. and HOPKINS K. (2013) *supra* note 267 p 15.

maximum amount that could be collected by the issuer and the maximum amount that each bidder could invest.

This principle is based on the fact that the market will be able to decide what should be the maximum amount to invest and collect for each project. For instance, a way to achieve this “protectionist result” could be the introduction of disclosure rules proportionate to the amount offered. In general, here too, the wisdom of the crowd will be able to overcome this issue.

1.7 Complementary purposes

Apart from the ones listed above, there are other principles that crowdfunding legislation should follow in order to favor the use of this instrument according to the issuer's point of view. However, those principles are nearer to other perspectives, such as that of the investor or the platform. For this reason, these principles will be regrouped here, affording them merely a brief description.

The first consist of *favoring aware marketing*. Because of the high risk of fraud connected with such investment, a desirable regulation should promote a *fair* use of marketing instruments. Each marketing campaign should expose the characteristics of the investment in a clear and non-misleading way, always showing the risk connected to the investment.

The principle listed before aims at improving the *trust of investors*. Trust is the other fundamental principle that regulation should follow to convince potential shareholders to take higher risks. In doing so, the web is a double-edged sword. On the one hand, it favors the free flow of information so impeding the creation of a market for lemons. On the other hand, it has the potential to become a strong fishing net when used with bad intent. The recommended rules on equity crowdfunding should take consideration of this power, redirecting it towards good purposes.

Finally, regulations should discourage investors as much as possible from moving “off-line” to conclude investment proceedings that started *online*. Doing so, indeed, will cause a waste of money in terms of transactional costs, making the whole operation much less appealing for investors.

2. Good aspects of European and National regulations.

The following paragraphs aim to show the aspects of European and National regulations that respect and follow the Issuer’s Perspective principles listed earlier.

2.1 Higher threshold.

Under the Issuer’s Perspective, the initial aim is to make access to equity crowdfunding as easy as possible. The costs of access to this instrument are the first obstacles from this point of view. Exemption from the Prospectus Directive aims at reducing those burdens. Therefore, the first move should be to use these exemptions as much as possible, and then leave to the market, to the crowd and to the issuers the decision on how much should be raised.

In line with this, as noted in the previous Chapter, UK and Italian Legislation may be cited. Both fixed the exemption threshold at the highest level permitted by the Prospectus Directive: €5 million. In both countries the public will decide if the amount requested is coherent with the project presented. For instance, in Italy, notwithstanding the high threshold, no company launched an offer bigger than €1 million²⁷⁷ and the most successful campaign in the end collected only €502,000.²⁷⁸

It is also important to underline that when a maximum threshold is established, this should be fixed as the same level for all Member States. Indeed, the possibility of modifying this threshold by national legislation causes the territorial limitations exposed in Paragraph 1.1.

After defining a common, potentially high amount that could be collected to gain the exemption from the Prospectus Directive, the introduction of other rules to protect investors will thus also be possible. One of these could be the limitation of the amount sought on the basis of the net capital of the issuer. A similar rule was provided in the old French regulation. There, to acquire a prospectus exemption each company could not seek an amount higher than 50% of its net capital.²⁷⁹ In this way, investors were protected against the higher risks of companies’ failure, requiring them to provide adequate capital if they wanted to seek really large amounts of money.

²⁷⁷ This was the case with Cynny SPA. This company sought this amount twice and on two different platforms, reaching on both occasions less than €120,000.

²⁷⁸ This was the successful and much-discussed case of Paulownia Social Project. Further information is available at <http://www.assitecacrowd.com/progetto/paulownia>. Critics have been moved by some journalist and are available here: http://www.repubblica.it/rubriche/startup-stories/2014/08/26/news/crowdfunding_caso_paulownia-94459210/?refresh_ce – SANTELLI F. (2014) Crowdfunding, lo strano caso di Paulownia, *La Repubblica*. [Online] 26th August 2016. Available at: <http://www.entrepreneur.com/article/254730> [Accessed: 10th January 2016]

²⁷⁹ See HORNUF L., and SCHWIENBACHER A. (2015b) *supra* note 16 p. 14.

2.2 Simple information.

The next step to reduce the costs mentioned above is to guarantee to the public only the information that they need and that they can easily understand. To make this instrument more accessible, issuers should spend as little as possible, in terms of time and money, in disclosure operations. At the same time, the information disclosed should be more understandable by investors, especially retail ones.

The Italian²⁸⁰ and German²⁸¹ regulations introduced two rules in line with this principle. Both provided the obligation for issuers to offer simple but complete information to the public. Italy with a five-page prospectus, Germany with a three-page one.

The final result is the reduction, not only of disclosure costs for issuers, but also of “understanding costs” for investors. Retail investors are a big slice of the crowd. Giving them simple and clear information is the perfect way to protect them while reducing burdens for issuers.

2.3 Proportionate Information.

Some regulations considered the discipline mentioned above excessively hazardous for the investors' protection. For instance, in Italy the five-page rule applies without any consideration of the amount of shares offered. For this reason they have adopted other solutions. Above all, the only rules that match the adopted perspective are those of the USA.

The latter's regulator has followed a *proportionality* principle. The information to be disclosed is proportionate to the amount of money requested. The lower level is a simple certification of the documents by an issuer's officer. The highest one, conversely, requires an audited financial statement. In this way, companies that cannot afford high disclosure costs could also use this instrument to look for a smaller amount of money, while investors are adequately protected.

2.4 Self-certification.

Another way to reduce disclosure costs is providing self-certification for investors.²⁸² This method consists of requiring investors to answer some questions before being able to access the investment. These rules are adopted in the UK and Italy²⁸³ where investors are requested to fill out a questionnaire to give evidence of the understanding of the risk and the possibility of bearing an eventual loss.

²⁸⁰ The details and the model are provided in Attachment 3, Consob Regulation 26-06-2013, n. 18592. Also discussed in Chapter II, Paragraph 1.2.2.1

²⁸¹ Discussed in details in Chapter II, Paragraph 1.5.2.1

²⁸² See HOOGHMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 238 p. 155.

²⁸³ For further details see Chapter II, Paragraph 1.2.2.2

The advantages of self-certification are numerous. The investor is *forced* to understand the possible risks of investing in equity crowdfunding by correctly answering the questions. Otherwise, the platform will not give them the possibility to access the offer. Obviously, the questions should be posed in such a way as to look for investor interaction. Formal questionnaires, such as the ones in which the answers are always “no”, will not have the same effect. In regards to solutions of this kind, some have argued that self-certification is equivalent to having no standards at all.²⁸⁴

LUSARDI (2006) demonstrated that lots of investors do not pay attention to information disclosure.²⁸⁵ Self-certification will solve this problem, giving the possibility to force them to answer some questions regarding the concrete offer before letting them have access to the offer.

A good example of this self-certification process can be found on the UK platform *Crowdcube*.²⁸⁶ First of all, it requires investors to demonstrate a healthy consciousness regarding the risk of the investment. It is designed to make sure that the investor read the questions and answer correctly. Answers are also somewhat tricky. Undertaking this quiz demonstrates that one knows the most important dangers of investing in startups. The first part concerns the investor’s personal knowledge.²⁸⁷ The second one is

²⁸⁴ See BRADFORD, S. C. (2012) *supra* note 232.

²⁸⁵ LUSARDI, A. (2006). Financial literacy and financial education: Review and policy implications (NFI Policy Brief No. 2006-PB-11). Available at: <http://ssrn.com/abstract=923437>

²⁸⁶ For further detail about the platform see: www.crowdcube.com

²⁸⁷ Here is the first part of the questionnaire that people have to complete before the platform lets them have access to the offer.

“Your Knowledge

1. What happens to most start-ups?

a) They fail; b) They’re a success and make investors big profits

2. What happens if the start-up I invest in fails?

a) I am unlikely to get my investment back; b) Crowdcube will pay me back;

3. Will I be able to get my money back whenever I wish?

a) Yes, the company legally must pay me back my investment whenever I want; b) No, typically I will not easily be able to sell my shares unless the company is bought or floats on a stock exchange

4. Do start-ups pay dividends?

a) Yes, I can expect dividends periodically; b) No, generally start-ups do not pay dividends

5. What happens if I invest and the company is successful and I want to sell my shares?

a) Typically, you will not easily be able to sell your shares unless the company is bought by another company or floats on a stock exchange; b) The company founders must buy back your shares by law;

6. What will happen to the level of your shareholding if a company issues more shares in future after you invest?

a) My proportionate shareholding of the company will increase; b) My proportionate shareholding of the company will decrease

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about the investor's job and past economic experiences.²⁸⁸ The website collects investors' answers and remembers them for the next investment. If they fail some of these, the platform will not let investors go on with the investment, but it will give them the possibility to read a short tutorial. After that they can re-answer the questionnaire. Only when the correct answers are given does the platform give the option of investing money in the issuer.

Finally, this mechanism avoids the imposition of "*a cap per investor/participation*".²⁸⁹ Indeed, these regulations do not impose any *a priori* limits on investors, and in this way, do not limit the financial resources available for issuers. On the other hand, risks of fraud are reduced due to the level of investors' understanding and awareness.

2.5 Tax relief

Each State should have an active role on improving crowdfunding by other means, moving forward from the space left empty by EU directives. One of these instruments can be an adequate mechanism of tax relief such as the one provided in Italy²⁹⁰ or the higher one existing in the UK.²⁹¹ For instance, with a relief that reaches, in the worst circumstances²⁹², more than the 75% of the amount invested, the UK protects investors in the best way, sustaining them only in the worst scenarios and encouraging them to use this instrument. It is no coincidence that the UK surpasses all other European countries in the number of campaigns founded and the amount of money collected via equity crowdfunding.²⁹³

7. Which of these is the best method to use when investing in start-ups?

a) Invest all of your money into a single company; b) Spread your risk by investing in multiple companies"

²⁸⁸ Here is the second part of the questionnaire.

"Your Job

1. Have you invested in a start-up, early stage or growth business more than once in the last two years? This could be through Crowdcube, directly, as part of a syndicate or a fund.

a) Yes; b) No;

2. Does the most senior job role you have held fall into one of the categories below?

Managerial or Senior Official (e.g. Sales, Marketing, Finance, HR, Manufacturing, IT Manager / Director; Senior Civil / Public Servant; Armed Forces Officer); Professional (e.g. Finance, Legal, Engineer, Teacher, Public Service or Health Professionals); Technician or associate professional (e.g. Policeman, Engineer's Assistant, IT Help Desk Operator, IT Technician, Nurse, Occupational Therapist etc.); Business Owner.

a) Yes; b) No"

²⁸⁹ See HOOGHMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 238 p. 153.

²⁹⁰ Investment in ISU or I-SME provide a tax relief between 19% and 20% for investment made respectively by physical and legal person. The relief is higher if the companies has a social purpose (from 25% and 27%). However, it should be underlined that the Italian mechanism is not so good. Indeed, it do not contain an additional tax relief in case of failure of the company.

²⁹¹ See Chapter II, Paragraph 1.4.3.3.

²⁹² It is a reference to the additional relief provided in UK in case of failure of the companies in which has been invested.

²⁹³ See the data reported in Chapter I.

The use of this tool grants each state benefits in many cases. First, because it helps the entrepreneurial panorama of its country, creating new jobs and all the macroeconomic implications connected thereto. Second, if a non-harmonized regulation persists, that State will attract more companies from all over the world.

Finally, the benefits for the issuers are also clear: the higher the success rate that such a policy participates in creating, the more the costly authorization process will eventually be compensated.

2.6 Other solutions

Some Member States tried to favor the development of different “models” to aid the financing of companies while protecting investors. The most profitable case can be found in Germany. Here the use of another “investment model” became famous: the Profit Participation Loan. As seen in the previous chapter, this model was born spontaneously in the attempt to avoid the low threshold of €100,000 provided by the German Regulator. In this way, issuers were completely exempted from the prospectus requirements.

When German lawmaker understood the success of this scheme, they decided that it could be excessively dangerous to leave this instrument without regulation. Therefore, they covered this scheme under the existing regulation for equity participation. However, the regulator decided to be more “clement”, providing bigger exemptions for those who used this instrument. So, while it left untouched the exemption regarding the offering of shares, it provides a more permissive regulation for PPL. A reason for that should be an evaluation of the major safety of this instrument compared with the issuing of shares, although on this point some authors maintain the opposite view.²⁹⁴

2.7 Other perspectives

There are other aspects of the legislation analyzed in the previous Chapter that can be highly useful in fostering crowdfunding but that deal more with other perspectives. For this reason, here too, these will be quoted briefly for their capacity to bring indirect benefits to companies.

Platforms have a relevant role in fostering crowdfunding. Some dedicated legislation will help the development of these equity intermediaries. They have an active role in marketing and in developing

²⁹⁴ The reasons for such an assumption are the following. First, KLÖHN, HORNUF. and SCHILLING (2015) affirm that PPL and similar instruments, apart from being risky investments, in addition, are not protected by the rule of corporate governance existing for silent partnership. Moreover, it is difficult to distinguish silent partnership from PPL and the like, and this tends against the creation of a reliable legal framework. Finally, this option is also not adequately safe for investors because the platform will not pursue the benefit of investors that could be achieved only through a silent partnership. To maintain its offering volume, the platform will not be interested in favoring exit strategies that would mean turning the PPL into a silent partnership. - See KLÖHN L., HORNUF L. and SCHILLING T. (2015) *supra* note 186 p. 14

each single campaign. Indeed, most of them maintain many profitable relations with professional investors. For this utility, they deserve legislation completely dedicated to a platform based on the French or the Italian example. In this way, platforms can enjoy a legislation lighter than the one provided for other investment intermediaries. In addition, when the accreditation procedure is complete, the French rule of distinguishing the approved platform with a *label* is a choice that will help investors to increase their trust and so the amount invested, with accompanying benefits for issuers.

On the basis of the same principle, company law rules that grant investors specific rights should be favored. In this group, there are tag-along clauses and withdrawal rights as the ones provided in Italian regulation. These instruments will increase the trust of investors and so their participation in crowdfunding campaigns, reducing the risk of their investments.

3. Bad aspects of European and National regulation.

In this section, conversely, the aspects of the European and National regulations that do not favor the adopted perspective will be reported. In addition, it will be highlighted that in some cases, even the interests of platforms and investors are damaged.

3.1 Limiting “who” can use crowdfunding.

In some regulations, equity crowdfunding is considered under a wider set of rules to favor their economic development. For this reason, this instrument is granted only to some kinds of companies together with other advantages such as tax relief, registration duty discounts, and access to advantageous loans.

For instance, the Italian legislation, as pointed out in the previous Chapter, reserves the use of crowdfunding only to “innovative businesses”. Therefore, issuers are forced to acquire a particular status to offer shares on a crowdfunding platform. However this approach needs to be criticized. *Innovative* can be a particular characteristic of companies and can also be considered as a signal of its potential profitability. It cannot be viewed as a filter to permit the use of this instrument only by some companies. The crowd and the market should have the duty to evaluate the profitability of their investment, without forcing it to be linked with *innovation*.

It is clear why under the Issuer’s Perspective these rules are unacceptable.²⁹⁵ In the paragraph above, the benefits of crowdfunding have already been described and it was clear that those benefits are not limited to certain predetermined companies. Discrimination of this kind is only a way to make access to this instrument more difficult and to force companies to use crowdfunding in another Member State.

In the following paragraph it will be argued that perhaps this rule is the reason why Italy was the first European State to regulate crowdfunding but also the last in terms of using it, compared with any other major European country.²⁹⁶ This position can be validated because Italy is the only European country analyzed which has adopted this particular rule.

²⁹⁵ That is also true for other Perspectives. Investors should have more investment opportunities and the possibility of choosing the risk level to bear. Indeed, although investment in startups is potentially more profitable, investment in non-innovative SMEs is less risky. Not extending the use of crowdfunding to those companies too, is a limit on the investor’s freedom. On this point see ALLEGRINI F. (2015b) Come migliorare il regolamento dell’equity crowdfunding in Italia. *Crowdfunding Buzz* [Online] 15 February 2015. Available from: <http://www.crowdfundingbuzz.it/come-migliorare-il-regolamento-dellequity-crowdfunding-italia/> [Accessed: 20th December 2015]

²⁹⁶ The articles that sustain this position are numerous. For instance see: ALLEGRINI F. (2015b) Come migliorare il regolamento dell’equity crowdfunding in Italia. *Crowdfunding Buzz* [Online] 15 February 2015. Available from:

3.2 Forcing specific investors.

Some legislations require, for the success of the campaign, the participation of a specific “classes” of investors. For instance, as shown in the previous Chapter, this rule is also present in Italian regulation. Here an institutional²⁹⁷ investor is required to subscribe at least 5% of the amount offered.²⁹⁸ Without this, the campaign will be declared failed, no matter how much has been subscribed by other investors.

Because of the perspective adopted, such a rule needs to be criticized.²⁹⁹ The first reason is that institutional investors follow investment strategies that are different from others, especially retail ones. This logic affects the different choices that they take. The result is that a risky investment could be supported by a “professional” investor without that fact representing a guarantee for the others.

Another reason is linked with the amount/portion of the offer that institutional investors are required to subscribe. In some cases, indeed, investors of this class can find a business not to be worthy because the money that they are “required” to invest cannot grant the returns they expected. For instance, in a campaign where a total amount of €100,000 is offered, a professional investor is required to invest at least €5,000, that is to say a very small amount of money that will not grant a return able to repay the cost of analyzing the opportunity of the investment itself.³⁰⁰

Finally, this mechanism is also a source of confusion and misinformation during the campaign. Because the clause says “5% of the collected money” and there is often a high divergence between the fixed goal and the funding limits investors and issuer will not know whether the campaign is successful until the last moment. To explain this concept it may be useful to consider the following example. Considering a campaign in which the funding goal is 100 and the funding limit is 200 means that, when the amount of 100 is reached, all the money collected between 100 and 200 will be taken by the issuer. Now suppose that 95 has been collected only by retail investor and the institutional one

<http://www.crowdfundingbuzz.it/come-migliorare-il-regolamento-dellequity-crowdfunding-italia/> [Accessed: 20th December 2015]

²⁹⁷ In this case, “institutional” refers to class of investors who hold this status if they respect the conditions provided in the law.

²⁹⁸ A critic of this rule can be found in AIEC(2015) *supra* note 156.

²⁹⁹ According to some expert this rule is not a real obstacles for any crowdfunding campaign. It has been argued that less than 5% (on 30 projects published) of Italian crowdfunding campaign fails for this reason.

Web interview at F. Allegreni and A.M. Lerro. Available at <https://www.mixcloud.com/radiostonata/radiostonata-oggi-crowdfunding-crowd-advisors-equity-consob-alessandro-lerro-13012016/> [Accessed 13th January 2016]

³⁰⁰ See ALLEGRENI F. (2015b) *supra* note 295.

invested the required percentage, i.e. 5. If one second before the close of the campaign, one retail investor decides to invest whatever amount, the campaign will (absurdly) fail.³⁰¹

In more general terms, the amount requested from the professional investor changes over time. Therefore, while it may not cause the failure of the campaign, the result of this rule is the creation of more uncertainty, both for investors and issuers.

3.3 Cap on investment participation

As mentioned earlier, some legislations require a limit on investor participation.³⁰² In other words investors cannot give issuers more than a prescribed amount for the same campaign. The purpose of this rule is to reduce investors’ risk by forcing them to diversify their investment. But forcing diversification it is not the right way to reduce risks that retail investors face. To reach this result, they should formulate investment strategies and bear costs that only professional investors could afford.

Other solutions can better achieve the same protective purpose. One of them is the imposition of a maximum investment amount per year, proportionate to the investor’s net income. The important fact is that it will be not limited on the basis of the potential receiver. Another is the self-certification mechanism discussed in Paragraph 2.4. HOOGHMSTRA and DE BUYSERE (2015) argue that, considering the investors’ protection, the benefits of imposing such caps are even lower than the ones reached via other solutions.³⁰³ In addition, often, forms of legislation of this kind do not distinguish between retail and professional investors while the latter already follow some portfolio strategies.

Therefore, these limitations are damaging under the proposed perspective and, in addition, not desirable for some classes of investors. The only notable result is less money for issuers.

3.4 Restriction on the secondary market

As anticipated above, regulations of some States restrict the secondary market in different ways. Sometimes, those limits are provided expressly in the laws that regulate crowdfunding.³⁰⁴ At other

³⁰¹ There are numerous examples based on that principle. Another is the case in which the funding limit is reached only by retail investors before the expiration of the campaign. Here, the company will need to issue more capital and to modify its offer on the run, to “give more space” to professional investors. But to do so, the issuer needs the approval of its general meeting and of the platform. The direct result is also, in this case, uncertainty and confusion.

³⁰² Further information in Chapter II.

³⁰³ See HOOGHMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 238 p.153.

³⁰⁴ For instance, the USA regulation forbids the transfer and the sale of share for one year. See SCHWARTZ, A., (2013) p. 1463

times, regulations do it indirectly, for instance, by providing some tax benefits for investors that hold their shares for a fixed period of time.³⁰⁵

The major reasons for limitation of the secondary market are linked with the risk of fraud. The aforementioned regulations limit the resales of shares for a fixed period of time because the re-buyer will acquire less information than the first who enjoyed all the benefits from the disclosure mechanism on the platform, during the campaign.³⁰⁶ But, against this problem, many solutions could be taken into consideration. One might be the request to the crowdfunded company to gather and store all the information already disclosed on its website and update it. A similar obligation would be imposed on the provider in charge of managing the trading for a secondary market.

In some other cases, limitations on re-sale of shares are the effect of tax relief policy. Here those reliefs are granted only to whoever holds his shares for a certain number of years.³⁰⁷ In this way, people are induced not to sell their shares before the time period expired in order to enjoy some tax benefits.³⁰⁸

All these rules will slow down the development of a secondary market for shares acquired via crowdfunding. Due to the fact that it deal with shares in SMEs, a secondary market in equity crowdfunding, that naturally develops, is a difficult phenomenon to bring to fruition. GREEN (2015) argues that this is because early stage startups do not possess track records and, in addition, there are small information flows that have an important “missing” role. In this way it becomes difficult to trace and define equity prices.³⁰⁹

At the end of the day, illiquidity instead of being reduced, paradoxically will become bigger and, conversely, investor participation will not increase, with clear damage for issuers.

³⁰⁵ This is a reference to France and UK legislation, as highlighted in Chapter II.

³⁰⁶ See SCHWARTZ A. (2013) *supra* note 211.

³⁰⁷ For instance, UK legislation requires the investor to hold their share for at least three years, while France does so for five. In some case, as in the UK, the benefits are maintained if the sum received in advance is re-invested in the same categories of share. However, this does not let the “second buyer” acquire the tax benefits granted to the first.

³⁰⁸ Moreover, based on the percentage of tax relief granted, the “frozen period” expiration, can influence the price of the shares possessed. For instance, if the title price was 100 and the buyer enjoyed a tax relief of 30%, the owner would be interested in selling them even at 70. This is truer also because the buyer will not get the tax relief. The final result is also a negative effect on the share value. GREEN H. (2015). What will secondary markets look like in crowdfunding and P2P? And what should investors be thinking about? *City A.M* [Online] 24th November. Available from: <http://www.cityam.com/229070/what-will-secondary-markets-look-like-in-crowdfunding-and-p2p-and-what-should-investors-be-thinking-about> [Accessed: 18th January 2015]

³⁰⁹ *Id.*

4. Final suggestion for a possible harmonization.

4.1 Why harmonization

It has been underlined how European legislations on equity crowdfunding are diverse and how these differences limit the territorial use of this instrument.³¹⁰ These differences are in general caused by different implementation of European Directives and also by different national company law.³¹¹

The same opinion has been shared by the European Commission that has made clear how non-harmonized equity crowdfunding regulation can fragment the internal market, so limiting the cross-border use of this instrument. The result is damage for the potential growth of the capital market in Europe.³¹²

Therefore, from the Issuer’s Perspective, the intervention of different regulators is necessary to abolish or reduce these differences.³¹³ Harmonization is a desirable result to improve cross border use of this instrument, having as its final effect the growth of the financing instrument available for companies.³¹⁴ Obviously, each lawmaker should be prudent in performing this operation. The reason is to avoid the killing of equity crowdfunding while “*it is still in its crib*”.³¹⁵

4.2 The final proposal

On the basis of a completed analysis, the final step is the suggestion of a possible “*set of common rules*” to favor equity crowdfunding development. The suggestion addresses, first of all and for some aspects, the European regulator in preparation for its possible intervention on this issue.³¹⁶ In addition, it directs national lawmakers that have not yet regulated crowdfunding, or that would like to improve the use of this instrument within their territory.

³¹⁰ See HOOGHMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 238.

³¹¹ In this group, tax legislation plays also an important role. This is, for instance, a reason for arbitrage or concentration of the use of this financing instrument in a country with higher tax relief with regard to other Member States. This influences companies in regard to where to create a company. See EUROPEAN COMMISSION (2014) *supra* note 237 p. 9.

³¹² *Id.* p 8.

³¹³ See HOPKINS J. & HOPKINS K. (2013) *supra* note 267 p 17.

³¹⁴ See EUROPEAN COMMISSION (2014) *supra* note 237 p. 8.

³¹⁵ ENRIQUES L. (2012) used this term referring to the premature crowdfunding Italian legislation that overburdened crowdfunding development.

³¹⁶ This intervention is still only a possibility, as showed in the official website of the European Commission. Notwithstanding this, during the 4th European Crowdfunding Network Convention, it has been highlight that Crowdfunding industry would need more “*agreement on the exemptions from EU regulation*” than “*more layers on top of local regulation*”. - TORRIS T. (2015) It’s a Long Way to European Equity Crowdfunding Regulation. *Crowdfund Insider*. [Online] 30th October 2015. Available from: <http://www.crowdfundinsider.com/2015/10/76509-its-a-long-way-to-european-equity-crowdfunding-regulation/> [Accessed: 25th January 2015]

4.2.1 Fixed threshold

The first requirement contained in these rules should be the fixation of a unique common threshold to be exempted from the Prospectus Directive. For instance, it can be fixed as the maximum amount permitted by this Directive, that is to say €5 million. Considering the average amount of money collected using equity crowdfunding³¹⁷ until now, the fixation of a “high” threshold is not important, compared with the necessity to have it “common and fixed”. In doing so, the territorial limitations caused by *that* freedom³¹⁸ of each Member State can be avoided. Indeed, the issuer, the market and the wisdom of the crowd will be able to establish the most adequate amount to collect in the specific case.

4.2.2 Proportionate disclosure principle.

The second rule should be the adoption of a *proportionate disclosure principle*. In this way, it is possible to achieve the reduction of the risks of fraud without burdening the issuer with costly disclosure requirements. This means the creation of different levels of disclosure based on the value of shares offered.

For instance, inspired by the European regulations analyzed, a good application of this principle should require a really cheap but effective disclosure condition for the first rung. The amount of information disclosed shall be limited to the three-sheet paper required by German Law.³¹⁹ In this way, the reduction of the costs for both issuers and investors can be achieved.³²⁰

In deciding where to place the first step, inspiration should be taken from the old French regulation. These rules imposed a threshold proportionate to the issuer's capital and it was equal to 50% of its net assets. In other words, a company with capital of €500,000 should respect the minimum disclosure requirement if it wants to collect less than €250,000. In this way, the issuer could provide the necessary guarantees to protect investors. This should be permitted until the amount of €1 million is sought. This is in line with the current French regulation that allows exemptions from the Prospectus Directive when the amount of shares offered on the platform is under the aforementioned amount.³²¹

The upper limit of a potential second rung should be fixed at €2.5 million, which is also the current German limit for the use of equity crowdfunding with PPL. At this level, a higher level of information

³¹⁷ Data available in the Chapter I, Paragraph 6. The average is near €150,000.

³¹⁸ The reference is made to the freedom to fix the exemption threshold from the Prospectus Directive between €100,000 and €5 million.

³¹⁹ More information in Chapter II, Paragraph 1.5.2.1.

³²⁰ As emphasized in Paragraph 2.2 the former will have to satisfy fewer disclosure requirements, the latter will have access to simpler documents, easier to understand.

³²¹ More information in Chapter II, Paragraph 1.3

should be required from the issuer. Looking at the USA’s experience³²², a financial statement reviewed by a public account can favor enough investors, especially professional ones, which could better evaluate the financial situation of the company.

Between €2.5 million and the maximum amount exempted of €5 million, as per the current UK and Italian legislation fixed limit, it will be possible to request a higher disclosure requirement. At this stage, following the USA example, an audited financial statement could be a reasonable duty to protect investors and give them enough guarantees without being too burdensome for companies.³²³

4.2.3 Self-Certification

Sharing the point of view of HOOGHMSTRA and DE BUYSERE (2015), limits on investment in relation to the same project shall be removed. Although other rules will have the same level of efficacy, relying on the UK and Italian models, a self-certification process could be the cheapest way to protect retail investors from an issuer’s point of view.

Indeed, imposing a cap, especially if excessively low, means also forcing the investor to differentiate their investment.³²⁴ In addition, according to the adopted perspective, it means lesser opportunities for the issuer to reach his funding goal. To avoid all these issues, due to investment limitations based on investor protection, a self-certification process could be sufficient to achieve the same purpose. The key element is that the investor clearly understands how high is the risk of losing all the capital.³²⁵

4.2.4 Adaptation of Company Law

Finally, the company law of each Member State should be adapted to make the path for the application of the rule mentioned above as smooth as possible, avoiding eroding the benefits granted by European Directives.

³²² As discussed in Chapter II, Paragraph 2.2.

³²³ As discussed in the previous Chapter, this level of disclosure is requested in the USA for firms that want to collect more than \$500,000.

³²⁴ Previously discussed in paragraph 3.3

³²⁵ Of the same opinion HOOGHMSTRA and DE BUYSERE (2015) (p. 156), proposing the introduction on a pan-European basis of self-certification and investors’ information. A quiz or a film is suggested to make this certification and let unsophisticated investors understand the risk associated with the investment. According to the author, the quiz or the film should be the condition to allow investment below €1 million. To invest between €1 million and €5 million, the authors suggest a document under the PRIIP-Regulation, that is to say, a simple document, with maximum five pages, with simple information regarding the issuer, the kinds of business, and any past performances. In this way, according to the author, this is a possible harmonized solution to repeal the prospectus exemption under €5,000,000.

Taxation law³²⁶ should also be considered to support the development of crowdfunding in other ways. An example could be the use of larger tax relief following the UK example or something more moderate as in the Italian rules. If states want to promote the use of crowdfunding, in order to foster their entrepreneurial background, each of them should be disposed to renounce some tax revenues and participate in the reduction of the investors' risks.

4.2.5 Complementary Provision

In addition to the ones listed above, a number of other provisions would push the development of the equity crowdfunding industry. All these provisions are complementary to the ones already listed because they either regard other perspectives or they would be better applied by each single Member State without affecting the harmonized framework. The following are the most relevant ones.

The first regards the introduction of common rules on the promotion regime. In this way, companies should not be forced to adapt their marketing campaigns on the basis of the legal requirements of each Member State.³²⁷ For instance, one can suggest the introduction of advice to be inserted in all the ads to show the risks of losing all one's capital, on the example of the German regulation.³²⁸

Another important rule should impose the obligation of setting a minimum funding goal for companies.³²⁹ In this way, each firm will be forced to provide a request proportionate with the project they want to develop. Moreover, from this point of view, a rule that establishes an equal relation between funding goal and funding limit is also desirable. In this way, one will eradicate the risk of a substantial transformation from the All-Or-Nothing model into the Take-It-All one³³⁰, as shown in the first Chapter.

³²⁶ See HOOGHMSTRA S.N. and DE BUYSERE K. (2015) about how national company law limits equity crowdfunding. On p. 157 he also suggest the introduction of a "relatively cheap regime for crowdfunding" in the company law of each state. - HOOGHMSTRA S.N. and DE BUYSERE K. (2015)

³²⁷ Generally speaking, this theme can be viewed as strictly linked with the self-certification principles discussed above. If those rules are applied in the best way, excessive restriction on the promotion regime can be avoided.

³²⁸ More information in Chapter II, Paragraph 1.5.2.1

³²⁹ The HOOGHMSTRA and DE BUYSERE (2015) suggests a fixed funding goal. According to the adopted perspective, a simple "minimum" could be enough, so letting companies to choose a higher one. Setting the right funding goal has an important function in setting up the crowdfunding company. Higher funding goal creates more trust with investors, especially if this funding goal is proportionate to the project. When the funding goal is not reached, money is remitted to the people concerned. For further information see Chapter I, Paragraph 3 - HOOGHMSTRA S.N. and DE BUYSERE K. (2015) p.156

³³⁰ This was the case with Cynny SPA, an Italian startup that tried equity crowdfunding twice in two different platforms. Its main characteristic was the setting of a low funding goal and a high funding limit. Moreover the platforms that was chosen did not make clear if the amount reported was the funding limit or the funding goal. The result was misinformation for the confused investor. They were not going to have their money back if the amount displayed in the platform was not going to be reached. This was because the minimum amount for the "success" of the campaign was so low, that could be satisfied with a single bid. This system was not clear without reading the five-page document and all the others related information

Finally, from the issuers’ perspective too, a passport for EU platforms is a desirable harmonized law that should be introduced. The current regulation forces platform to comply with the foreign member-state law in which it wants to operate. The result is that platforms are not all open to foreign companies. For instance, Italian companies cannot raise money on Crowdcube³³¹ unless they set up a UK branch. From an issuer’s perspective, companies coming from different countries might not have access to the community that they prefer. Lack of harmonization, from this point of view, could cause business limitation for some companies that will be forced to set up an enterprise in another country. It could also foster the concentration of companies and platforms only in some Member States.

5. Conclusion

In the first Chapter it has been shown what equity crowdfunding is and the distribution of its use in Europe, given by market data. In the second Chapter, the legislation of the major European countries has been analyzed. In the last, the Issuer’s Perspective has been adopted and, on this basis, European legislation has been classified as good and bad in terms of whether or not it has respected those principles. Finally, thanks to that classification, a final set of rules to improve the use of Equity Crowdfunding has been suggested.

At the end of this analysis, it is useful to highlight the relationship between market data and crowdfunding regulations, that is to say, between rules and results achieved. It can be noted that the ones classified as “good rules” are present for the major part in the UK and Italy³³², while the “bad ones” can mostly be found only in Italy.³³³ In other countries (Germany and France), conversely, the regulation analyzed can be defined as “moderate” because their rules were classified as neither good nor bad.

It becomes evident that in Italy, notably bad results are also related with “bad regulation”. In Germany and France, a “moderate regulation” is linked with reasonable results. In the UK a “good regulation” is associated with extraordinary results. For all these reasons, when a lawmaker looks for a crowdfunding regulation, it will find the answer to its doubts simply by looking for the results that they would like to achieve. Here, some of the possible answers have been highlighted.

presented in the platform. The result was the transformation of a typical “All-Or-Nothing” into a hidden “Take-It-All” campaign.

³³¹ More information available in the web site of Crowdcube at <https://www.crowdcube.com/how-crowdcube-works/raising-finance/equity>

³³² As revealed above, this is a reference to the highest threshold and the self-certification.

³³³ As noted in the paragraphs above, those rules concern restriction on issuer participation and the necessary presence of institutional investors.

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