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MARKET ANALYSIS, ECONOMICS AND SUCCESS DRIVERS OF EQUITY CROWDFUNDING

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Introduction

The main scope of this dissertation is to identify which are the determinants on equity crowdfunding development from two different points of view: (i) the one of the market; and (ii) the investor one. In order do so, Chapter 1 describes equity crowdfunding and its more relevant dynamics; Chapter 2 deals with factors determining equity crowdfunding market development; Chapter 3 identifies the drivers that attracts investors participation, testing its theoretical findings in the case study of Chapter 4.

Chapter 1 – Equity crowdfunding

1.1 Definition and origins

According to the Oxford Dictionary, crowdfunding is "*the practice of funding a project or a venture by raising many small amounts of money from a large number of people, typically via the Internet*" [1]. In other words, crowdfunding could be defined as an innovative financing method that uses Internet as a vehicle for raising capitals from a wide public.

Crowdfunding is a particular form of crowdsourcing. This term was firstly used by HOWE in 2006 [2] and describes the practice of obtaining needed services, ideas, or contents by soliciting contributions from a large group of people – the crowd - especially online. [3]. In this sense, crowdfunding can be defined as the particular form of crowdsourcing in which the crowd participate mainly giving money for the development of ideas and projects.

Although the word "crowdfunding" was created less than 10 years ago, the essence of what this idea represents dates back to almost one and a half century before. One of the most relevant and old phenomena that could be assimilated to a crowdfunding experience was indeed initiated in 1885 in New York, when the Statue of Liberty arrived from France. The 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 $100,000 [4] 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

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[1] The Oxford Dictionary of Modern English, 2014.

[2] HOWE (2006), *The Rise of Crowdsourcing,* Wired. Available at https://www.wired.com/2006/06/crowds/

[3] 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.

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

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 crowdfunding. At the time, the role that now is covered by the Internet, was achieved using another mass media: the newspaper. So 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 and virtual communities. Each individual supplies a small amount of money to give funds for the undertaking of a specific project. But the innovation of crowdfunding does not end with the collection of money. According to NASRABADI A. G. (2015), the potentials of this financing method are intricately linked with the interaction of financial, technological and, especially, social aspects. Indeed, as will be detailed in the following paragraphs and chapters, sometimes the financial aspect plays only a secondary role in this environment. [5]

Crowdfunding generally involves the participation of three subjects: (i) the creator of the crowdfunding campaign, that seeks funds for his project or his company; (ii) the contributors; and (iii) the manager of the crowdfunding platform.

The creator of the funding campaign, hereinafter generally referred as the *promoter*, is the subject, a single person or a company, that needs an amount of money for the developing of a specific project. Depending on the specific crowdfunding model considered, it could be referred to in different ways. For instance, he is named "issuer" in equity crowdfunding, simply "creator" in reward and donation crowdfunding and "borrower" in lending crowdfunding.

The contributors are the generality of people that decided to help the creator to develop the presented project. They send money to the creator of the campaign in exchange of something that may differ on the base of the crowdfunding model adopted. Also to contributors can be associated different names on the base of the

[5] *See* WILLFORT R. AND WEBER C. (2016) *supra* note 3, p. 205.

crowdfunding model in which they participate. For instance, they are “investors” in equity crowdfunding, “donors” in donation crowdfunding or “lender” in lending crowdfunding.

The manager of the crowdfunding platform, hereinafter generally referred as the *crowdfunding platform* is the intermediary of the financing operation. He is usually the owner of an online platform on which the promoter publishes his project in an appealing way, using video, photos or documents, in order to gather supporters, willing to participate in the endeavour. Each crowdfunding platform has in common the fact that the homepage of the website presents all the projects seeking for funds, linking to a specific page of the platform dedicated to the single project. This page contains a presentation video and a thorough description of the idea and of the people behind it. Depending on the specific crowdfunding project, this page contains also a pyramidal list of “prizes” [6] associated with the amount of money contributed to the project. In addition, there is also a specific section dedicated to the communication with the community where the promoter can sent updates and the contributors can ask questions. In summary, the crowdfunding platform has the important role of giving the project the possibility to be viewed by a wide public of potential contributors while giving them the possibility to capture all the relevant information regarding the project, interacting with each other and with the promoter directly.

1.2 Classification

Crowdfunding could be classified considering at least two variables. First it is possible to distinguish several crowdfunding *models* in which what vary is how to reward each contributor. Secondly is also possible to classify crowdfunding on the basis of what happen if the amount of money requested is not reached.

1.2.1 Equity crowdfunding and other crowdfunding models

The principal crowdfunding model that this dissertation is going to analyse is equity crowdfunding, it could be useful to understand better its functioning to rapidly enlist also the most common crowdfunding models that with equity crowdfunding creates

[6] As indicated in paragraph 1.2.1.2 below, the specific term usually is “perks”.

the category of the alternative finance instrument. This is more truer also because some important implications of equity crowdfunding can be understood only by reference to other crowdfunding models. In particular, above all, reward crowdfunding merits a more specific reference. This choice is based on the fact that most aspects of equity crowdfunding are also present in reward crowdfunding but not vice versa. Therefore, this could be fundamental to explain better some equity crowdfunding principles.

Crowdfunding models differs and could be classified on the base of how the money is gathered. For instance, some of them have a simply *do ut des* structure, so that contributors get something concrete in return for their participation; others are simply aimed at building something bigger together, getting investors involved in the project itself without giving them nothing in exchange for their monetary participation. Understanding what the participants get in exchange for their contribution is important also to understand the regulation (existing or not) that could be applied to that model.

1.2.1.1 Donation Crowdfunding

Donation crowdfunding is the model in which participants do not receive anything for their participation, or at least nothing that is different from the gratitude for having participated to solve a civic or social problematic. [7] It is the simplest crowdfunding model.

Donation crowdfunding 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. [8]

This type of campaign usually does not entail remuneration of the donors, aside from the moral reward they would get from their good deed. For this reason, donation crowdfunding suits more social or civic projects and it is not usually adopted to fund an entrepreneurial one. Apart from that, it could be an useful instrument to help

[7] *See* PIATTELLI U. (2013) *supra* note 4, p. 10.
[8] *Id*

bringing the development of the public endeavour to a quicker completion, relying on the citizens' generosity. [9]

1.2.1.2 Reward Crowdfunding

In *reward crowdfunding*, contributors receive always something *concrete* in exchange for their participation. This is generally indicated using the term *perks*. Perks can be both promotional gadget created for the campaign by the promoter (i.e. t-shirt, mugs, etc.) but specially future products that the promoter is going to trade using the funds collected with the crowdfunding campaign, realizing a real pre-sale of a product that in some case, does not still exist. [10] Perks would vary in quality and quantity in relation to the given amount. 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 may become the sponsors of the project.

Reward crowdfunding represents the archetypical design of equity crowdfunding in his role as an innovative financing method [11]: 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. The entrepreneur does not need to apply for banks loan or government subsidies proving complex material or solid guaranties to be funded, nor there is no need to interact with big entities, such as venture capitalist, eager to take over the project and intruding on their future decision-making process. The general public, the crowd, will be their main counterpart in the venture. This has lots of positive effects, resulting, most of the time, the crowdfunding campaign a sort of preselling of the products that the promoter wants to develop. From this point of view, the crowd is fundamental in reward crowdfunding not only helping with the project-financing, but also giving the promoter a first reaction and evaluation of the idea he is developing.

There is, also, no obligation to give the money back if the promoter fails in developing the project. In some country, on the base of the extension of each

[9] *Id*
[10] *Id* p. 12.
[11] *Id* p. 11.

consumer legislation, indeed, the obligation to give the promised perks is only a moral duty, not always being legally binding such as when it is provided by the terms and conditions of the crowdfunding platform. [12]

1.2.1.3 Lending Crowdfunding

Lending crowdfunding, commonly referred as social lending or peer-to-peer lending, is deeply diverse form the ones described above both for its structure and its aim. [13] All around the world it is the alternative financing instruments that is collecting more money and it is maybe the only one so strong that could compete with traditional financing instrument such as banks loan.

In lending crowdfunding, the promoter receive money from the crowd, promising to give them back after a certain period of time and paying also a fixed interest. Lending model is based on a loan made without any traditional financial intermediary between lenders and borrower. The only intermediary is the crowdfunding platform that, giving access to its online portal, gives the possibility to the borrower to promote its investment project. The platform validates it, dealing with security and financial solvency checks of those future debtors. Platforms usually set a framework for the contractual terms and conditions and organize the repayments.[14]

On the base of the concrete business model adopted by the crowdfunding platform, lending crowdfunding can be less risky in respect to the other crowdfunding models. This is the maybe the reason of its success. Indeed, in some case lenders have their investment automatically diversified by the platform that allocate the money received among several different borrowers. The lenders set the level of risk and the interest rate in which they are interested and the crowdfunding platform allocates the money following lenders request. In addition, the platform may cover the residual risk using particular insurance agreements. In other business models, instead, the platform

[12] ARMOUR, J. and ENRIQUES, L. (2017), *The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts*, ECGI - Law Working Paper No. 366/2017, p. 18. Available at SSRN: https://ssrn.com/abstract=3035247

[13] *See* PIATTELLI U. (2013) *supra* note 4, p. 13 - 14.

[14] EBA (2015), *Opinion of the European Banking Authority on lending-based crowdfunding*, p. 9. Available at https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-03+%28EBA+Opinion+on+lending+based+Crowdfunding%29.pdf

shows the suitable project and the lenders decide directly in which project is more safe and convenient to invest.[15] There are also others that may include, for instance: an auction-based mechanism, where lenders bid between themselves in auctions to be able to offer the lowest interest to the borrower; or the cooperation with a credit institutions which provides the loans so that as soon as the campaign target is reached, loans are then passed on to the lenders who become entitled to the repayments. [16]

The aim of a lender is of course that of getting a financial return from the capital he invested onto the marketplace, helping, at the same time, enterprises starting and improving their businesses without having them recurring to banks or other traditional institutions.

1.2.1.4 Equity Crowdfunding

Equity crowdfunding [17], also referred in the literature as crowdinvesting [18], investment-based crowdfunding [19] or securities crowdfunding [20], the exclusive model studied with this dissertation, could be defined as the crowdfunding model in which a contributor get in return of their monetary participation the possibility to be part of the company that he has supported.

This means that (i) the contributor became a proper *investor* or *shareholder* in the crowdfunded company and (ii) each contribution can be used to buy *participations* or *shares* in the company. Equity crowdfunding is the only crowdfunding scheme that lets contributors became real partner of the company they are giving money to.

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[15] *Id*
[16] *Id*
[17] *See* PIATTELLI U. (2013) *supra* note 4 p. 14.
[18] This terms is used by KLÖHN and HORNUF in KLÖHN, L. and HORNUF, L. (2012) *Crowdinvesting 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) *Crowdinvesting – Angel Investing for the Masses?*, working paper. Available at: http://ssrn.com/abstract=2401515
[19] 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'."
[20] KNIGHT, LEO and OHMER 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.

Through the use of the equity crowdfunding platform, the issuer presents its company's businesses model so that investors could evaluate the profitability of becoming new partner of that company. Depending on the platform and on the legislation in force, it may be possible that only investors with specific capital requirements may contribute in that crowdfunding campaign. [21] This sum will *de facto* represent their share of capital conferred to the issuers' companies. Nevertheless, the newcomer investor is not considered always as a fully-fledged partner, since the company could establish some limitation in the participation acquired such as no voting rights.

Starting an equity crowdfunding campaign requires amendments to the company's bylaws and article of incorporation, with possible influences on the company's financial structure. Indeed, the company has to decided: (i) the percentage of company's capital to be offered for subscription; and (ii) the minimum participation that is required to be invested to became shareholder of the company. These decisions involve the convey of an extraordinary shareholders meeting voting on the issuance of new shares and so on the above mentioned amendments to the company's bylaws and article of incorporation. At the end of a successful equity crowdfunding campaign, the financial structure of the company will be modified to take in consideration the increase of company's equity.

In addition, an equity crowdfunding campaign involves also company evaluation, defined as "pre-money". This is simply the value of the company before it receives the funds deriving from a successful equity crowdfunding campaign. It is used to give investors a prior idea about the value of the company and it is also used by the directors of the company to define the share premium. This is represented by the difference between the face value of the share and its price. In other words, it is the value that exceed the face value that the company receive for its shares.

What makes equity crowdfunding so innovative - in respect with other *traditional* financing methods that involves the issuance of share to the public, such as IPOs - is the fact that the use of the Internet and of online platforms reduces the transaction

[21] See for example US regulation, that under some condition let only *accredited* investors to participate in the equity crowdfunding campaign. This aspect, with its economic consequences, will be analyzed more in deep in Chapter 2.

costs of raising fund. Those fixed costs are the traditional impediment against the offering of shares of small companies to the general public. [22]

In addition, equity crowdfunding could become a viable alternative to traditional financing ways for companies located in countries where the solicitation of the general public without costly prospectus requirement is not permitted. Indeed, the use of Internet permits the company to overcome territorial limitations typical of traditional financing form, giving the possibility to reaching investors from all around the worlds. [23]

For its relative low cost of usage, equity crowdfunding, has been indicated by the European Commission as worth for its potential to fill the "SMEs financing gap" and to help those companies move up the "funding escalator" within the firm life's cycle. [24] As of today, this recognition has been shared by almost the most developed country, that, for this reason started to enact specific regulation of this innovative financial instrument. [25]

As will be clarified below, there are three main risks connected with equity crowdfunding investment: fraud, failure and illiquidity. Equity crowdfunding, indeed, concern investment in small and medium size enterprise that cannot afford the disclosure costs of an IPO. As a response, two are the main issues concerning equity crowdfunding regulation: combining low costs for early stage enterprise with high investor's protection. This will be the Gordian knot that each regulator must cut in favour of equity crowdfunding to let it *unleash all his potential.*

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[22] 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

[23] *Id. [*HORNUF, L., and SCHWIENBACHER A. (2015b)] See also ARMOUR, J. and ENRIQUES, L. (2017) *supra* note 12, p.8. Obviously, the regulation of equity crowdfunding applicable to that company or to the potential investors of that company should permits so. For more specific information, please see Chapter 2.

[24] According to the EUROPEAN COMMISSION (2014), crowdfunding can be followed by other forms of financing such as bank loans, venture capitals or, also, IPOs. - 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

[25] *See* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 22, p. 7.

1.2.1.5 Hybrids

Apart from the "traditional" crowdfunding models exposed above, the last years have seen the spread of new models. They are called hybrids because they include in some ways peculiarities and features of the traditional models, combined as to recreating a new one.

The first that merits to be reported is *royalty* or *profit sharing crowdfunding*. It can be defined as a more complex variation of the reward model that is emerging in these years. [26] The distinctive factor is that in this model the reward has the shape of a royalty. In exchange of their contribution, the crowd gets an established percentage in the profits of a business activity. In this way contributors obtain remuneration that is directly linked to the revenues of the undertaking.

Another spreading crowdfunding model is the *real estate crowdfunding*. This can be defined as a recent clever deviation from the scheme of the classic lending crowdfunding. Usually real estate business has always been a way to diversify one's portfolio. In real estate crowdfunding potential investors have the opportunity to finance the start of a businesses in real estate fields, combing their money together via online portals. Through the use of joint capital, the promoter will be able not only to acquire a property, but also to manage it, renew it, rent it or sell it in order to make profit that will be shared with the investors.

Finally, a real new crowdfunding model is the *litigation crowdfunding.* It can be defined as another variation of lending crowdfunding for a specific purpose: start of defend from a legal action. It combines third-party litigation funding with the above described principle on crowdfunding. It always involves a promoter that in a civil dispute seek to finance some of his costs by aggregating small amount of money

[26] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017b) *Hitting Stride - The Americas Alternative Finance Industry Report*. Available at: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-05-americas-alternative-finance-industry-report.pdf

through online contributions. In exchange of their contribution, each contributor will have a financial return if the dispute is won. [27]

1.2.2 Definition of the target and type of campaign: All-Or-Nothing vs Keep-It-All

As anticipated above, it also possible to classify a crowdfunding campaign taking in consideration the establishment of the funding target and, in particular, what happens if the funding target is not reached.

Indeed, apart from the duration of the campaign [28], an important reference point for a crowdfunding campaign is the sum of money that the promoter asks the crowd and that he wants to get before the expiring of the campaign to develop the presented project. Indeed, while projecting the crowdfunding campaign, the promoter has to set the amount of money that he wants to collect from the crowd. This target is usually defined as *funding goal.* In its definition, the promoter should take in consideration all the costs that he should sustain in developing the presented projects plus the eventual costs of the rewards that he is going to offers to each contributor. The sum of this costs should be the targets that the promoter need to collect.

In relation to the decided target and the process of collecting money to reach that target, most platforms let the creators to choose between two different schemes. These are: the Keep-It-All (KIA) scheme and the All-Or-Nothing (AON) ones. [29] The difference between AON and KIA is based on what happens if the funding goal chosen by the promoter is not reached. When the promoter decided to opt for an AON crowdfunding campaign, the entrepreneur receives the money collected from the crowd only if the funding goal is reached at the end of the campaign. Otherwise, every single contributor will take the pledged money back.

[27] For a deeper analysis of litigation crowdfunding please see PERRY R. (2017), *Crowdfunding Civil Justice*, in Boston College Law Review, Forthcoming. Available at SSRN: https://ssrn.com/abstract=3041129

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

[29] 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.

If, instead, the promoters choose for a KIA campaigns, he will get all the money sent to the platform at the end of the campaign. Whether the funding goal fixed is reached or not, the platform will not sent back each contributions at the end of the crowdfunding campaign. [30] The funding goal is still decided before the launching of the campaign, although the contributors should know that its reaching is not fundamental to give their money to the promoter.

These two different schemes are mostly used in reward crowdfunding campaigns. Notwithstanding they origins, quite important implications can be found also for other crowdfunding models, especially for equity crowdfunding as will be showed shortly. In addition, in relation to some of the exposed implication, it will be looked for a practical demonstration in the case study of Chapter 4.

1.2.2.1 Economic and social implications.

Before analysing the possible implication of the adoption of this two models for equity crowdfunding, it is important to highlight the economic and social implication behind this choice.

Giving the possibility to the promoter to gain always something, even if his idea is not supported by many backers to reach the established funding goal, at first sight, it could seem that KIA model would be the more advantageous model for entrepreneurs. The promoter will always win something although he does not reach a predetermined goal.

But this is not always true. Because of different social implications between KIA and AON models, indeed, the concrete case demonstrates the opposite. [31]

The reason of this can be found in the role played by risk allocation. Indeed, each model finds application only when determined conditions, taking this role into account, are set.

Goes without saying that in the AON model the crowd receive a strong message from the promoter: he will not undertake the project if an insufficient sum is raised.

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[30] 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

[31] *Id.* [CUMMING D. J. and LEBOEUF G. and SCHWIENBACHER, A. (2015)]

[32] The direct consequence is that backers see the risk they bear reduced. They gain the assurance they are not wasting their money giving them to a company not promptly in a financing condition to develop a determined project. So, they have also an 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, as anticipated, are riskier for the promoter. Indeed, the risk is *all* borne by the campaign creators. This precondition in not always a bad aspect because this choice can make the promoter to gain more confidence, and so, visibility by the public. This means a *wider* public and, for sure, more money.

One of the most important drivers of a crowdfunding campaign success is the combination of risk and trust. From an investor point of view, the less risky is a campaign, the more attractive a crowdfunding campaign will be. Indeed, the lesser is the risk born by contributors, the more a crowdfunding campaign will resemble a simple sale of goods. So the more a product is desired, the more is the attraction generated, considering the low risk to not receive the product for which contributions has been sent.

Obviously, as will be said, another important success driver is the creation of a strong community around each project. In those cases, people, indeed, are willing to participate even if they can only vaguely assess the project's fate. In addition, this may provoke also the creation of herding behaviour [33] so that a contributor counts on the positive opinions of others, to reinforce their own until "*this multitude of vague hunches accumulates to relatively precise aggregate information*" and feel safer in receiving the perks that they were promised in exchange for their money.. [34]

On the other hand, KIA model nullifies the risk for promoters, because at the end of the day they will always get something. Therefore, this time the risk is born all by

[32] *Id.* [CUMMING D. J. and LEBOEUF G. and SCHWIENBACHER, A. (2015)] p. 4.

[33] See ARMOUR, J. and ENRIQUES, L. (2017) *supra* note 12, p.8

[34] 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

contributors. Indeed, an underfunded project is less probable that could reach the developing of the products promised.

For this reasons, contributors are really more reluctant in giving the campaign creator their money, because the possibility that they will not receive their products promised is higher. [35] The fact that KIA model inspires less trust in money givers is the price the promoters pay for having less risk.

From the above, it will seem totally useless to start a KIA campaign. In the reality, there are still some conditions under which KIA model could still generate trust on investors. To do so, the project that wants to opt for KIA model need to present some determined characteristics. As also shown on the home page of one of the first crowdfunding platform that enabled KIA models, Indiegogo [36], this model should be selected by companies only if they are sure they will be able to fulfil their obligations with the public, notwithstanding the amount of money that they will receive.

In sum, this means that KIA is suitable only for very scalable projects, with a really low incidence of fixed cost so that bidders could still gain some results if only a percentage of the funding is achieved. The incidence of fixed costs should be so small that it should be always possible to develop the project on a smaller scale, regardless of the amount of money raised. Without those characteristics, the crowd will be less willing to participate in a crowdfunding campaign (CUMMING, LEBOEUF and SCHWIENBACHER, 2015).

For this reason, at least, startup companies should always present their project following AON models, setting a funding goal so to cover fixed costs. Differently, not so much contributors may trust the entrepreneur if those conditions are not respected.

Therefore, a risk-return trade-off is at the entrepreneurial level: choosing KIA models involves less risks but also lower returns and lower expected rate of success;

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[35] *See* CUMMING D. J. , LEBOEUF G. and SCHWIENBACHER, A. (2015) *supra* note 30 p. 4.
[36] 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-

on the contrary, AON models carry on more risks for the campaign creator that is compensated by higher chances of reaching the funding goal.[37]

The demonstration of these theoretical assumptions can be found in the study conducted by CUMMING, LEBOEUF and SCHWIENBACHER (2015) on the famous, and already mentioned, reward-based platform Indiegogo. [38] The research shows that the success rate of AON models is double with respect to the one of KIA campaigns: it is the 34% of the AON against only the 17% of KIA models. [39] And that is not the only result found out. It has been seen that promoters choosing the AON model campaigns obtained twice the number of backers than the ones that choose KIA campaigns.

In general terms, how remarked also by CUMMING, LEBOEUF and SCHWIENBACHER, the data do not imply that AON is always superior to KIA. Both have some characteristics that make them suitable for different purposes. All depends on the costs structure of the project to be developed. Given the fact that promoter has no always any law obligation vis-à-vis the bakers to deliver the result of the projects developed, it is natural for a potential contributors to the be diffident. The more is this diffidence the more what appear a risky project will not be funded.

From the promoter perspective, it will be without sense to ask money to develop a specific project and then keeping per se an amount of money that is not enough to develop that project promised. From this assumption, KIA campaign shall be used only by already developed company that have already covered fixed costs to produce the promised product. It this way, regardless of the amount of money collected, the contributors will be assured on the possibility that their money will not be wasted. Startup, instead, should always opt for an AON campaign, setting a funding goal that is enough to cover the fixed costs required to produce the promised project plus the costs of the rewards that may be asked by the contributors for the reaching of the funding goal.

[37] *See* CUMMING D. J., LEBOEUF G. and SCHWIENBACHER, A. (2015) *supra* note 30 p.4.
[38] *Id*
[39] *Id* p. 5.

1.2.2.2 Implications for equity crowdfunding

Although the two models exposed above finds specific application in reward crowdfunding, their eventual adoption in an equity crowdfunding campaign brings particulars implication. Although, indeed, in equity crowdfunding is not possible to opt from one of this two models, as will be explained above, there are still some condition in which an equity crowdfunding campaign may resemble the KIA model.

To understand how this mechanism works, the starting point is the definition of a *funding limit*. This is the maximum amount of money than an entrepreneur can accept at the end of an equity crowdfunding campaign. That limit virtually exists only in equity crowdfunding. In reward crowdfunding, instead, there is no reason to refuse pledged funds, and so to pose a limit in the fund received because users are moved by consumption-based decisions providing a concrete reward for each correspondent given sum.

Equity crowdfunding, dealing with investment decisions, needs the establishment of a limit. For each amount received, indeed, the issuer sells participation in its company and so there is a natural limit on the company's portion that could be offered to the market. Indeed, before starting an equity crowdfunding campaign, the company always needs to summon the extraordinary general meeting to deliberate two capital increase that would define the number of shares offered to the crowd through the platform. The first capital increase establishes the already mentioned funding goal. This is, in practice, a capital increase of an established amount of money, subordinated to the condition that this sum is effectively collected. It represents the minimum amount to be collected so that the company could accept new investors and their money.

But in order to introduce the mentioned limit, the general meeting deliberates a second capital increase, conditioned to the first. Its amount is technically the *funding limit*. This second capital increase will be deliberated for an amount proportionated to the difference between the amount collected at the end of the campaign and the *funding goal.* In other words, each company's general meeting usually deliberates on two conditional capital increases. [40]

This complex procedure sets a limit on the number of shares that the company is going to issue. One of the reason for the decision of this limits stays in the fact that the issuer usually wants to retain a certain percentage of its company for himself. Another is linked to disclosure costs that may raise the higher is the participation subscribed by the future investors. This because generally disclosure costs and other organizational requirements are proportionated to the amount of shares offered. This depends also on the legislation concerned as will be analysed more in deep in the next chapter. [41]

So, although in the reality, some mechanism allowing the offer of unlimited shares to the crowd while retaining voting right exist, it is simply not convenient for the company or not attractive for the investors.

For these reasons, the model followed by equity crowdfunding is usually the AON. This is also true because, a company may have no interest in gain a small amount of money but still a certain number of new investors. Indeed, the administrative costs related to the entrance of new investors will not be balanced by the received benefits in terms of the amount of money collected. [42]

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[40] The following example may clarify better this principle. Company Alpha wants to start an equity crowdfunding campaign. It wants to collect € 100.000 offering in exchange 10% of its equity. In addition, Alpha it is ready to accept up to € 150.000, offering an additional 5% of its equity. So, the general shareholder meeting deliberates the first capital increase that is subject to the condition that the amount of € 100.000 is collected. Then, the shareholders can deliberate on a second capital increase, subject to the two additional condition that (i) the first capital increase will be concluded with success, and (ii) investors may subscribe whatever amount is collected that is more that € 100.000 but less than € 150.000. So, if less that € 100.000 is collected, no capital increase will be effective and the equity crowdfunding campaign will be considered failed. Instead, if more that € 100.000 is collected, the equity crowdfunding campaign will be considered successfully concluded and whatever amount less than € 150.000 will be accepted giving back the correspondent and proportional percentage of share of the company. For instance, if € 125.000 is collected, the amount of shares offered to the new investors will be 12,5%. Finally, after that the amount of € 150.000 is reached, every additional subscription will be refused and no one could be an investors of the company any more.

[41] 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 2, Paragraph 1.5.1. - HORNUF L., SCHWIENBACHER A.(2015a), *The Emergence of Crowdinvesting in Europe: With an in-depth analysis of the German market*, p. 6. Available at http://ssrn.com/abstract=2481994

[42] This principle will be specifically addressed in paragraph 1.4.2.

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 minimum subscription and a funding goal so low that it could be satisfied with a minimum investment. In this way, the first condition established in the general meeting can immediately be satisfied, letting the new contributors became shareholder of the company at their first investment.

The adoption of an hidden KIA model could be very dangerous for investors. This mechanism can arise problems of information disclosure to the damn of incautious investors. This danger is also magnified if the crowdfunding platforms did not make clear if the amount showed in the home page of the project is the funding limit or the funding goal. The result will be misinformation for the confused investor, because they were not going to have their money back if the amount displayed in the platform is not going to be reached. Mostly, the adoption of this hidden KIA models will not be clear without reading all the documents and all the others related information presented in the platform. But, contributors most of the times do not read documents containing information disclosure, if they could understand it, because they are prone to make investment decision on the base of herding behaviour and bias judgment.[43]

1.3. Equity crowdfunding benefits

In the following paragraphs, the most relevant advantages[44] related to the use of equity 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 share and the eventually connected financial return.[45] Indeed, also other advantages need to be take in consideration, especially the one generated by community participation. As it will be highlighted in the paragraphs below, community involvement is the characteristic determining the success of equity crowdfunding.

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[43] See ARMOUR, J. and ENRIQUES, L. (2017) *supra* note 12, p. 5. For more details, please see also Chapter 3, paragraph 3.3.2

[44] 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.

[45] *Id.*

1.3.1 Advantages for investors

Bidders of an equity crowdfunding campaign are usually defined as proper investors. From their participation to the equity crowdfunding campaign, they could extract the following main advantages.

- **Financial Return**. The first reason that moves investors/bidders to participate in a crowdfunding campaign is obtaining a direct and immediate *return*. If this is clear in reward crowdfunding, the return is less immediate in equity crowdfunding.

  Reward crowdfunding, instead, gives bidders the possibility not only to receive a symbolic "*thank you*" from the company [46], but, in most cases, on the basis of the pledged amount of money, it also 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.

  In equity crowdfunding, instead, investors acquire the subscribed number of shares of the company. In most of the case those are startups' shares, and for this reason they may bring incredible financial returns if compared with the money invested. Those will be expected in case of buyout by a bigger company that wants to buy the consider startup or even in case of IPO or profits distribution. [47] Obviously, those potential extraordinary rewards are compensated by the high risk of losing all the money invested in case of premature failure of the considered company. [48]
- **Being part of a community**. Investors of equity crowdfunding have the possibility to freely surf the Internet looking for projects they are interested

[46] 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.

[47] For instance, investing in Uber granted a returns 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: 1st January 2017] - GRIFFITH E. (2014) Meet the Uber Rich. *Fortune.com.* [Online] Available at: http://fortune.com/2014/06/05/meet-the-uber-rich/. Instead, in more general terms, investment in startups has been estimated in giving a returns that is 2.5 times bigger than the initial investment. For more information see WILTBANK R. (2012) Angel Investors Do Make Money, Data Shows 2.5x Returns Overall. *Techcrunch.com* [Online]

[48] For the complete description of the risk related to crowdfunding investment see next paragraph 1.3.

in. This element promotes the creation of a community around each project. Communities are open to anyone, and consist of heterogeneous individuals [49] in which the knowledge of the single member amplifies within the crowd, creating what was defined as "Wisdom of the Crowd" (SUROWIECKI, 2005). [50] According to DE CARVALHO et al. (2014), just 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.[51] 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.[52]

- **Risk reduction**. The above mentioned "wisdom" has also an important role in the reduction the of investors personal risk, bringing lots of advantages to fund seekers too.[53] Generally, startup failures are caused by the lack of specific know-how or shortage of capital. [54]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 investment. Indeed, crowdfunding fosters the collection of small amounts of money from lots of people.[55] The final result is a higher chance for investors and bidders to receive a financial return or the requested product.

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[49] *See* WILLFORT R. and WEBER C. (2016) *supra* note 3 p. 215.
[50] "*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]
[51] 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
[52] AGRAWAL, A. K. , CATALINI, C. and GOLDFARB, A. (2013). *Some simple economics of crowdfunding*. NBER working paper series.[Online] NBER, Working Paper 19133. Available at: http://www.nber.org/papers/w19133 p. 16
[53] *See* NASRABADI A. G. (2015) *supra* note 44.
[54] *See* WILLFORT R. and WEBER C. (2016) *supra* note 3.
[55] *Id.*

1.3.2 Advantages for issuers

What makes equity crowdfunding an attractive financing instrument also for the issuers are also the peculiar advantages that it bears and that could not be found in the traditional financing forms.

- **Financial benefits** The first advantage granted by the use of crowdfunding is the access to lower cost of capital.[56] 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 favours the possibility for people to look for something that they want, no matter in which part of the world it is produced. [57]

  In addition, crowdfunding gives the possibility to bundle the sale of equity 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" [58]. This assumption came from the Prospectus Theory elaborated by KAHNEMAN and TVERSKY in 1979.[59] 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.[60] The investment in startups involves a high risk but can as well grant high

[56] *See* AGRAWAL, A. K. , CATALINI, C. and GOLDFARB, A. (2013) *supra* note 52 p. 10.
[57] *Id* p. 12
[58] HELM (2007), *There is a chance to make big money,* in Harms 2007:3.
[59] "*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
[60] BIFFI A.(2013) *Equity crowdfunding: un modello di analisi del comportamento di imprenditori e investitori*. p 87

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 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.[61] For this characteristic it can also have a positive effect in enhancing competition on the supply of early stage capital market.

- **Benefits from the community.** 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"[62] 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 stronger interest in the success of the campaign.

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.[63]

The third one and maybe the most important is *market validation*. Financing through crowdfunding, indeed, gives the possibility to test the potential success of a product. According to MARTIN (2012)[64], the community provides with feedback and responses to the entrepreneur during the campaign that can be

[61] *See* DE CARVALHO L. F., IMBRIZI F.G,, TURRI S. N. & MACCARI E. A. (2014) *supra* note 51 p. 5
[62] *See* NASRABADI A. G. (2015) *supra* note 44 p. 208
[63] *Id* p. 209
[64] 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

used to drive the future product to be successful on the market.[65] This avoids huge investments in a future failure of that product.[66] 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 consideration [67]. Due to this mechanism, big companies started to use crowdfunding to test their products too. The company gains undeniably a pre-market analysis at zero cost.[68] Finally, co-creation and market validation have an important role in reducing the risk of failure.[69] Indeed, the use of crowdfunding by big companies[70] 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"* [71]. This demonstrates that there are notable advantages[72] that a company going public in the traditional way does not gain directly.]

Benefits coming from the community participation are also more evident in equity crowdfunding that in other crowdfunding models. In this case, the entrepreneur gains the possibility to expand company's team.[73] 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 fulfil 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

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[65] *See* NASRABADI A. G. (2015) *supra* note 44 p. 208

[66] *Id[*NASRABADI A. G. (2015)] p.205

[67] 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

[68] *See* NASRABADI A. G. (2015) *supra* note 44

[69] *Id[*NASRABADI A. G. (2015)] p. 203

[70] 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: 1st January 2017]

[71] For detailed information see the website of Indiegogo at https://learn.indiegogo.com/usecase-enterprise/

[72] 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*.

[73] *See* NASRABADI A. G. (2015) *supra* note 44 p. 206

the concept of "*cross-pollination of idea*"[74], 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. [75]

- **Maintaining control.** Contrary to other forms of financing, such as venture capital, in crowdfunding entrepreneurs do not need to give investors control rights.[76] According to VALANCIENE L., JEGELEVICIUTE S. (2013), the issuers 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, together with the possibility to issue shares without voting rights, the entrepreneur could always maintain the majority control, if compared with the other form of financing listed above.

[74] 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

[75] *See* NASRABADI A. G. (2015) *supra* note 44

[76] *See* VALANCIENE L., JEGELEVICIUTE 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

1.4 Equity crowdfunding risks

Financing through equity crowdfunding involves risks for both, contributors and promoters, that should be taken in consideration. For contributors, these risks are fraud, failure and market illiquidity. So, in general the investor bears the risk of losing all the money sent to the issuer. But some risks exist also for the issuer. These are related to the publication of the idea on the Internet and the increasing of administrative costs connected to the relationship with the investors and the crowd.

1.4.1 Risk for investors

As anticipated, the following are the risks for investors associated with investments in equity crowdfunding:

- **Online frauds.** If on the one hand Internet gives the issuer the possibility to be known by an indefinite number of people, on the other, it offers the perfect ground for committing frauds thanks to the possibility to reach a really high number of people without entering physically in contact with them. According to AGRAWAL et al. (2013), while projecting a crowdfunding campaign "*it is relatively easy to use false information and craft fraudulent pages*". This opportunity makes crowdfunding an appealing target for professional criminals. This is truer because usually retail investors do not make any due diligence, being each single contribution of relative small amount and thanks to the high possibility of free-ride on investment decision of others. [77] This fact expands the possibility to became victims of a fraud.

  However, the lack of a precise due diligence is compensated by the mentioned *wisdom of the crowd* that participates in the reduction of the risk of fraud through the use of crowdfunding platform. This is possible thanks to ability of Internet in maintaining transparency. Indeed, if someone prepares a fake project in one of these big platforms, first there are higher probability that some participant of the crowd could intercept it and spread the word all over the community. Second, after doing a similar action, it would be difficult for him

[77] *See* AGRAWAL, et al. (2013) *supra* note 52 p. 20

to escape. The whole community, knowing about the fraudulent action, will not let him do something similar again.

For all the above mentioned reasons, very little cases of fraud has been reported in proportion with the number of campaigns concluded with success [78]. In addition, in most of those cases, all contributors cheated received their money back while the creator has been punished. For instance, in Hanfree's Case the promoter, Seth Quest, received two different punishment: one from the legal system and the other from the community. Not only he went bankrupt after the lawsuits started by just one contributor to claim only $ 70, but, as reported, he had also real difficulties in finding a new job because of his bad reputation. [79]

- **Failure of the issuer.** In some other cases, it is also possible that, although managers of the company do not try to cheat investors, not acting badly, the company, simply, fails in developing the project undertaken. Also in those cases, as for fraud, the subscription made by the investors is worth nothing. The reasons for the failure could be several and diverse and they are common specially when the promoter is a startup. Most of the times, the process goes far beyond creator's expectations, especially when creators make some errors in considering his total costs or if they have little experience with logistic issues, such as building the product or dealing with suppliers. [80]

However, thanks to the so called *wisdom* of the crowd, the number of startups that fail after concluding a successful crowdfunding campaign are few. Data confirm this assumption. A research made by AltFi and reported by the Financial Times[81], states that "only" the 20% on the companies using equity crowdfunding failed. This is a big result, considering that the actual rate of

[78] 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/

[79] 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. [Accessed: 1st January 2017]

[80] *See* AGRAWAL, et al. (2013) *supra* note 52 p. 19

[81] BARRETT C. and ROVNICK N. (2015) One in five UK crowdfunding investments fail. *Financial Times* [Online] Available at: https://www.ft.com/content/90eff1cc-8e00-11e5-8be4-3506bf20cc2b [Accessed: 1st January 2017]

failure for startups is between 80% and 90% after the first two years from their incorporation.

- **No secondary market.** Finally, another risk concerning equity crowdfunding is illiquidity. This means that, after buying shares in a company through the crowdfunding platform, the buyer is unable to re-sell them to make a capital gain, or just to have his money back, for difficulties in finding someone willing to acquire those shares. The main cause of this risk is the fact that secondary market of such instruments is still underdeveloped. [82]

  However, lots of business are trying to favour the growth of a secondary market for the shares acquired through equity crowdfunding. Sometimes, is the same equity crowdfunding platform that deals also with the creation of the fundamental infrastructures to give the possibility to the contributors to exchange shares in the company funded.

So equity crowdfunding, from an investor point of view, it is one of the riskiest of all other alternative finance instruments. This is confirmed by a research conducted in the UK. As shown in Figure 1.1 below, comparing the perceived risk of all alternative finance mechanism, equity crowdfunding is one of the riskiest investment activities that an investor may undertake, second only to investment in cryptocurrencies. [83]

[82] In Chapter 2 some of the reasons for such underdevelopment will be exposed. Indeed, sometimes it is the regulation that forbid the re-selling of share for a certain period of time after having acquired them in order to enjoy certain tax relief. For further information see paragraph 2.2.3.

[83] For more detail please see CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017), p. 37

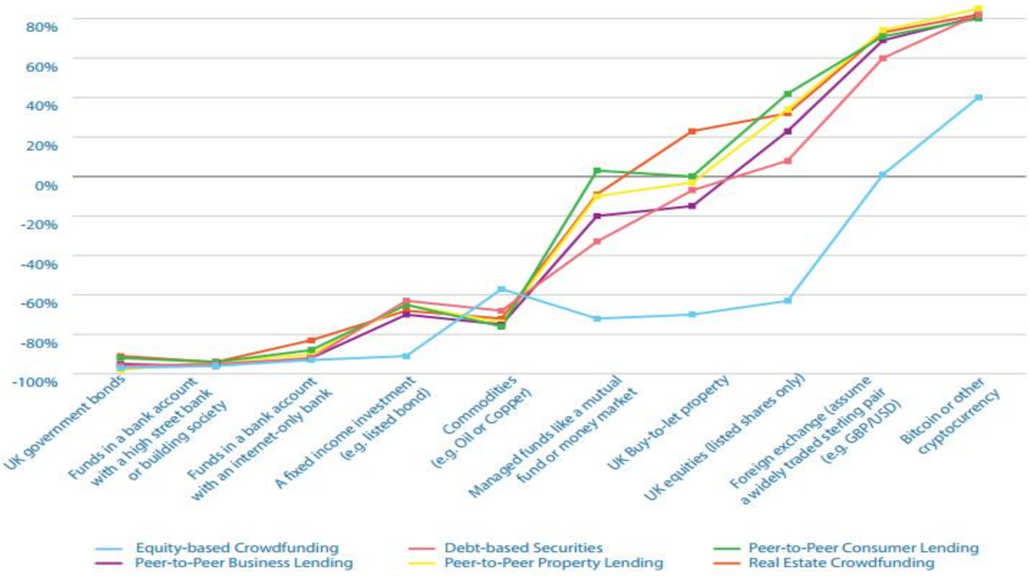

Figure 1.1 – Perceived Risk of Alternative Finance Compared to Other Forms of Investment by Model
Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)
To compare perceptions of risk against other asset classes, responses were measured relative to one other, assigning the most risk as -100% (i.e. all the respondents considered crowdfunding riskier than the individual asset class) and the least risk as 100% (i.e. all the respondents considered crowdfunding less risky than the individual asset class). On this scale, 0% would represent the same amount of risk when comparing crowdfunding with the asset class.

Unfortunately, although it may have been interesting, no researches has been conducted in Italy addressing the same issues. The reason could be linked with the low number of Italian investors [84] and the small development of Italian equity crowdfunding market. [85] According to a research conducted in Italy regarding financial investments knowledge, whose results are exposed in Figure 1.2, only the 4% of the respondent has declared to be well-informed about equity crowdfunding, while it is still unknown by the 74% of them. Also the interest in investing in startup it is not so high, being influenced by risks connected to such investment decisions. Indeed, according to the same research, while only the 19% declared to be interested in equity crowdfunding investment, within the 81% of no-interested respondent, a really high percentage (the 58%) it was afraid of online frauds while a considerably decent percentage (the 18%) consider this investment generally too risky.

[84] The precise number is 1.196 subjects until July 2017 according to CONSOB (2017), p. 31.
[85] This specific issue will be addressed in Chapter 2.

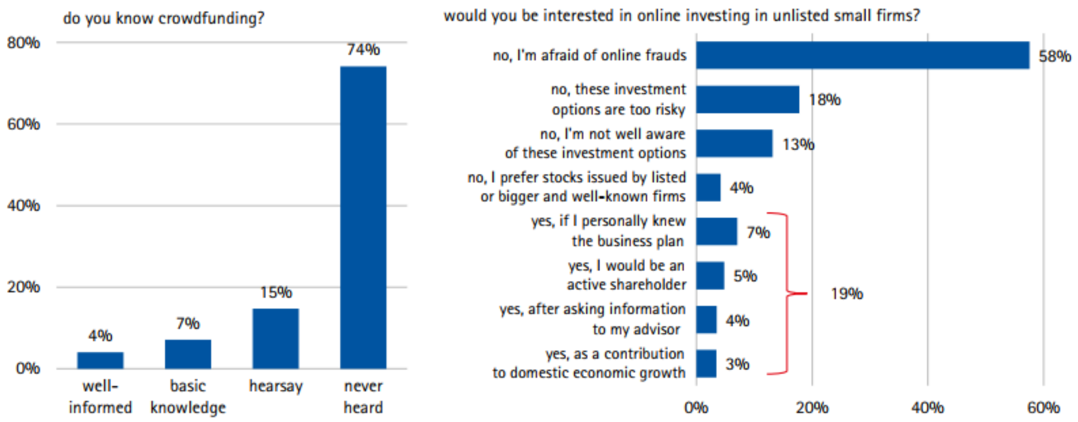

Figure 1.2– Knowledge of crowdfunding and interest in online investing in unlisted small firms

Source: CONSOB Report on financial investments of Italian households (2016)

In order to have an idea of risks regarding equity crowdfunding, it is also possible to consider three different research analysing the risk industry perception UK, USA and Italy. All of them addressed equity crowdfunding platforms that were asked to rate different factors on the base of the perceived risk to their operation.

Therefore, according to all these researches, the perceived risk across the considered factors remain high. On average, indeed, to most of the considered factors has been associated a high-to-medium risk. In particular, considering this high-to-medium risk range, cyber security is the higher perceived risk in UK (81%) and in America (76%), while this is less true for Italy (only 40%). Immediately after that, there is the perceived risk that a fraudulent campaign could be completed on the platform. This risk is perceived high-to-medium by the 61% of the platform in UK, by the 64% in America and by the 60% in Italy.

In relation to another *traditional* risk associated to the investment in startups, that is to say the high default rate of those kind of companies, it is possible to note that the risk that the default rate will increase is perceived as high-to-medium only by the 50% in UK, while it is higher in America (63%) and in Italy (60%). Taking in consideration other significant data, it is necessary to highlight how in Italy the 80% of the platforms are worried about changes in national legislation, while this rate is significantly lower in UK (59%) and in America (55%). This data is coherent, as will be reported in the remaining part of this dissertation, with the still "instable" regulatory framework that characterizes Italy. Finally, the perceived risk of "crowding out", that is to say the substitution of retail with institutional investors, is also quite low in Italy and UK, being only low-to-very low in Italy and considered high-to-medium only by the 14% in UK, and by the 22% in America.

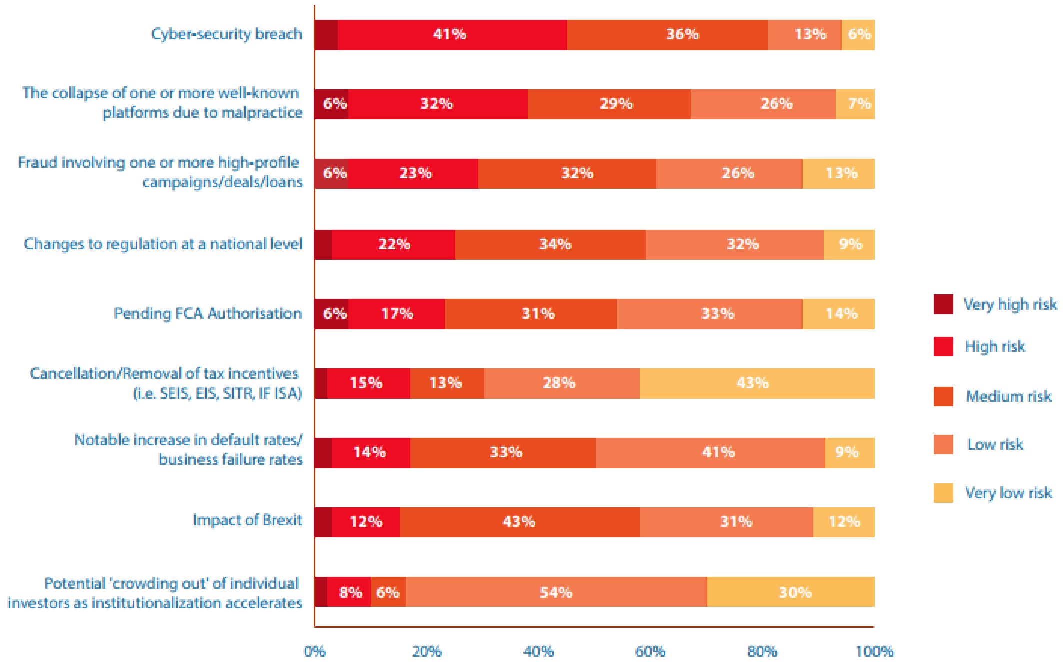

Figure 1.3– Industry Perceptions of Risk in the UK in 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

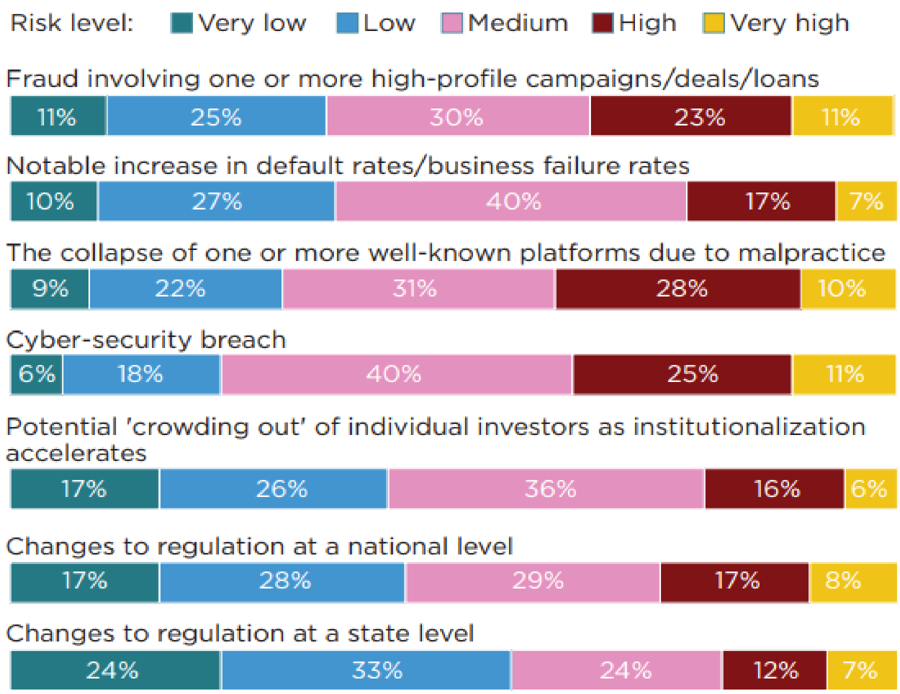

Figure 1.4– Industry Perceptions of Risk in the US in 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017b)*

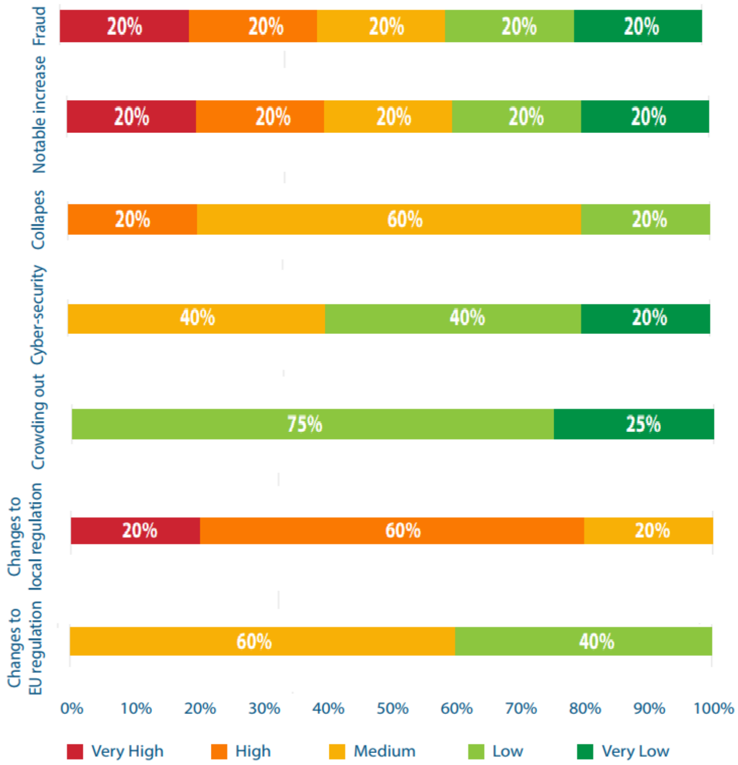

Figure 1.5– Industry Perceptions of Risk in Italy in 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2018)*

In summary, from data and considerations exposed above, from an investor point of view equity crowdfunding is without any doubt a risk investment activity. This risk is mostly related with the potentiality to use the crowdfunding platform to commit fraud, but also with the fact that subject of the investment are startups, that is to say small companies with an high default rate. On a positive note, as the perception of the industry demonstrate, great part of risk is caused by *external factors*, that it to say elements that are not connected or dependent by the issuer (such as regulation changes or cyber security breach). The good point here is that the evolution of the equity crowdfunding market, in the future, will for sure overcame those risk with the result that investment in equity crowdfunding may became a safer activity as it happens for financial markets from their origins until today.

1.4.2 Risks for entrepreneurs

Starting a crowdfunding campaign means, first of all, an increase of administrative costs. [86] This is a point that should not be underestimated, especially for small and medium-sized enterprises composed by small teams. Usually the components of these costs are linked with the management of the campaign itself, that includes the necessary interaction with the crowd that is recommended 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), just the simple action of sending rewards, making updates and answering the questions of the community are activities that are really time consuming and that uses important energy that should be dedicated to the running of the business. [87]

It is also important to consider all the costs concerning the modification of the previous shareholder relations. Indeed, before starting an equity crowdfunding campaign, startups are usually composed by 4-8 members. After a successful campaign, this number can become really higher. According to KITCHENS and TORRENCE (2012), having a large basis of retail investors is quite challenging, just to comply with all the communications duties. [88]

Equity crowdfunding include also legal compliance costs that need to be considered. These are not only the ones that derives from modifications of company's statutes but also all the other legal advices related to the issuance of new shares and compliance with equity crowdfunding regulation.

In addition, also public exposure of the promoter idea is a risk that need to be considered. Spreading an idea on the Internet is not always a benefits. A promoter should consider at least two major drawbacks in making its project public. These are the possibility for his idea to be stolen and his reputation to be harmed. [89] Crowdfunding entails a real risk that better-funded companies may steal the project

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[86] *See* VALANCIENE L., JEGELEVICIUTE S.(2013) *supra* note 77 p. 43.

[87] 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 52 p. 17.

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

[89] *See* AGRAWAL, et al. (2013) *supra* note 52 p. 17

shown on the platform (SULLIVAN and MA, 2012, BECHTER et al., 2011 and GALWIN, 2012). This happens because in most cases the products showed are not patent protected. In addition, legislations on intellectual property law usually do not protect the pure "idea" behind a project, with the consequence that a business model being public on the Internet could be easy copied and realized in a better way by bigger companies. In those cases, there are only few and expensive legal ways that could be taken in consideration by the creator of the campaign that could not always undertaken for financial reasons.

Another risk linked with information disclosure regards the relation with potential suppliers. Reading the companies documents uploaded in the crowdfunding platform a supplier may know the company structure of costs and ask for higher compensation of the services provided. In an equity crowdfunding company is, indeed, requested the disclosure of future plans and strategies. The consequence is a unstoppable loss of bargaining power. [90]

Finally, another danger not to underestimate is the harm to creator's reputation in the hypothesis that the crowdfunding campaign will fail. Depending on the specific reason of the failure, it could have consequences on the future possibilities to produce that product or to conduct his business, especially when the creator does not maintain a complete fair conduct during the campaign, also for simple inability to give the necessary attention to a wide community.

[90] *Id* p. 18

Chapter 2 – Market analysis and factors influencing the development of equity crowdfunding

The aim of this Chapter is to highlight which drivers favour or obstacle equity crowdfunding market development. To do so, first it will be necessary to report the available market data, with particular regards to those countries in which equity crowdfunding is already well developed, such as the USA and the UK, together with the performance registered by Italian market of this instrument.

Indeed, equity crowdfunding, especially in Italy, it is a very recent phenomenon. While in UK or in the USA this market has already completed its developing phase, reaching a sort of stability in terms of more stable growing rates, in Italy this phase is still in action. As will be argued above, the main cause of this *late* development is Italian equity crowdfunding regulation that only in the last years has been amended in a way to unlock the potential of this instrument, although some limits still exist. In addition, also other factors (such as banking sector's presence, financial market development or entrepreneurship level) participated in creating this developing difference. Although their influence it not so direct as the one that will be reported with reference to equity crowdfunding legislation, there are still important factors that, if a metaphor is permitted, may have created the "soil" in which equity crowdfunding seed has been planted.

To demonstrate the mentioned assumption, after the market analysis of this innovative financial instrument, the controversial relation between equity crowdfunding, financial markets evolution and banking industry will be described. Then, also the regulatory limitation of the mentioned countries will be described in order to understand most of the result of the market analysis. In this way, it could be possible to dedicate a specific focus to the parts of Italian regulation that could foster or limit equity crowdfunding development. Finally some other residual but still important factors such as entrepreneurship level and its clear influence on equity crowdfunding development will be explained.

2.1. Market Analysis: the equity crowdfunding industry

Equity crowdfunding market, together with the global alternative finance market, had an incredible growth in the last 3-4 years, reaching some form of stability only from 2015.

Indeed, the European alternative finance market, passed from € 1.27 billion collected in 2013 to € 5.43 billion in 2015, reporting an incredible growth of 327% from 2013 to 2015 (*see* Figure 2.1). Only from 2015 to 2016 the growth rate decreased (*only* 41%), considering a total amount collected of € 7.671 billion in this year.

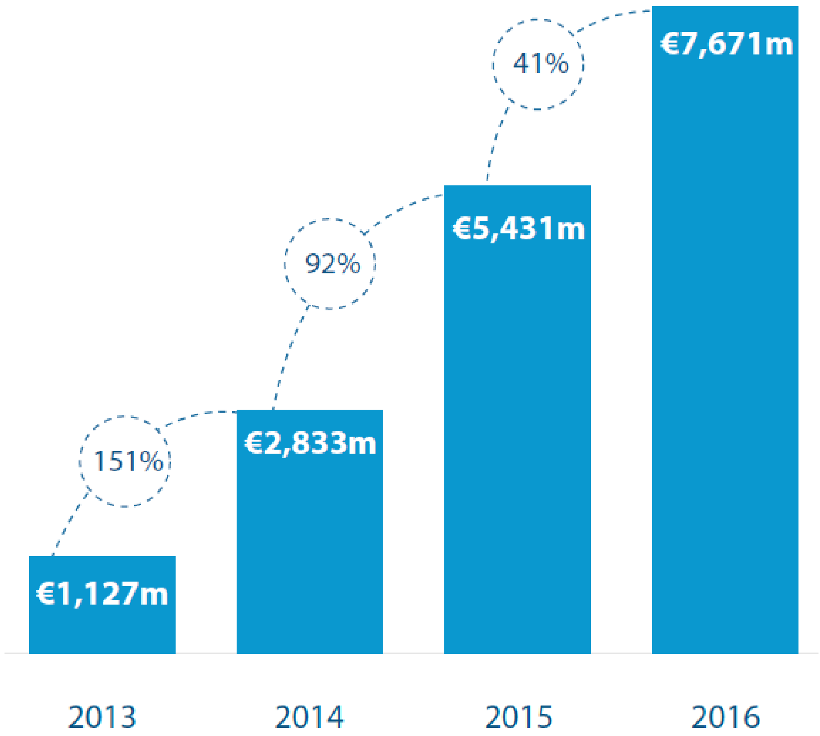


Figure 2.1 – European online alternative finance market volumes 2013 – 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2018)

American alternative finance industry is bigger than the European. However, with $ 4.46 billion collected in 2013 and $ 11.7 billion in 2014, its growth rate was similar to the European one (162%), while collecting $ 28.7 billion in 2015, its growth rate was higher from 2014 to 2015 (145%). However, the American increase of the last two years was lower. Indeed, collecting $ 36.5 billion in 2016, the measured growth rate was only of 27%, that is to say quite half than the European one that was of 41% (*see* Figure 2.2).

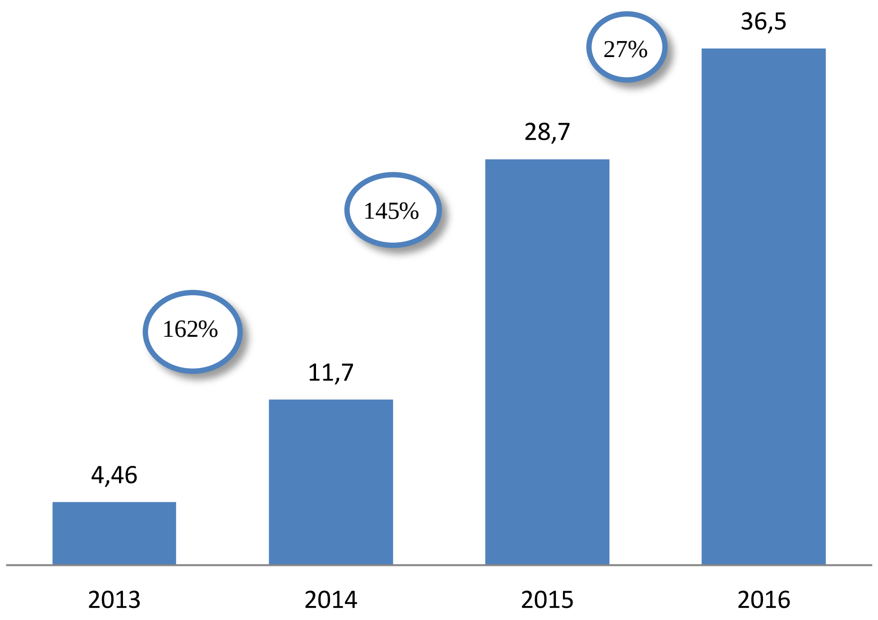


Figure 2.2 Americas online alternative finance market volumes 2013 – 2016($ billions)

Source: Adapted from CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017b)*

The United Kingdom is the undiscussed leader of European alternative finance market. Indeed, having collected € 4.4 billion in 2015 and € 5.6 billion in 2016, those amounts represents the 81% and the 72% respectively of all the European alternative finance market (*see* Figure 2.3 and Figure 2.4) [91]

[91] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2016), *Sustaining momentum, the 2nd European Alternative Finance Industry Report*. Available at: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2016-european-alternative-finance-report-sustaining-momentum.pdf

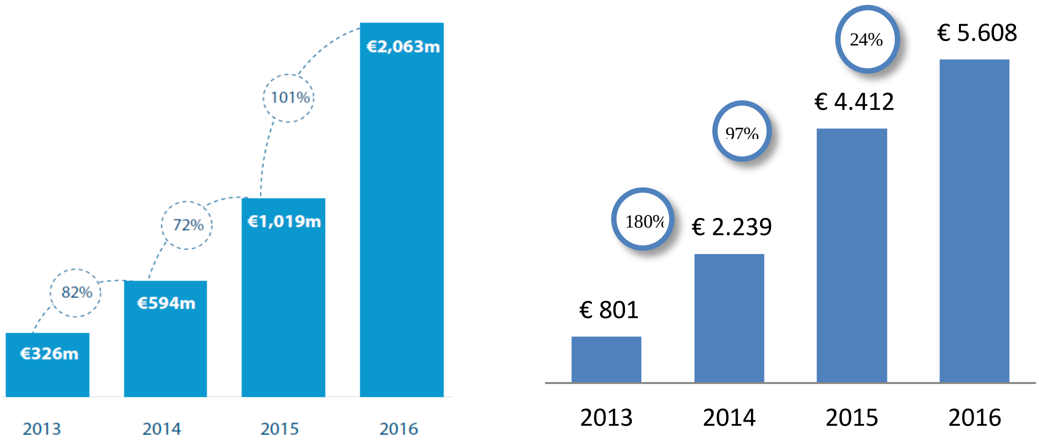


Figure 2.3 – European (excl. UK) vs UK online alternative finance market volumes 2013-2016(€ million)

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2018)*

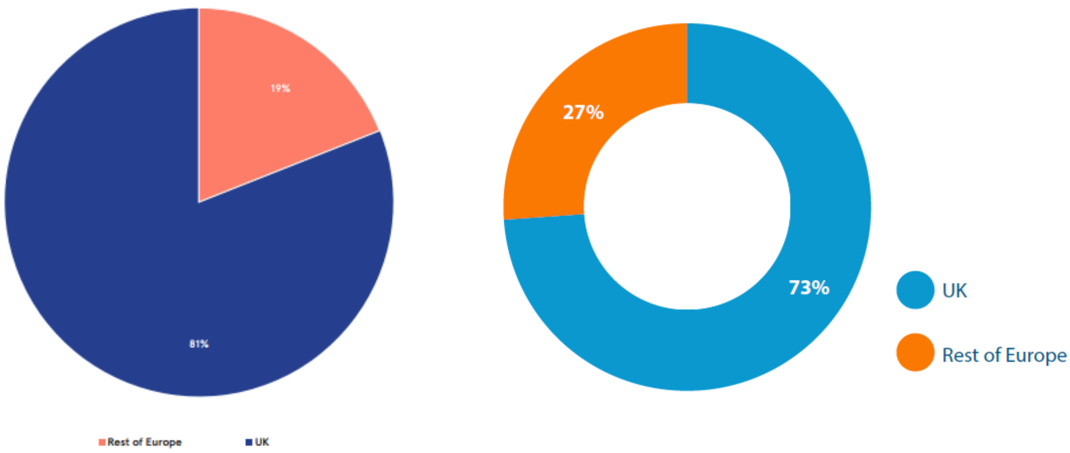


Figure 2.4: Share of alternative finance market, UK vs Europe in 2015 and 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2016) and*

CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2018)*

A similar predominance could be observed in America, where the US leads this market, having collected $ 28.5 billion in 2015 and $ 35.5 billion in 2016, that is to say more than the 99% and 97% respectively of the American alternative finance market volume.[92]

[92] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017b) *Hitting Stride - The Americas Alternative Finance Industry Report*. Available at: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-05-americas-alternative-finance-industry-report.pdf

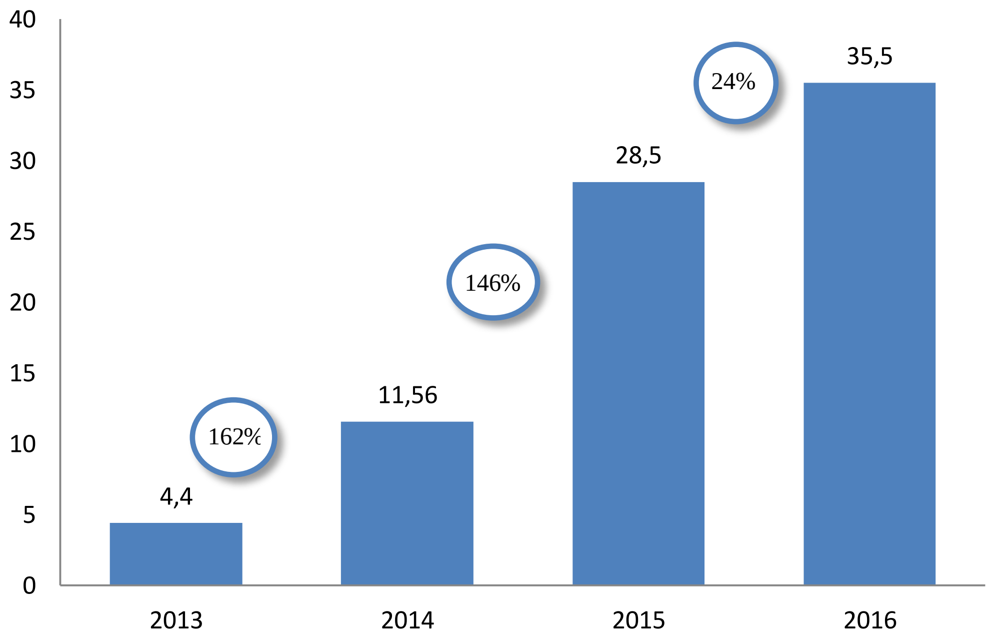


Figure 2.5 – US online alternative finance volume 2013-2016($ billions)

Source: Adapted from CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2016) and CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2018)

Notwithstanding the UK crowdfunding market volume, (collecting € 5,6 billion in 2016), represents only the 15% [93] of the amount collected in US in the same year ($ 35,5 billion), proportionally, equity crowdfunding has more relevance in the UK than in the US. This is confirmed by the fact that, in 2016, as shown in Figure 2.6 and 2.7: UK equity crowdfunding market, collecting $ 220 million, represented in the same year only the 39% of the US one, which volume was $ 549.1 million; [94] equity crowdfunding in the US, represented just the 1,6% of the total US crowdfunding market against the 5,94% of the UK one; UK equity crowdfunding growth rate, between 2015 and 2016, was higher than in the US one, having the last a negative value of -5%, while the former a positive one of 10%. [95]

[93] The comparison has been made converting the UK collected amount in dollars at the exchange rate (0,94 $/€) of the 31/12/2016.

[94] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017), *Entrenching Innovation - The 4th UK Alternative Finance Industry Report*. Available at: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-12-ccaf-entrenching-innov.pdf , p. 12

[95] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017b) p. 30 and CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017) pag. 59. To make a comparison between the two amounts, as the one presented in Figure 2.6, the GBP/USD exchange rate adopted was the average from 2013 to 2016.

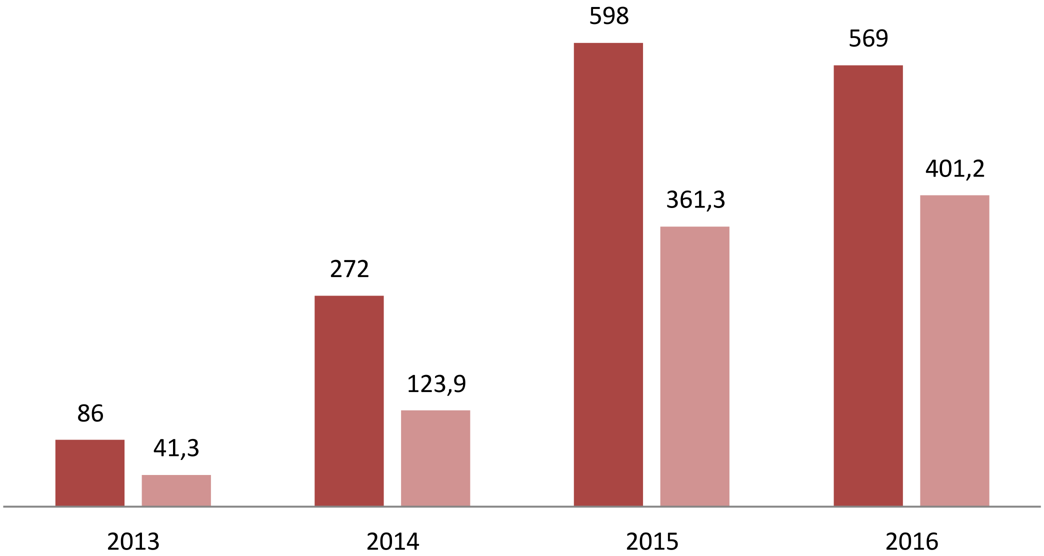


Figure 2.6 – UK(pink) vs USA(red) equity crowdfunding market volume ($ million).

Source: Adapted from CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017) and* CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017b)*

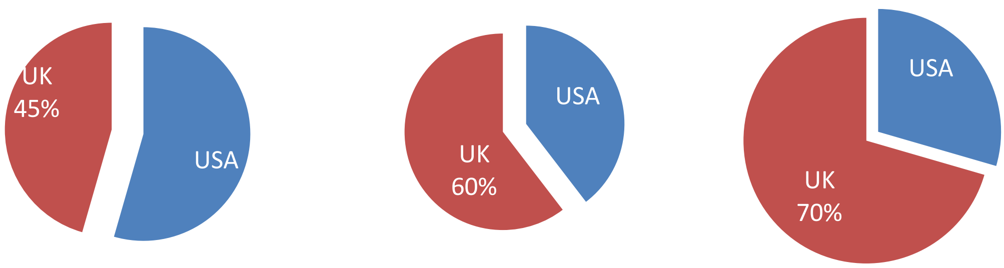


Figure 2.7 – Percentage of UK equity crowdfunding market volume in relation to the US one ($ million) from 2014- 2016.

Source: Adapted from CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017) and* CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017b)*

However, the most important data that need be highlighted from the graphics reported, is the fact that after a rapid growth in previous years, from 2015 to 2016 the growing rate of equity crowdfunding market in US and in UK is now quite stable.

Indeed, the representation would be distorted if the exchange rate of each year would have been considered, because of a strong depreciation of GBP from 2015 to 2016, the £/$ exchange rate passed from 1,48 £/$ to 1,23 £/$.

This clearly means that in those country equity crowdfunding ended its developing phase, reaching now a form of stability. The definition of a clear and definitive regulation of this instrument had a really important role in the reaching of this stability. For instance, in USA only in 2015 was permitted to retail investors to invest through this instrument. This "unlocking" procedure explain the increase of more than 100% in the growth rate between 2014 to 2015.

The research providing data on the most funded sectors, given to the platform the possibility to rank the top sectors funded via equity crowdfunding. Although data on the specific volumes are not available, those research provide still precious information. As exposed in Figure 2.8 below, equity crowdfunding is a financing instruments used most by ICT companies both in UK and in the US. Moreover, although the second place is occupied by different sectors in those two countries, (Community and Social Enterprise and Internet ad E-commerce respectively), also the Finance sector represent one of the top common sector for financing through equity crowdfunding, [96]

#	United Kingdom	United States
1	**Technology**	**Technology**
2	**Community and Social Enterprise**[97]	**Internet ad E-commerce**
3	**Finance**	**Finance**

Figure 2.8 – Top three represented sector funded via equity crowdfunding - UK vs US.

Source: Adapted from CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017) and* CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017b)*

Considering equity crowdfunding platform, equity crowdfunding market is still an oligopoly with only few companies controlling a wide part of the market. For instance, in UK the most famous equity crowdfunding platform is Crowdcube, that is

[96] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017) p. 17 and CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017b) p. 44

[97] The second place in UK were occupied by Real Estate and Housing sectors. Given the distinction made in this dissertation between equity and real estate crowdfunding, this sector was deleted from the Top three.

also one of the most successful equity crowdfunding platform in the world, controlling the 48% of UK equity crowdfunding market, followed by Seedrs with the 26% and SyndacateRoom with the 18%.[98]

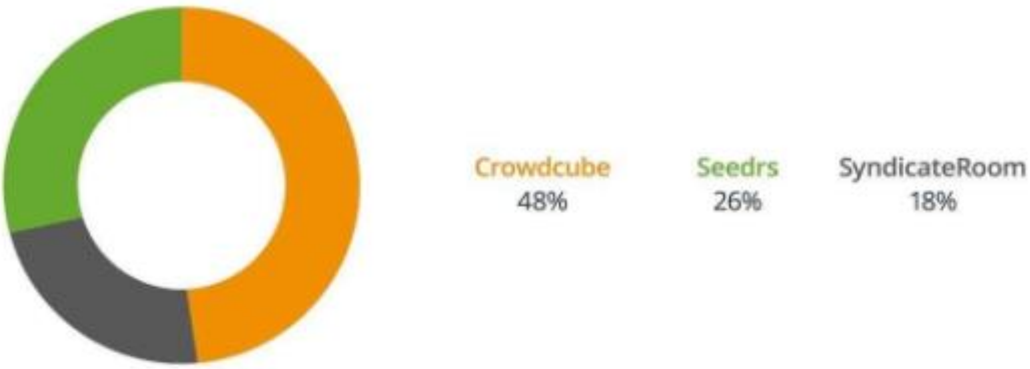


Figure 2.9: UK equity crowdfunding market share (2017)
Source: www.beauhurst.com

In US, indeed, it is possible to find an higher number of platforms than in UK. This could be the result of at least two factors: the less US stringent authorization, if compared with the UK one, as described in paragraph 2.3.1.2.; and the higher market volume that gives the possibility to more operators to enter the market. In this way, US equity crowdfunding market is less concentrated than the UK. If concentration is calculated on the base of the market share owned by the three bigger platforms, US concentration is 68% against the 92% of the UK one. The most famous US equity crowdfunding platforms, also in terms of money collected, are EquityNet and CircleUp, controlling respectively the 40% and the 15% of the market, followed by Crowdfunder and Seedinvest, controlling both the 13% of the market.

[98] Information available from the databank of www.beauhurst.com

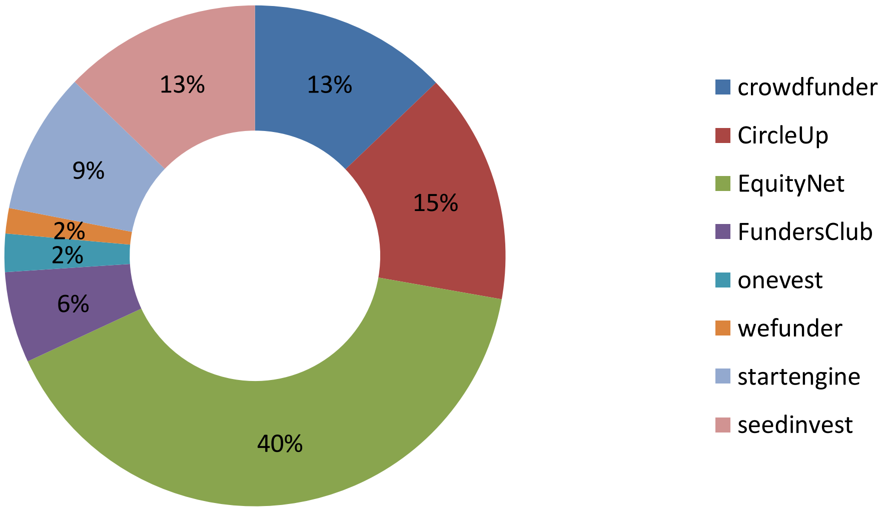


Figure 2.10: US equity crowdfunding market share (2017)

Source: Adapted from crowdexpert.com

Similar trends cannot be observed considering the Italian equity crowdfunding market where this instrument *is still in its crib.* [99] Indeed, notwithstanding the possibility to study real-time data, [100] Italy does not occupy a really important position among other countries in terms of market volume. As will be argue in the following paragraphs, the reason of the low development of this market it is connected with the fact that Italy has been the first country in the world issuing a specific regulation addressing retail investors of equity crowdfunding.

Only in 2017 Italian equity crowdfunding market volume have seen a sensible growth, passing from the € 1,766 million collected in 2015, the € 4,363 million collected in 2016, to the € 11,788 million collected in 2017 (*see* Figure 2.11 below).

[99] Expression used by ENRIQUES (2012)

[100] Data provided by OSSERVATORIO SUL CROWDFUNDING – POLITECNICO DI MILANO. Databank available at: http://www.osservatoriocrowdinvesting.it/ [Accessed: 15th December 2017]

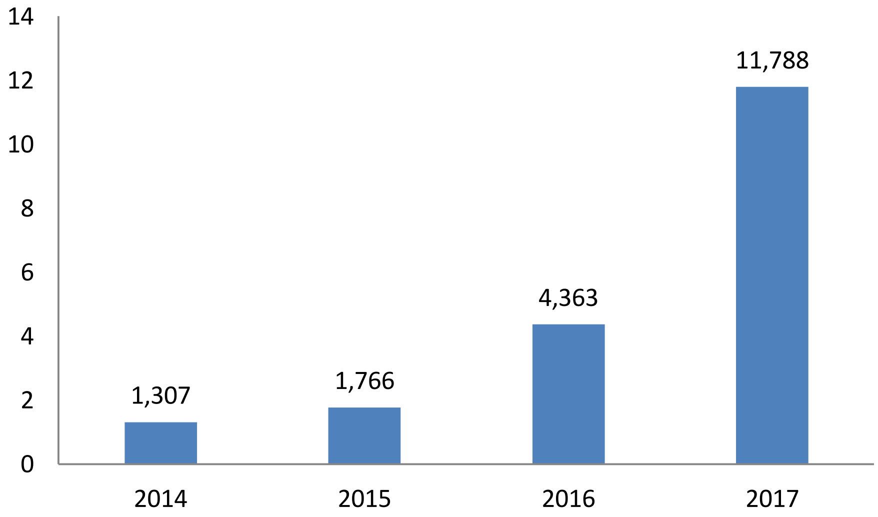
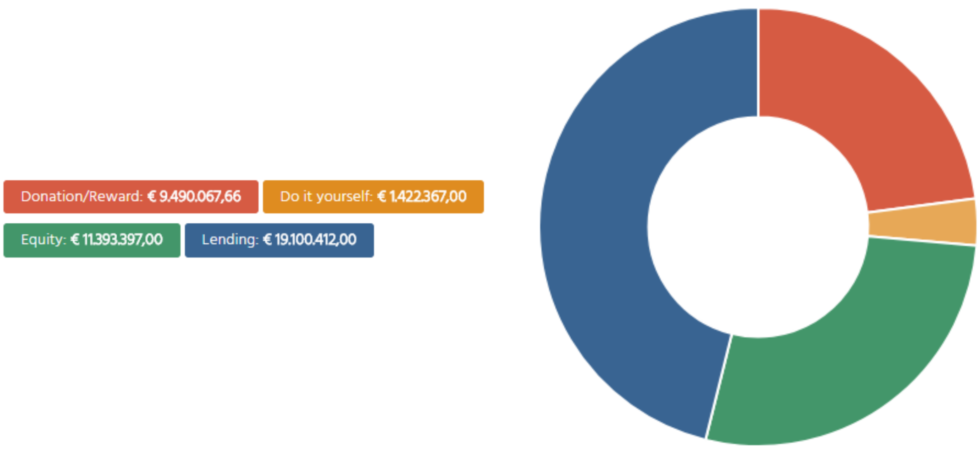


Figure 2.11: Italian equity crowdfunding volume 2014-2017(€ million)
Source: CrowdfundingBuzz.it

Equity crowdfunding represents an important percentage of Italian alternative finance market. In 2017, it represented the 27,5% of Italian alternative finance market of that year, collecting € 11.9 million only in 2017 from the € 4,36 million of the previous year. Considering, indeed, the total amount of money that the Italy alternative finance market collected until 2017 (that is near €133 million, of which €41 million collected only in 2017), equity crowdfunding represents the 14,2% of crowdfunding industry. [101]



[101] Data provided by Crowdfunding Report and available at: http://www.crowdfundingreport.it/#fourth [Accessed: 15th December 2017]

Figure 2.11: Composition of Italian alternative finance market only in 2017

Source: www.crowdfundingreport.it

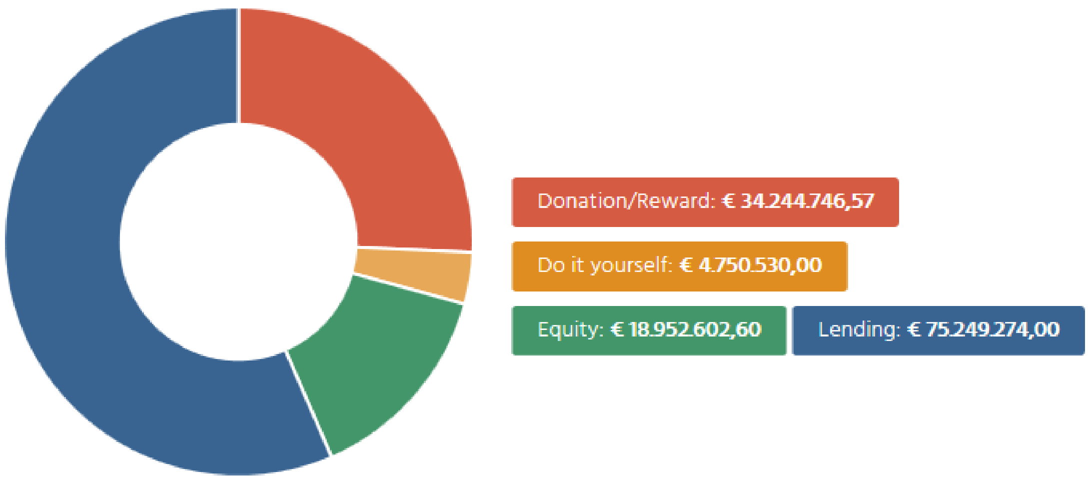


Figure 2.12: Composition of total Italian alternative finance market until 2017

Source: www.crowdfundingreport.it

Recently, the amount of money raised through equity crowdfunding campaigns in Italy have sensibly increased as Figure 2.13 shows. Indeed, its growth rate was around 150% from 2015 to 2016 and around 170% from 2016 to 2017. It is interesting to observe that this is similar to the 150-160% growth rate find out in UK and in US from 2013 to 2014. This is the confirmation that Italian equity crowdfunding market is still developing; in addition, this means that during 2017 something has been changed (or removed) in a way to let equity crowdfunding market develop. The following paragraphs of this dissertation will argue that it is thanks to some *right* amendments in the equity crowdfunding legislation that this Italian market is starting to bloom.

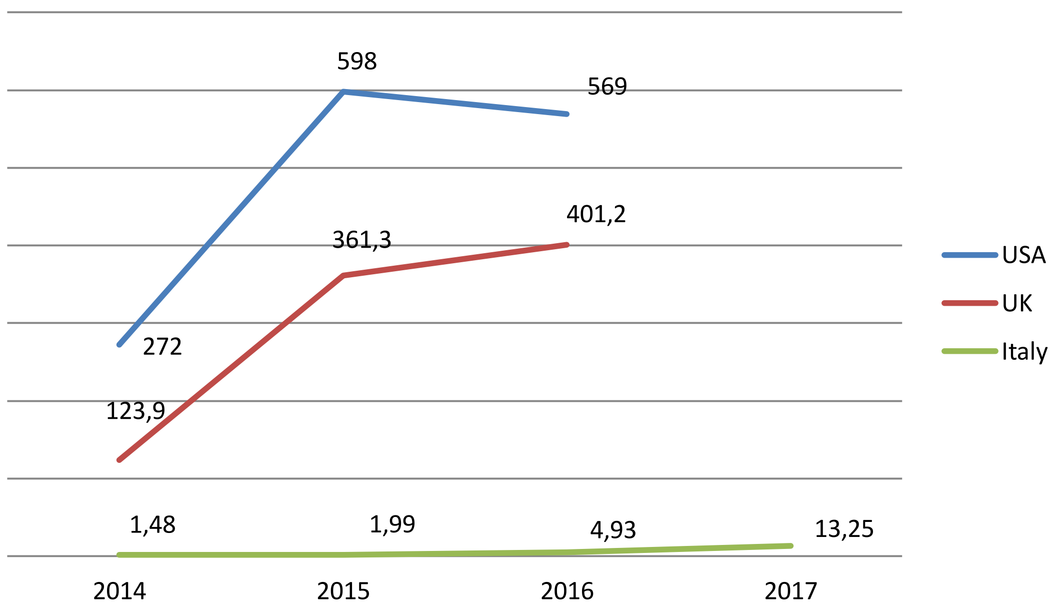


Figure 2.14 – Amount of money collected 2014-2016 ($ million).[102]

Italy has also in common with the UK and the US some of the top sectors funded via an equity crowdfunding platform. Indeed, considering the 106 companies that get founded via equity crowdfunding until the 30/06/2017, the most funded sectors from 2012 are the Sharing Economy and the Social Services sector, with 28 companies funded in total, of which 18 only in the previous year. ICT is the second most funded sector, with 25 funded companies, of which 15 only in the last year. The third is the sector for Professional Services, with 14 companies funded of which only 5 in the last year. [103]

#	Italy	No. companies funded until June 2016	No. companies funded in the last year
1	**Sharing Economy/Social Services**	**28**	**18**
2	**ICT**	**25**	**15**
3	**Professional Services**	**14**	**5**

[102] As far as the data of 2017 are not available for USA e UK, they are not be represented.
[103] CONSOB REPORT (2016)

Figure 2.15 – Top three represented sector funded via equity crowdfunding in Italy- UK vs US.

Source: CONSOB REPORT (2016)

Finally, in terms of market concentration and Italian equity crowdfunding platforms, Italian market is less concentrated than the UK one. Indeed, considering only the 14 most relevant platforms of the 22 authorized to operate in Italy, if they are classified on the base of amount of money collected, the first three platforms hold the 60% of the market volume, while all the other 19 have to share the 40% of the market. This grade of concentration may suggest that in the next years smaller platforms may leave the market, so that also the Italian equity crowdfunding market will became an oligopoly as the UK one.

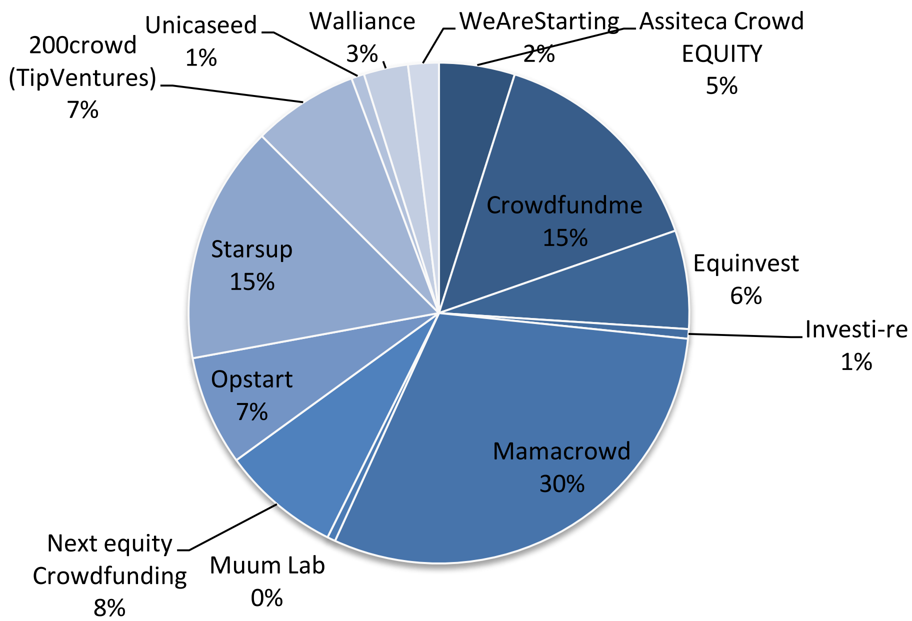


Figure 2.16 – Italian equity crowdfunding platforms by the amount of money collected(2017). Source: Adapted from www.crowdfundingreport.it

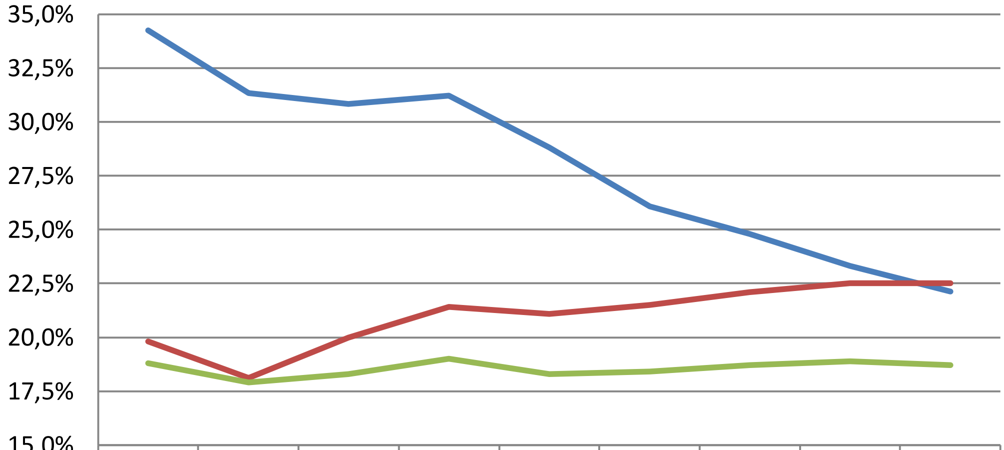
2.2 Analysis of factors influencing the development of equity crowdfunding market

2.2.1 Banking sector

The spread of the alternative finance market has been possible thanks to the fact that, also according to the World Bank, those instruments has been elected as the perfect source of funding for small and medium-sized enterprises (hereinafter SMEs). [104] For instance, in 2016 in the UK, the 72% of all the alternative finance market funds was raised for startups and SMEs and, although the principal source of funding derived from debt-based models, equity crowdfunding provided still £371 million funding to 482 SMEs, representing the 5,94% of the total alternative finance volume. [105]

The aforementioned assumption is based on the events that followed last financial crisis. Indeed, immediately after 2008, possibilities of receiving funds for SMEs from the traditional financial system (above all banks) drastically lowered. [106] Figure 2.17 shows how volume of outstanding loans dedicated to SMEs (calculated as percentage of total outstanding loans for enterprises) decreased in USA, UK and Italy after the financial crisis, although for the last two country it is necessary to consider also Figure 2.19 and Figure 2.20 as will be explained above. In particular, the most important decrease could be observed in USA, where the considered percentage passed from the 34,3% of 2007 to the 22,1% of 2015. This data is consistent with the fact that the USA were the place in which the financial crisis exploded after Lehman Brothers bankruptcy. But a reduction of the volume of loans dedicated to SMEs could be signalled also in Italy and in UK, where the reduction is more evident only analysing the growth rate of loans dedicated to SMEs from 2008 to 2015, instead of its percentage on the total loans to enterprises.[107]

[104] HORNUF L. and SCHWIENBACHER A.(2017), *Market mechanism and funding dynamics in equity crowdfunding*, in Journal of Corporate Finance, p. 1
[105] *See* CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017) p. 18
[106] ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (2015)
[107] Indeed, in Italy and UK, apart from a little reduction of 1-2% of percentage of loan dedicated to SMEs on total loans, Figure 2.16 shows how the mentioned percentage remained quite stable (around 18-22%) in that period.

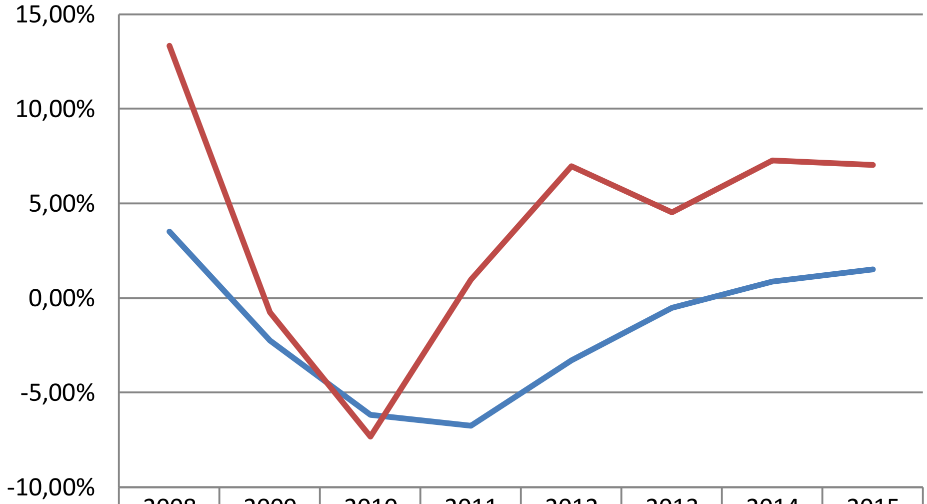


	2007	2008	2009	2010	2011	2012	2013	2014	2015
USA	34,3%	31,3%	30,8%	31,2%	28,8%	26,1%	24,8%	23,3%	22,1%
UK	19,8%	18,1%	20,0%	21,4%	21,1%	21,5%	22,1%	22,5%	22,5%
Italy	18,8%	17,9%	18,3%	19,0%	18,3%	18,4%	18,7%	18,9%	18,7%

Figure 2.17 – Share of SME outstanding loans (% of total outstanding business loans) 2007-2015

Source: Adapted from www.stats.oecd.org/

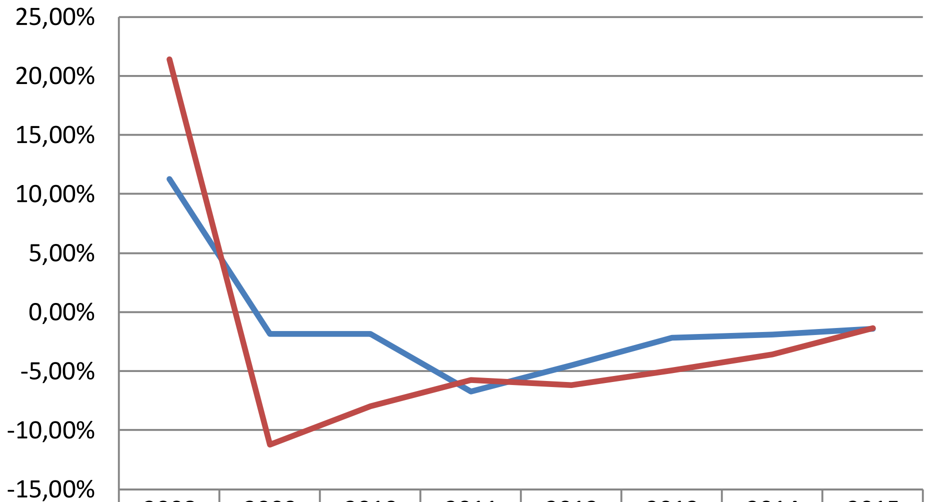
Indeed, analyzing how growth rate of outstanding loan for SMEs changed in the mentioned period gives a more useful insight on the increasing difficulties for SMEs to get financed after the financial crisis. As shown in Figure 2.18, 2.17 and 2.20 below, in all the mentioned countries from 2008 the growth rate of loans issued for SMEs strongly decreased, becoming almost all negative. In USA, for instance, notwithstanding the fact that total loans growth rate started to increase in 2011, the percentage dedicated to SMEs remained negative for other three years before becoming positive only in 2014. In UK, instead, the growth rate from 2009 to 2015 is always negative, without differences between total loans and SMEs dedicated loans . A similar situation could be seen in Italy where growth rate of loans issued for SMEs started going down to became negative only after 2012, with important decrease around 3-4% from 2013 to 2014.



	2008	2009	2010	2011	2012	2013	2014	2015
Loan to SMEs	3,49%	-2,25%	-6,19%	-6,75%	-3,29%	-0,51%	0,85%	1,53%
Total Loan	13,32%	-0,75%	-7,32%	0,96%	6,97%	4,52%	7,25%	7,04%

Figure 2.18 – Evolution of USA bank loan growth rate 2007-2015

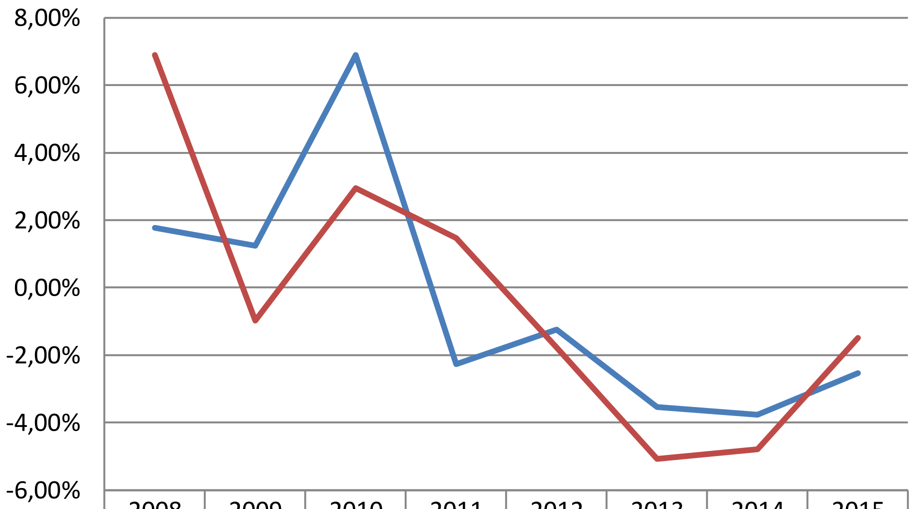
Source: Adapted from www.stats.oecd.org/



	2008	2009	2010	2011	2012	2013	2014	2015
Loan to SMEs	11,25%	-1,83%	-1,82%	-6,72%	-4,49%	-2,18%	-1,89%	-1,40%
Total Loan	21,42%	-11,23%	-7,96%	-5,72%	-6,17%	-4,95%	-3,58%	-1,35%

Figure 2.19 – Evolution of UK bank loan growth rate 2007-2015

Source: Adapted from www.stats.oecd.org/



	2008	2009	2010	2011	2012	2013	2014	2015
Loan to SMEs	1,78%	1,23%	6,89%	-2,27%	-1,24%	-3,53%	-3,77%	-2,52%
Total Loan	6,90%	-0,98%	2,96%	1,47%	-1,78%	-5,08%	-4,79%	-1,48%

Figure 2.20 – Evolution of Italy bank loan growth rate 2007-2015

Source: Adapted from www.stats.oecd.org/

The reason for the reduction of the volume of loans issued, with particular reference to the one issued in favour of SMEs, is linked with the more restrictive capital requirements that regulation imposed to banks after 2008. Indeed, new regulation forced a reconsideration of the risk that each credit institution could bear, and, as a consequence, the reduction of loan conceded to risky business such as the one conducted by SMEs.

Indeed, in most cases, SMEs are companies that, in the better scenario, have a product without having yet a market for it; in the worst one, the product does not still exist. This creates diffidence in credit institutions because of the difficulties for them in making forecasts on futures cash flows of such enterprises, [108] and so, for the impossibilities to evaluate the potential to repay their debts. [109] A relatively high risk of failure together with strong information asymmetry makes loans for SMEs riskier than loans issued to families or to big companies. To respect capital requirement imposed by new regulation, banks were impeded by issuing loans to whom cannot demonstrate the capacity to repay their debt.

[108] See ARMOUR et ENRIQUES (2017) *supra* note 33
[109] WILSON and TESTONI (2014) *Improving the Role of Equity Crowdfunding in Europe's Capital Markets*, p. 4. Available at SSRN: https://ssrn.com/abstract=2502280.

In the described scenario, SMEs were forced to look for "alternatives". One of them was represented by equity crowdfunding that supplied the financing role played by banks. In this way it was possible to use the Internet as a solution to fill the so created "*SMEs financing gap*". [110] Indeed, according to a famous study of the World Banks published in 2013 [111], instead of having for each step of firm's cycle a particular form of finance available, SMEs suffer of a lack of financing instruments in a specific stage before the "maturity" of their life cycle (see Figure 2.21).

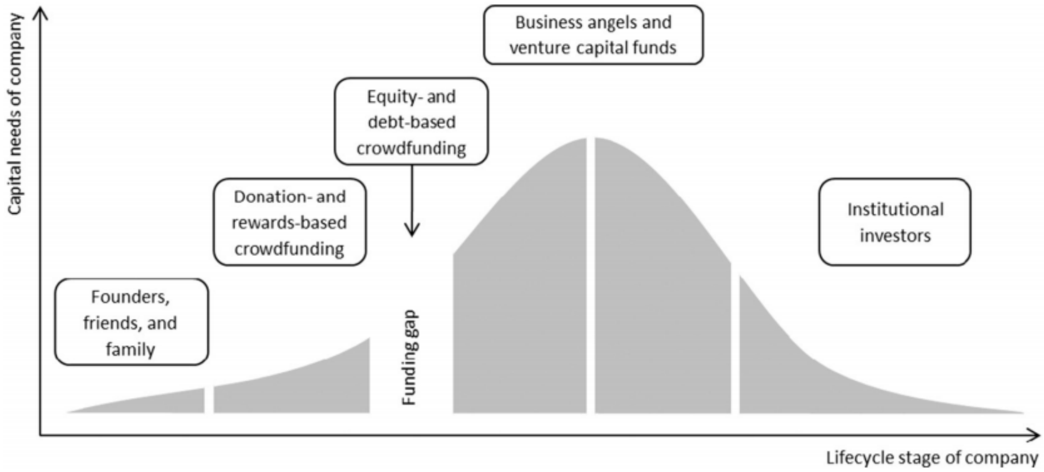


Figure 2.21- SMEs life cycle and funding gap

Source: LUKKARINEN *A., et al., (2016) Success drivers of online equity crowdfunding campaigns, Decision Support Systems,* http://dx.doi.org/10.1016/j.dss.2016.04.006

Therefore, during the first step, the so called *inception stage*, the company is created counting on personal funds or in the ones of family and friends. Only when company starts selling the produced product or service and so, only when track record is available or there are enough assets to guarantee for the loan received, the access to traditional external form of finance is possible. [112] It is this the so called *maturity stage*. The needs of high amount of capital to develop the projects together with lack of track records or assets leave a company, between the inception and the maturity stages, without any possibility to access traditional financing instruments to develop

[110] OECD 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*.
[111] WORLD BANK (2013), *Crowdfunding's Potential for the Developing World*, infoDev, Finance and Private Sector Development Department, World Bank, Washington, DC,
[112] WORLD BANK (2013) p. 17

its business. It is a phase in which *nobody* is available to finance SMEs, creating this funding gap. [113]

In the absence of traditional financing instruments, equity crowdfunding, among other instruments belonging to alternative finance category, has been recognized as an useful financing alternative. Indeed, facilitating the meeting of people that have money to invest with people who need it to develop their entrepreneurial idea, [114] Internet creates the fundamental connection, solving an intermediary problem that before neither banks nor venture capitalists could solve in its stead.

This means that equity crowdfunding occupies a position in the market for firm financing where there is no – or at least little – presence of traditional financing forms. The demonstration of the aforementioned assumption could be observed comparing data from 2013 to 2015 on growth rate of outstanding loan for SMEs (see above Figures 2.18-20) with the data of the same period regarding the growth rate of equity crowdfunding volume in UK and in US. In doing so, it is observed that as the volume of loans available for SMEs decreased, equity crowdfunding market volume increased at rate that was near 876% for UK and 595% for USA in the same period [115] (see above Figures 2.6). A similar growth rate, around 300%, could be reported for Italy although its equity crowdfunding market was still too small in terms of volume to be significant.

This would suggest that the lower is the supply of loan from the banking sector in the market of that country, the higher is the chance that a SMEs will look for equity crowdfunding to finance its entrepreneurial project. [116]

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[113] Definition given by Investopedia.

[114] 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: 1st January 2017] p 101

[115] Instead, from 2013 to 2015 the growing rate of the alternative finance market was, instead, near 381% in UK and 541% in USA.

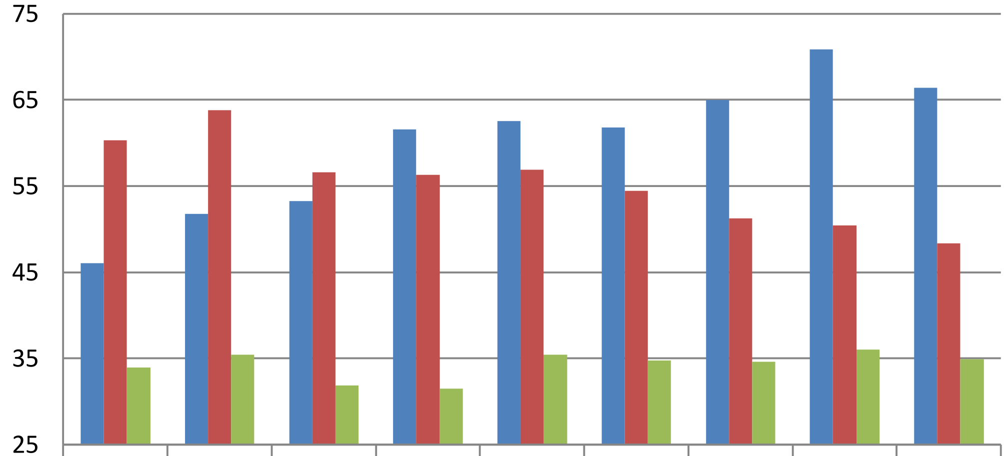
[116] This assumption is coherent with the relation find out between equity crowdfunding development and traditional financing forms in the current literature.To be more precise, the current literature used to find a more negative relation between equity crowdfunding and the banking sector. For more information see PELIZZON L. et al. (2016), *Classification of Crowdfunding in the Financial System*, in Banking Beyond Banks and Money, New Economic Windows, Springer International Publishing Switzerland; RUBINTON B (2011), *Crowdfunding: disintermediated investment banking,* in MPRA, arguing crowdfunding will be an evolution for investment banking, given is theoretical superiority, being crowdfunding more efficient, scalable, wiser and risk distributing; HAAS et al. (2015),

Another way to demonstrate the above mentioned statement on the relation between banking sector and equity crowdfunding development is to consider data on banking sector concentration in US, UK and Italy. [117] Figure 2.21, indeed, shows important differences between those countries. In Italy, after 2009 banking sector concentration increased, passing from 46% of 2009 to 66% of 2015. The opposite happens in UK, where, after the financial crisis, banking sector concentration passed from 60% of 2007 to 48% of 2015. In USA, after a little reduction between 2009 and 2010, banking sector concentration remained very low, being stable around the 30-35%.

Now, if the reported data are considered together with equity crowdfunding volumes of the analysed country, as summarized in Figure 2.6 above it is possible to observe an inverse correlation between banking sector concentration and equity crowdfunding market. Countries with lower banking sector concentration, or where concentration decreased after 2008, developed bigger equity crowdfunding market than other where banking concentration increased. For instance, US, where banking concentration remained stable around 30-35%, developed an equity crowdfunding market that collected $ 1.525 million from 2013; UK, where the mentioned concentration was initially high but then decreased, collected $ 454 million from the same year; Italy, instead, where banking concentration was already high and then increased more, collected less than $ 15 million from the same year.

Modularization of Crowdfunding Services – Designing Disruptive Innovations in the Banking Industry, Thirty Sixth International Conference on Information System, Fort Worth, on how crowdfunding represents a disruptive innovation for the banking industry for its "modularization"; and SCHWIENBACHER (2016), *The internet, crowdfunding and the banking industry*, in The Palgrave Handbook of European Banking, on the relation between lending crowdfunding and the banking industry, concluding however that this area of research is still developing.

[117] Following the approach adopted by the WORLD BANK for each country, banking concentration has been measured as the assets owned by the three largest banks on the total banking assets.



	2007	2008	2009	2010	2011	2012	2013	2014	2015
Italy	46,08	51,8	53,24	61,56	62,55	61,82	65,01	70,85	66,41
UK	60,34	63,82	56,59	56,31	56,91	54,44	51,21	50,4	48,37
USA	33,94	35,4	31,83	31,47	35,4	34,79	34,59	36,02	34,92

Figure 2.22 – Bank concentration, in terms of assets of three largest commercial banks as a share of total commercial banking assets (%)
Source: Adapted from http://databank.worldbank.org

In this way, it could be also explained why, in all its aspects, Italian equity crowdfunding development was so slow compared with the other countries. Indeed, the increase of banks concentration after 2008 slowed companies needs or possibility to access alternative source of funding. Confirmation of this assumption could also found out in the fact that while in 2015 banking concentration in Italy decreased by 4% from the previous year, it is from that year that equity crowdfunding volume started to considerably increase registering a 230% growth rate in the next year.

Therefore, at the end of this paragraph it possible to draw two important conclusions. The first is that equity crowdfunding volume growth rate is related with volume of outstanding loan available for SMEs in this way: the less SMEs have access to "traditional" financing forms, the more they tend to look for alternatives such as equity crowdfunding. The second is that concentration of banking industry is related with equity crowdfunding volumes. Indeed, in countries with lower banking concentration (e.g. UK and US), equity crowdfunding grew of higher volumes than in country with higher banking concentration (i.e. Italy).

To conclude, equity crowdfunding market development is deeply but inversely related to the development of the banking sector that country. This is also confirmed by a recent research conducted in the US by the CAMBRIDGE CENTER FOR ALTERNATIVE FINANCE (2017b) that could be interesting to report. Indeed, an interviews to some alternative finance platforms that recently exited the market, reported that most of the exit decisions have been taken after that banks re-started the issuance of loans at the end of the financial crisis. This is a valid testimony of the existence of a strong competition between "alternative" and "traditional" financing actors. [118]

2.2.2 Financial market and financial literacy

Differences in financial markets dimensions may have created different grounds or frameworks causing the wide spread in terms of development of equity crowdfunding market between US and UK, on the one hand, and Italy, on the other.

To have an idea on how Italian financial market is different from the ones of the other two countries, it is sufficient to compare the most recent data available[119] from the World Bank database and from the Global Financial Development Report 2017/2018 of the WORLD BANK (2018) [120] regarding (i) their number of listed companies and (ii) their stock markets capitalization in terms of percentage of each country GDP, as Figures 2.24 and 2.25 reports below.

[118] CAMBRIDGE CENTER FOR ALTERNATIVE FINANCE (2017b), p. 39

[119] The aim of the comparison is to study the volumes of the mentioned financial market, and not their evolution that, as the data show, it is quite stable in the long period. For more information, see: WORLD BANK (2018) *Global Financial Development Report 2017/2018 : Bankers without Borders*. Washington, DC. Available at: https://openknowledge.worldbank.org/handle/10986/28482 .

[120] WORLD BANK (2018) *supra* note 119

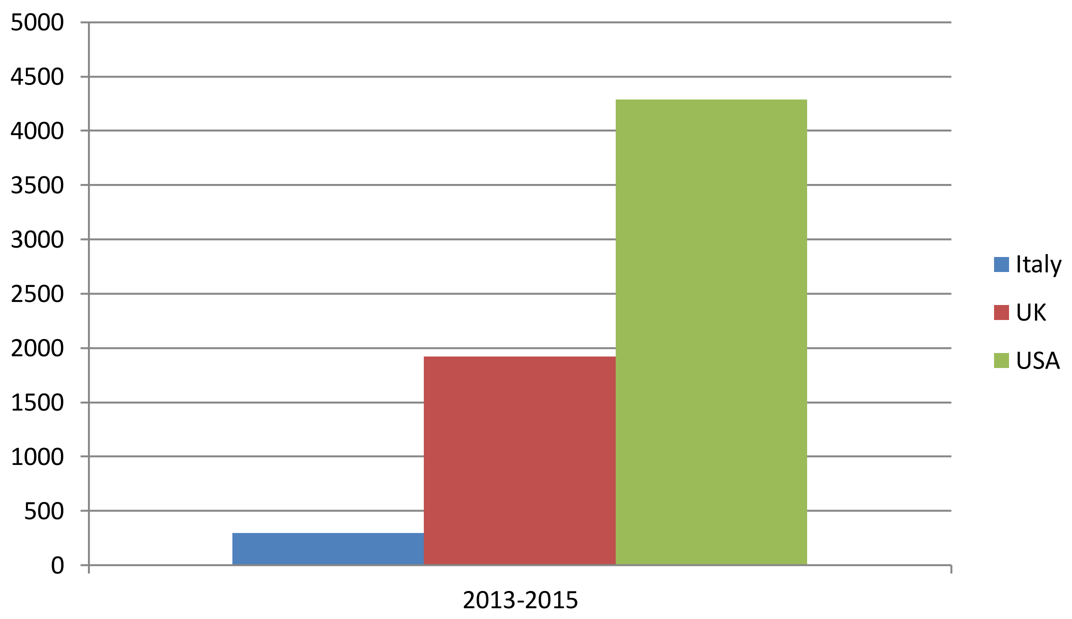


Figure 2.23 – Averaged number of listed companies from 2013-2015

Source: Adapted from http://databank.worldbank.org

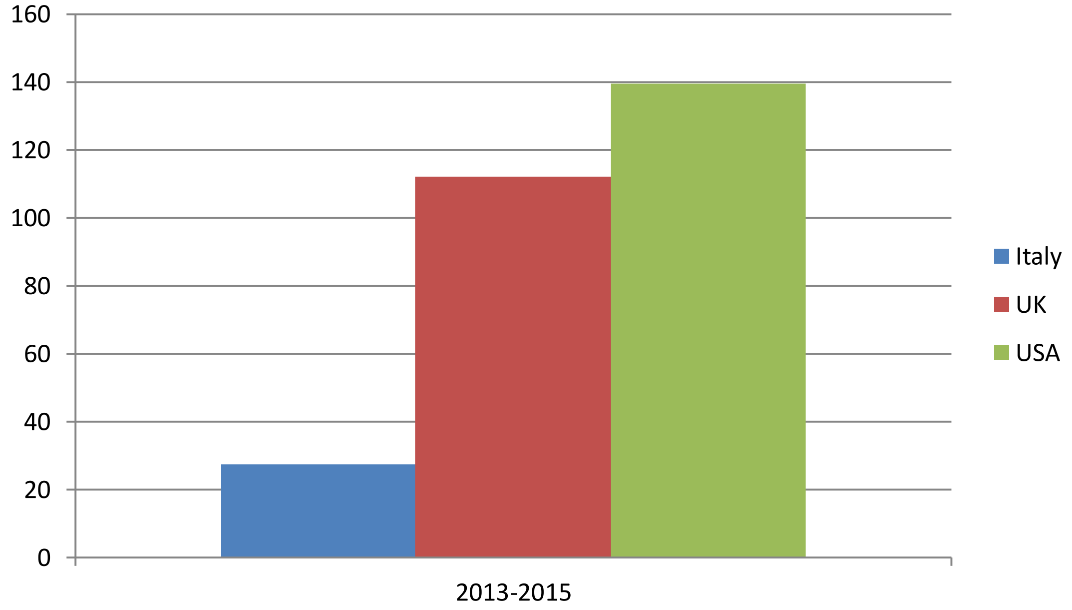


Figure 2.24 – Averaged stock market capitalization to GDP (%) from 2013-2015

Source: Adapted from WORLD BANK (2018)

The following analysis will take in consideration "volumes" instead of growth rates as in the previous paragraph.[121] The initial assumption is that development of financial markets, considering also data on financial literacy, constitutes the basic framework on which an equity crowdfunding market may develop.

After this premise, it possible to see that US financial market is the biggest, both in terms of number of listed companies (on average around 4.300 from 2013 to 2015) that in terms of stock market capitalization to GDP (on average around 139% on the same period). UK financial market is smaller than the American, although still important if UK's GDP is compared with the US one. Indeed, UK number of listed companies (on average around 1.900 from 2013 to 2015) is just less than half the number of the US and, specially, their averaged value of stocks traded to GDP differs only of less than 20%, being the UK around 112%. This results are impressive, considering that UK's GDP is 6 times smaller than the US, as showed in Figure 2.25 below.

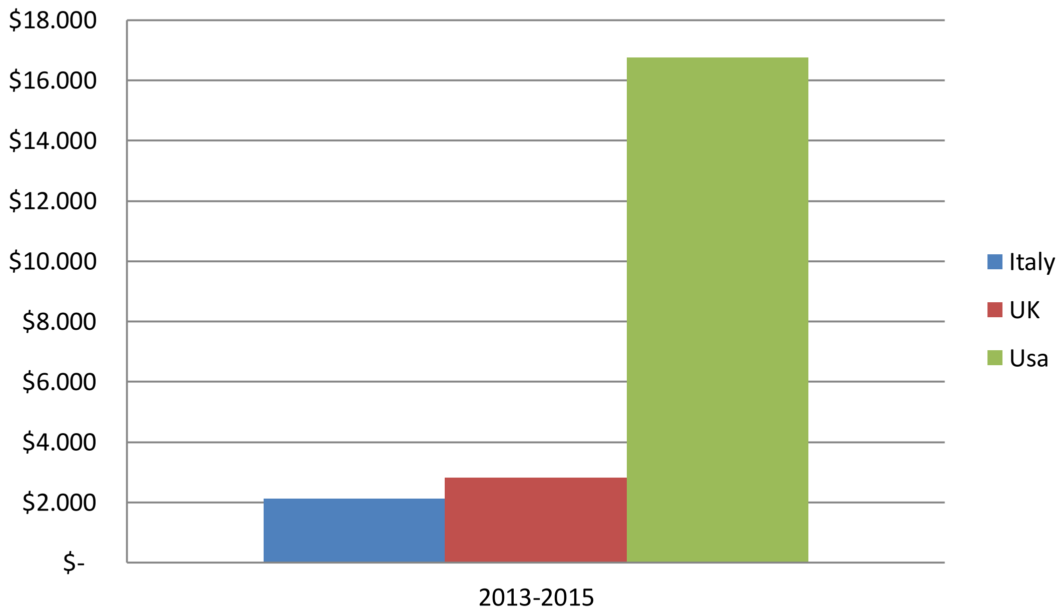


Figure 2.25 – Averaged UK, US and Italy GDP from 2013-2015 ($ billion)

Source: Adapted from http://databank.worldbank.org

[121] For this reason the consideration of a short and recent period of time (2013-2015) is sufficient for this analysis, reflecting the approach adopted by the last study on Global Financial Development. For more information see: WORLD BANK (2018) supra note 119.

Contrary, notwithstanding the similarity between Italy and UK GDP (UK GDP is, on average, only the 30% higher than the Italian), their financial markets are deeply different. Indeed, the number of Italian listed companies, between 2013 and 2015 on average is 290, while the value of Italian stock market capitalization represent only the 27% of its GDP.

From the above description, it is difficult to not recognize some similarity with the respective volume of equity crowdfunding market. Indeed, this difference, already described in detail in paragraph 2.1, could be summarized in the Figure 2.26 below. The Figure show that UK equity crowdfunding market volume, on average, between 2013 and 2015 is only 4.5 times smaller than the US ($ 78 million of the UK, against the $ 318 million of the US). Contrary, the Italian, as for its financial market, remain the smallest in terms of volume, being its averaged value only $ 1.28 million on the same period.

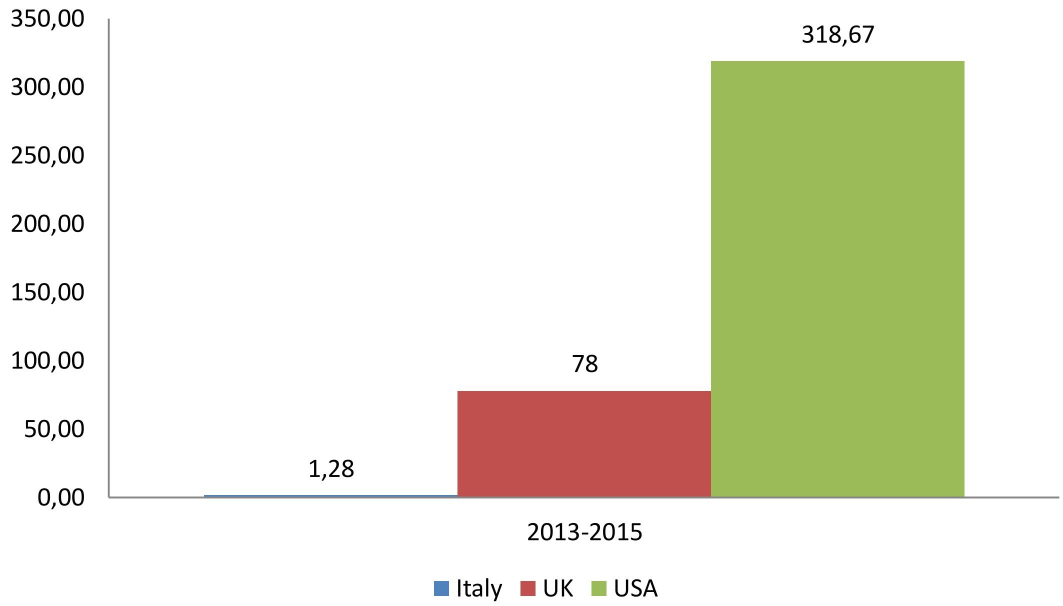


Figure 2.26 – Averaged UK, US and Italy equity crowdfunding volume from 2013-2015 ($ million)
Source: Adapted from www.worldbank.org/

The relation between equity crowdfunding and financial market could be justified by the fact that also the former is a financing instrument based on the subscription and trading of companies' shares, this representing the common factor between financial markets and equity crowdfunding. Indeed, equity crowdfunding could fully be considered as a premature IPO. It is evident that countries with bigger financial markets, such as USA and UK have also bigger equity crowdfunding market. Contrary, as it is the case for Italy, smaller financial markets may be related with smaller equity crowdfunding markets.

But different financial market developments could be observed also from an in investors point of view. Indeed, strictly linked with the level of development of financial markets, and also with the one of equity crowdfunding, it is the different level of investor financial literacy of those countries.

Financial literacy could be defined as the possession of a set of knowledge that allows individual to make informed decisions with their financial resources. Those decisions involve the right way to generate, invest, spend, or save money. With this regard, in a research conducted by Standard & Poor [122] studying the level of financial literacy around the world, Italy is in a really distant position from the US and the UK. Indeed, as Figure 2.25 shows, in Italy only a percentage of adults that is comprised between 35-45% could be considered capable of taking well-informed financial decisions. For this fact, Italy has the lower value of financial literacy between all the major advanced economies (see Figure 2.26), [123] instead of USA and UK that could count on higher results, between 55-75%.

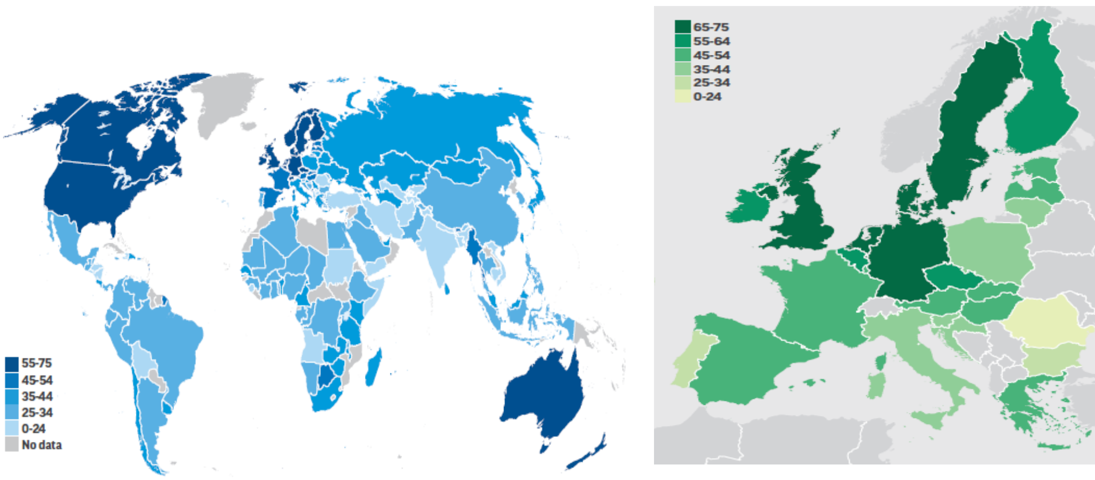


Figure 2.27 **-** *Global and European % of adults who are financially literate*

Source: S&P Global FinLit Survey

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[122] KLAPPER, A. et al. (2015) *Financial literacy around the world*. Available at: http://gflec.org/wp-content/uploads/2015/11/Finlit_paper_16_F2_singles.pdf

[123] *Id*, p. 8

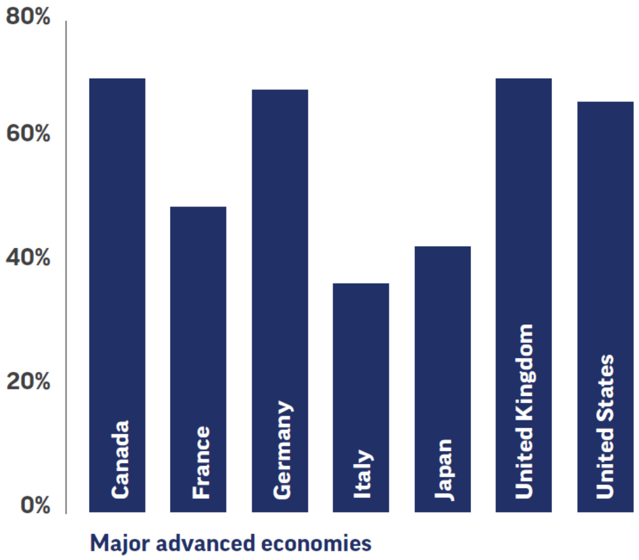

Figure 2.28- Major advanced and emerging economies % of adults who are financially literate
Source: S&P Global FinLit Survey

Lack or low financial literacy level is an element with strong influence on equity crowdfunding development. Indeed, people who are financially literate have the ability to make informed financial choices regarding saving, investing, borrowing, and more. But without an understanding of basic financial concepts, people are not well equipped to make decisions related to financial management. [124] In country where more people understand basic concept of finance, financial instruments, such as share of SMEs or of startups, are more likely that would be subscribed also through equity crowdfunding. The higher is the number of people understanding basic financial concepts, the more are the ones that may decide to invest trough equity crowdfunding. On the other hand, in country in which either traditional financial instruments are not understood (and so not subscribed), it is less probable that an alternative finance market could well develop.

2.2.3 Regulation on equity crowdfunding

As highlighted above, it is not easy to find a relationship - in terms of "direct" influence - between Italian equity crowdfunding market and the factors analyzed

[124] *Id*, p. 4

until now. Instead, a more "evident" relationship could be noticed between equity crowdfunding development and its regulation. To do so, it will be necessary to expose the major rules that at the European level trigger equity crowdfunding usage. After their brief description, it will be possible to understand the rules adopted in UK and in Italy, being those rules the results of the freedom given European Directives to each Member State. As soon as it is understood the regulation of equity crowdfunding in UK, after some comparison with USA regulation, it could be possible to define the rules that in Italy favor or limit equity crowdfunding development. Indeed, the comparison of Italian regulation with the one of two countries in which equity crowdfunding reached a big development, such as in UK and in USA, will help explaining Italian rules that effectivity influence equity crowdfunding market development.

2.3.1 Equity crowdfunding in Europe: United Kingdom, a case of success.

2.3.1.1 Principal limitation of using Equity Crowdfunding in Europe

In the previous paragraph the relation with the established financial sector has been described. But while traditional financing instruments are directly subject to important and harmonized rules at the European level (e.g. Capital Requirements or Prospectus Directives), instead, a dedicated and harmonized set of rules for equity crowdfunding does not still exist. This implies that a regulation of equity crowdfunding is enacted only at the single state level and so that there are different regulations of the same instruments, creating problems of non-harmonization between each Member States**.** The direct consequence of this non-harmonized situation is the imposition of territorial limitation to equity crowdfunding usage across Europe, with clear limitation also for its development.

The principal European Directives that directly affect potential equity crowdfunding development are the following: [125]

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[125] For more detail please see EUROPEAN COMMISSION (2013), *Crowdfunding Innovative ventures in Europe - The financial ecosystem and regulatory landscape*. DG Communications Networks. Available at: https://ec.europa.eu/digital-agenda/en/news/crowdfunding-innovative-ventures-europe-financial-ecosystem-and-regulatory-landscape-smart

- **Prospectus Directive**[126]. It is the major cause of territorial limitation of equity crowdfunding and finds application when shares are issued after a successful crowdfunding campaign. [127]

This Directive regulates the *soliciting of investment* and *the act of public offering* with the main purpose of harmonizing the rules on the information to be contained in the prospectus that companies have to publish when they want to offer securities to the public in the European Union. The prospectus is the document that discloses all the necessary information, [128] about the issuer and its offer, which are necessary for its investors in order to evaluate the investment and the connected risks.

Usually, compliance with the Prospectus Directive is a very expensive procedure. Moreover, it represents a high cost for a company in its early stage activity period. To reduce this burden, the Directive provides some exemptions to this rule that need to be introduced by each Member State in its national law. [129] The most important exemption provides that offers of securities for an

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[126] Directive 2003/71/EC *on the prospectus to be published when securities are offered to the public or admitted to trading*

[127] GABISON G. A. (2015a) *Equity Crowdfunding: All Regulated But Not Equal*, DePaul Business & Commercial Law Journal 13, p. 30. Available at: http://works.bepress.com/garry_gabison/5 [Accessed: 1st January 2017]

[128] "*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]

[129] "*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.

amount of less than €100.000 in a 12-month period are exempted by the application of the Directive and so by the publication of a prospectus. [130] The Directive grants each Member States to increase the threshold up to €5 million in a 12-month period, but to do so, each Member State needs to promulgate a specific legislation to define the increased threshold. This also means that the threshold of €100.000 has by default a "*cross-border value*", so only offer below this amount could address also potential investors of other Member States. [131]

- **MiFID II.**[132] Equity crowdfunding is based on the offering of shares to the public, implying the taking in consideration of MiFID II. [133] The Directive's two main objectives are the harmonization of financial markets and the protection of investors. This goal is pursued through the establishment of a minimum set of rules to be respected by those firms providing financial services (e.g. reception, transmission and execution of transferable stock market transactions).

Directive affects equity crowdfunding imposing rules on platforms on the fact that they "*help the trading* of *securities*". [134] Indeed, platforms to operate need to respect a set of rules issued by the regulatory agency of the considered Member State.

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].

[130] For the sake of brevity, other exemption from the Prospectus Directive that may influence less equity crowdfunding usage will not be reported and commented. Indeed, the issuer is also exempted if the offer is presented to less than 150 natural persons. This requirement is difficult to be respected for internet-based platforms in which the limitation to 150 person will be easily exceeded. 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 Directive.

[131] *See* EUROPEAN COMMISSION (2013) *supra* note 125.

[132] Directive 2014/65/EU *on markets in financial instruments*

[133] *See* GABISON G. A. (2015a) *supra* note 127

[134] *See* GABISON G. A. (2015a) *supra* note 127 p. 22

In more specific terms, platforms may need to comply with the Directive when they undertake the following financial services: 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; and services related to underwritings. [135]

Given a sort of variability in the business model adopted by each platform not all equity crowdfunding platforms fall under the scope of the Directive. In addition, each Member State in the implementation of MiFID II in their own legislation provides for the introduction of different exemptions. One of the most common is the provision of a threshold under which the operation, although included in the ones listed above, is still exempted from MiFID II costly requirements. [136] Other exemptions regards, for instance, the trading of stakes in private company [137]. Indeed, the great part of the companies using equity crowdfunding are at their early stage development so it is very uncommon for them to have shares traded in regulated markets.

The examined Directives imposes to each Member State the issuance of a specific regulation, with the result that the same financing instrument is regulated differently across Europe. Direct implications of this non-harmonized situation are, on the one hand, possibilities of arbitrage or concentration of companies and platforms in States with the more favorable legislation; [138] on the other, in the worst scenario, territorial limitation in the usage of this financing instrument.

So an example of non-harmonization is the imposition of "pass-porting procedure" to operate abroad. From this point of view, Directives and laws of each Member States are like "traps" imposing costs on equity crowdfunding operators. For this reason, usually, platforms move trying not to trigger any of these, limiting their operation to

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[135] *See* EUROPEAN COMMISSION (2013) *supra* note 125 p. 34.

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

[137] *See* EUROPEAN COMMISSION (2013) *supra* note 125 p.33.

[138] *Id*

a single Member State. The consequence of this fragmented regulatory situation it is that 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.

Also the Prospectus Directive is a source of territorial limitation in the use of equity crowdfunding. Indeed, first the Directive does not contain an "adequate" exemption for cross-border operations, that is limited to the sum of €100,000. Second, the Directive give the freedom to each Member State to fix the exemption threshold between the sum of €100,000 and €5 million. The result of this freedom it is that each Member State has adopted different conditions to be exempted from prospectus requirements. [139] Therefore, in relation to the same amount of shares offered, issuers can find in some Member States the full prospectus regime while in others the complete exemption. [140]

In addition, another source of territorial limitations is represented by the other rules of company law of each Member State. As pointed out by HOOGHIEMSTRA and DE BUYSERE (2015)[141], these kinds of limitations could be categorized as "*public offer limitation*", already described, and "*other substantial formalities*" [142] that makes prospectus exemptions useless, thus *eroding* the benefits that this regulation introduced.

[139] HOOGHIEMSTRA 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.

[140] For instance, as reported by HOOGHIEMSTRA S.N. and DE BUYSERE K. (2015): in 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.

[141] *See* HOOGHIEMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 139 p. 139

[142] HOOGHIEMSTRA 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.*

All this limitations should not be accepted in the European market where the will to constitute an internal market based on the *four freedoms* exists.[143] One of these freedoms is precisely the free flow of capital, although a capital market is still underdeveloped and fragmented. [144] The European Commission has also tackled these problems[145], promising to identify and removing these obstacles entirely. Indeed, it has recognized the Prospectus Directive as a barrier for smaller company in raising equity finance[146] promises to solve this issue[147] although it will be a long-term project. [148] For instance, one the suggested solution to this problem is the creation of the Capital Market Union. The main aims of its creation is the release of more investments that could be channeled to all the companies, "*including SMEs".*[149] Moreover, the increase of competition and financial integration to enhance cross-border operations and risk sharing is another point that has been taken into consideration.[150]

2.3.1.2. United Kingdom "non-specific regulation" approach.

United Kingdom equity crowdfunding market is the widest in Europe. [151] The merit is in UK approach to equity crowdfunding regulation that from the beginning was

[143] "*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].

[144] 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*". 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

[145] "*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 144 p. 5.

[146] *See* EUROPEAN COMMISSION (2015) *supra* note 144 p. 5.

[147] "*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* [EUROPEAN COMMISSION (2015)] p. 6

[148] "*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.*

[149] *Id [*EUROPEAN COMMISSION (2015)*]*p. 3.

[150] 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.*

[151] For more detail, please see paragraph 2.1.

very different from the one adopted by other Member State, such as Italy. Indeed, notwithstanding the fact that initially there was lobbying activities to regulate this instrument 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. [152]

In addition, the use of exemption to "cheat" existing regulation in UK has never been a common practice as in other countries such as in Germany. [153] FCA, indeed, has signaled its disapproval of platforms making use of it. [154]

The approach suggested by the FCA was really successful and now UK has one of the best equity crowdfunding regulation of the world as the market results of paragraph 2.1 demonstrate. This is also confirmed by the opinion of UK equity crowdfunding markets operators. Indeed, in a recent study conducted by the CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2016) the 93% of crowdfunding platforms confirmed the regulation to be adequate and appropriate to their activity, as also highlighted in Figure 2.29 below.[155] In the following paragraphs the rules composing this favorable regulation will be reported.

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[152] 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. [Accessed: 15th December 2017]

[153] Reference is made to the German initial use of Profit Participation Loan, a different scheme from the issuing of share (similar to the Italian *Associazione in partecipazione)* that has been used only to *cheat* the limit of €100,000 imposed to security offering without a Prospectus.

[154] *See* BLAIR D. and PRINGLETON A. (2014a) *supra* note 152.This also because, according to the English common law tradition, 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 after a long period of fraud and financial crisis.

[155] *CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017), p. 25*

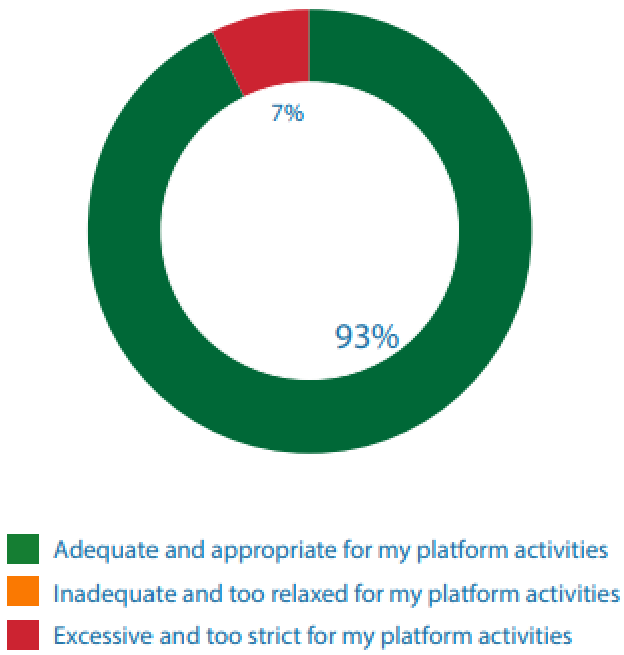

Figure 2.29:Perception of existing equity crowdfunding rules applicable to platforms.
Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2016)*

The first principle of UK approach to equity crowdfunding is that *all* equity crowdfunding campaign needs FCA approval. Indeed, every 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. So, all financial promotions addressing retail investors must be communicated and receive the approval of a FCA-authorized firm without exceptions. In this case, the financial promotion needs to comply with "*Chapter 4 of the FCA's Conduct of Business Sourcebook*" to ensure that the promotion is clear, fair and non-misleading. [156] This rule is successful because FCA revision of the offering induce more trust in investors that can count of FCA first due diligence, reducing to the minimum the risk of fraud. More trust means more investors participation.

[156] The only exception to the FCA approval is to use the *existing shareholder exemption*. To so do, the platform needs to creates a former shareholder relationship with all investors and a parent/subsidiary with the issuer but this is not very common. *See* BLAIR D. and PRINGLETON A. (2014a) *supra* note 152.

FCA authorization is also necessary to operates as crowdfunding portals. Platforms need to be authorized by the FCA according to the Financial and Services Markets Act (FSMA), requiring compliance with the FCA's business code of conduct. Authorization is quite 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. [157] Although this could be seen as a problem if associated with the low value transaction linked with crowdfunding, it should be noted that this expensive procedure did not stop English equity crowdfunding market from blooming. So also the solution to maintain controls on the *gatekeepers* has been a good choice in terms of markets results, although it may be the cause of the few numbers of UK equity crowdfunding platforms and its high concentration level. [158]

Indeed, as UK regulation aims at, the main scope of an equity crowdfunding regulation should be the protection of investors. As BLAIR and PRINGLETON (2014b) reported, "*crowdfunding combines indiscriminate online marketing with speculative start-up investment opportunities". [159]* UK regulator immediately understood that. In addition to the successful rules exposed above, UK regulation keep on protecting investors establishing that only certain investors can receive direct offers from issuers or platforms. These are: retail consumers who take "*regulated advice*" [160], 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 on a 12 months period. This last category shall confirm in writing this fact. [161] So, first,

[157] *See* GABISON G. A. (2015a) *supra* note 127

[158] Indeed, as exposed in paragraph 2.1, in UK the first three equity crowdfunding platforms have the control of the 92% of the market.

[159] *See* BLAIR D. and PRINGLETON A. (2014b) *supra* note 152

[160] "*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 [Accessed: 15th December 2017]

[161] 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 [Accessed: 15th December 2017]

investor protection is realized limiting the categories of investors allowed to participate in equity crowdfunding campaign; secondly, outside of this categories, protection is granted imposing an “auto-certified” limit to all the others.

But this is not enough. Indeed the proper protection of consumers is also granted through FCA supervision of the market. In particular, this includes monitoring platforms website and reviewing monthly information provided by the issuer. The scope is to verify that platform discloses all the relevant information in a way to let potential investors make informed decisions. FCA directly monitors financial promotion and takes action against firms that do not respect its standards[162]. In this way, parts of the costs aiming at protecting investors is sustained directly by the government and the regulator.

Finally, the better part of UK regulation for equity crowdfunding concern policies that enhance the use of equity crowdfunding through mechanisms of tax relief. There are at least two instruments to realize this scope. The first is the Enterprise Investment Scheme, a relatively old instrument, introduced in 1994, aiming at encouraging the financing of company not listed in stock exchange which investment is riskier. 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; and
4. an eventual Tax Relief in case of investment losses.

In addition to the described, in 2012, to encourage startup financing, the UK Government enacted an “update” of the just mentioned scheme, creating a startup tailored instrument: the Seed Enterprise Investment Scheme. The guidance principles are the same 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;

[162] *Id* [FCA (2015b)].

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; and
3. 100% inheritance tax relief.

In this way, UK regulation[163] not only aims at protecting investors before they takes investment decision. Protection goes far, giving aid to investors also in the worst situation, that is the failure of the company, through mechanism of good tax relief.

But some important rules in improving equity crowdfunding development has been take also with reference to the potential issuer. After creating a "safe" area for the investors thanks to the rule already discussed, UK regulator gives issuers free space to operate. Indeed, Prospectus Directive [164] has been implemented in the most favourable way for the issuer. [165] In UK, as in Italy, the regulator decided to use the prospectus exemption as wide as permitted by the Directive. For this reason, each issuer is exempted from the publication of a prospectus if the collection is less than

[163] There are also some rules to be respected in order to receive this tax benefits. Indeed, investors shall not be an employee of the company and the shares, which have been issued or held, should not represent more than the 30% of the company. At the same time, any issuer who wants to make the share issued as eligible for these benefits should follow some additional rules: 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; should not have been incorporated for longer than 2 years prior to the issuing of shares; and the company needs to operate in a business comprised in the SEIS/EIS permitted list.

[164] 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.

[165] With regards to the implementation of other European Directive, 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, acting as a fund, does not help the creation of a common issuer/shareholder relationship, but instead pools investor's contribution or of their income prior to the distribution without any involvement of shareholders in the day-to-day management of the company. This leads to the creation and the management of an AIF. For a platform adopting the described business model, the AIFMD will 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 CIS. For more information see BLAIR D. and PRINGLETON A. (2014a) *supra* note 152.

£5 million in a 12 months period from no more than 150 non-qualified investors [166]. Indeed, in a situation in which compliance costs are borne mostly by platforms and to investors are given as much guaranties as possible, there is no use for limit issuers' collecting capacity .

2.3.2 Equity crowdfunding in the US: the rules that favour equity crowdfunding development.

The USA was the first country in the world to formally regulate crowdfunding with the Jumpstart Our Business Startups Act (*JOBS Act*) signed into law on 5 April 2012, dedicating its Title III entirely to equity crowdfunding.

Before the implementation of this title, some exemptions from the Securities and Exchange Commission (SEC) regular regime provided for IPOs already 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 offering [167]. Unfortunately, this regulation was not incisive enough for launching equity crowdfunding, for at least two main reasons [168]: first, it was not applicable to the "crowd" but only to accredited investors *"who can fend for themselves"* [169];second, the $5 million exemption from the SEC's regime did not avoid state-by-state registration. In this way, equity crowdfunding was both personally and geographically limited or too expensive, involving compliance with each state "Blue Sky's Law" [170].

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[166]*See* GABISON G. A. (2015a) *supra* note 127 p. 30

[167] Implementing Title IV of the JOBS Act, Regulation A has been replaced with the so-called Regulation A+ that let companies 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* ALMERICO 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 [Accessed: 01st January 2017]

[168] For more information about Old Regulation A *see* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 22

[169] *Id* [HORNUF, L., and SCHWIENBACHER A. (2015b)] p. 8.

[170] "*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]

Notwithstanding the first regulation is from 2012, final rules implementing Title III where enacted only in 2015 by the SEC [171] that 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 *famous* three "F"s: Family, Friends and Fools [172].

Last, the JOBS Act also 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. [173] This provision is very important in helping the development of equity crowdfunding. Indeed, in this way it could be possible to avoid territorial limitation, impeding each state to introduce different regulation on equity crowdfunding.

With regard to regulation dedicated to the issuer, US is not so permitting as UK is. Indeed, Title III of the JOBS Act permits the fund seeker to raise up no more than $1 million in a 12-month period. This amount is far from the € 5 million that could be raised in UK or in Italy.

In addition, regulation of Title III introduces two main obligations for the issuers: information disclosure and advertising limitations. In relation to the first, issuers shall provide investors with the necessary information to appreciate risks and rewards of an investment. In doing so, an active role is played by the platform that 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 portal [174].

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[171] SEC press release available on its official website at: http://www.sec.gov/news/pressrelease/2015-249.html

[172] With 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

[173] *Id [*SCHWARTZ, A., (2013)*]*.

[174] 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 [Accessed: 01th January 2017]

One of the best aspect of US regulation is the “proportional disclosure approach”. Indeed, apart from giving basic information about the company and potential risks of investing in those securities, the issuer has the power to decide the amount of the information that it wants to disclose on the base of the amount that it aspires on collecting. Information to be published are so proportioned to the amount of money the issuer seeks, without imposing a *fixed* cost on him. 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; and
3. more than $500,000, an audited financial statement is necessary.[175]

In this way disclosure operations are not as expensive as the ones requested to conduct a traditional IPO procedure and can be tailored on issuer financial needs and possibilities. [176] In addition, issuers are also required to disclose other information regarding the campaign [177] and to publish periodical updates. But disclosure operations keep on 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 crowdfunding operations.

With specific reference to investor protection, instead, in the US, this is realized limiting the maximum amount of money that each individual can send to the issuer. This limitation is based on the investor’s annual income. On the contrary, there is no restriction on the maximum number of investors that each issuer could attract

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

[176] In particular, disclosure obligation is limited to four information: (i) personal detail and names of directors, officers and investor owning more than 20% of the company; (ii) description of the current and the future business plan; (iii) disclosure of certain related party transactions; and (iv) description of the financial conditions of the issuer. *See* SCHWARTZ A. (2013) *supra* note 172.

[177] These are: (1)Price of the securities issued; (2)Target capital; (3)Deadline for reaching the target; (4)Possibility to go overfunded.

through the crowdfunding campaign. [178] It is possible to distinguish three categories of investors: (i) investors with an annual income lower than $100,000; (ii) investors with an annual income higher than $100,000; and (iii) investors who do not want to disclose their annual income. The group *sub* (i) can invest no more than 5% of their greater income, and so, at best $2,000. The second one, *sub* (ii) can invest up to the 10% of their annual income. Finally, investors belonging to the last category *sub* (iii) are limited to the sum of $2,000. [179]

Not a good rule in enhancing equity crowdfunding development are the principle imposing limitation also in the secondary market of these securities [180], providing that investors are restricted from transferring their securities for one year. This rule is not valid only in case of transfer to: (i) the issuer, (ii) an accredited investor, (iii) an offering registered with the SEC and (iv) an investor's family member. Because of the reduced number of shares issued and these transfer limitation, some authors argue that a secondary market will hardly develop in US equity crowdfunding markets. [181] Limiting the secondary market for this instrument, indeed, enhance one of the specific risk of equity crowdfunding, that is to say illiquidity.

Investors protection is, in addition, realized through imposition of some obligation to the platform. [182] Indeed, they are forced to make the investor answer a questionnaire

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[178] *See* SCHWARTZ A. (2013) *supra* note 176.

[179] *See* 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: 01th January 2017].

[180] *See* ELLENOFF S. D., ADLER J., SELENGUT D. and DEDENATO M. (2014) *supra* note 174.

[181] *See* SCHWARTZ A. (2013) *supra* note 176.

[182] "*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/tmjobsact-crowdfundingintermediariesfaq.htm As seen above, equity crowdfunding platform activity could be realized taking the legal form of broker-dealer or of funding portal. This last one is a new classification of intermediary created by the JOBS Act, subjecting equity crowdfunding portals to SEC regulation. The procedure introduced by the JOBS Act to be recognized with the SEC as a funding portal is simpler than the one provided for broker-dealer, although it provides more limitations from an operation point of view. These are: prohibition of

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. In addition, if the investors answer correctly to the questionnaire, and mange to complete the investment, the platform has to adopt a mechanism to grant them the possibility to withdraw their investment. In general terms, the aforesaid requirement has to be implemented together with another providing that the issuer cannot receive the proceeds of the offering until the target amount is reached or exceeded. These are all good rules enhancing investors protection without imposing disclosure costs on the issuers.

US funding portals also need to take the necessary disclosure measures to reduce the risk of frauds. Concerning their relations with the issuers, portals has 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 equity crowdfunding share [183] but they are prevented from purchasing shares in the campaigns they are promoting.

2.3.3 Principles fostering equity crowdfunding development

In this part of this chapter, thanks to the analyzed regulation in which equity crowdfunding registered really good results, the principles that should be followed for fostering equity crowdfunding development will be presented. In this way, Italian regulation could be analyzed in light of this principles and each relevant rule could be classified as "fostering" or "limiting" equity crowdfunding development.

It has been shown [184] that the risk of fraud is the biggest enemy in the development of equity crowdfunding.[185] For this reason, the general rule is that a good equity

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offering investment advice and being in charge of investor education. This means that platforms have to provide educational materials without making recommendations or giving investment advice.

[183] *See* ALDERMAM P. (2015) *supra* note 179.

[184] The reason has been examined in Chapter I in the paragraph dedicated to crowdfunding's disadvantages for bidders/investors. For further details see paragraph 1.4

[185] 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

crowdfunding regulation should pursue two complementary goals. 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.[186]

Those results has been achieved by USA and UK regulations as demonstrated by their market results. For these reasons, from the exposed regulations, their analysis and their evolution, the following list contain all the principle that an equity crowdfunding regulation should respect in order to favor its development. These are:

1. **Removal of territorial limitations**. Equity crowdfunding was born thanks to the Internet that is the "infrastructure" that permits crowdfunding to work, allowing the crowd to gather and to collect 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 be pursued to let this innovative financing instrument to "*unleash all its potential*". [187]

   Indeed, territorial limitations directly affect equity crowdfunding, imposing: to platforms an expensive procedure for obtaining a "passport" to operate in a different country; to the issuer, the impossibility to offer its shares in other platforms without complying in full with the legislation of that country. In the European Union laws imposing these limitation are the European Directives and their application (e.g. Prospecus Directive as explained in deep in paragraph [2.3.1]) [188] The result is that platforms and companies are not allowed to publicize their offers in other countries, in this way limiting an instrument that, for its nature, should not have limits.

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[186] 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.

[187] 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

[188] 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.

Also past experiences give us a demonstration of this: territorial limitation was the reasons for the failure in the USA of the old Regulation A. [189] There, issuers considered compliance with the Blue Sky Laws of each state in which they wanted to address potential investors excessively expensive, meaning the aforementioned regulation was under-used.

2. **Abolishing business, size and time restrictions**. All kind of companies should use equity crowdfunding if they expect to obtain some benefit, without regard to their field of activity [190], the time passed from their incorporation [191], or they dimension. [192]. Indeed, as mentioned in the first Chapter, the advantages of equity crowdfunding are not only limited to the nature of its financing method [193], but there are many other benefits that companies could acquire through its use. Support from the crowd and marketing advantages are the most relevant.

Moreover, buying shares in bigger companies entails fewer risks than becoming a startup or SME shareholder. Although equity crowdfunding could be considered useless for the company purposes, having access to other financing forms,[194], 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, at least, on the size of the offer. [195]

Finally, legislation imposing time limits on the use of equity crowdfunding should also be avoided. This is because, the early-stage is not uniform for all

[189] Now replaced by Regulation A+ as it was described in footnote 180 of the previous paragraph.
[190] For instance, innovative or not, with a clear reference to Italian regulation analyzed in paragraph 2.3.4.
[191] This is another reference to Italian legislation in which equity crowdfunding could not be used by company that after four year *naturally* loses their status of ISU, without the possibility of acquiring in future other types of status giving access to crowdfunding(ISU or I-SME).
[192] This reference is made to the Italian Law and its definition of I-SME as seen in the previous paragraph.
[193] For a complete list of the other benefits obtainable *see* NASRABADI A. G. (2015) *supra* note 44 p. 2013. Most of them has been reported in paragraph 1.3
[194] 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.
[195] *See* BRADFORD, S. C. (2012) *supra* note 114 p. 132.

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 yet, technological developmental problems or technological precocity. In this way, legislation that limits the use of this instrument to only some years from the startup’s creation goes directly against the issuer’s needs, without letting it benefits from the advantages provided above.

3. **Restricted disclosure and compliance costs.** A good regulation favoring equity crowdfunding development should reduce disclosure costs for the use of this financing instrument, in light of the major users of equity crowdfunding that generally are unable to afford costly prospectus requirements.

With regards to disclosure costs, HORNUF and SCHWIENBACHER (2014) demonstrate that “*firms raise inefficiently low amounts of money when the exemptions are restrictive*” [196] and they continue by saying that strong investor protection is not beneficial for small firms. Thus, according to BRADFORD (2012), excessive disclosure requirements “*make no economic sense*” for small offerings such as the ones that crowdfunding facilitates. [197] Therefore, too few exemptions from disclosure rules can discourage entrepreneurial initiatives. [198]

The same is true with regard to 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. [199] In most cases, indeed, the compliance 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.

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[196] *See* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 22.
[197] *See* BRADFORD, S. C. (2012) *supra* note 114 p.144.
[198] *See* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 22 p. 5.
[199] *See* HOOGHIEMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 139 p. 164

The advantage determining the success of crowdfunding is the fact that the Internet reduces the transaction costs [200] that were, previously, the major obstacle impeding collection of money from a wide public. [201] But this is also possible thanks to crowdsourcing that, changed the existing relation of the classic forms of financing in which retail investors are no more advised by *ad hoc* consultant and are not moved to invest considering only the possible financial returns. In crowdfunding, the crowd "advise itself", caring less in studying in deep the business model of the company. Often investors decide to give money to the company, not *only* because they want a financial return. They are attracted by an idea they think that it is something that they understand and they could contribute to. Participation and advice favor the creation of a strong bond between the company and the community. [202]

Given these premises, rules imposing high costs for investors' protection can be relaxed. [203] 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. [204]

4. **Promoting exit process.** The promotion of the secondary market for financial instruments acquired through equity crowdfunding is important in a way to creates more and more exit opportunity for investors. In order to do so, legislative ties impeding the sale of shares before a fixed period should be

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[200] *See* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 22 p. 2.

[201] 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.

[202]. 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 44 p. 203

[203] 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.

[204] "*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) *The Regulation of Crowdfunding in the Draft Small Investor Protection Act: Content, Consequences, Critique, Suggestions* p. 13. Working paper. Available at: http://ssrn.com/abstract=2595773.

completely avoided. [205] These are the one introduced directly by company or tax laws.[206]

On this point restriction to secondary market is justified by the fact that secondary markets investors will not have access to the information available to the first buyer [207], thus involving higher risks of fraud. But 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 time [208]. In this way information will remain available also for secondary market investors.

In addition, the development of trades between retail and professional investors is necessary to enhanced exit possibility and so also reduce risk of illiquidity, one of the major risks of equity crowdfunding.

5. **State intervention.** Another profitable way to enhance equity crowdfunding development is State intervention in a way to protect investors, without imposing costs on companies. This is possible only through the introduction of state aid, also in the simple form of tax relief, that helps investors only when they receive patrimonial damage. [209] States will have a direct gain from this form of intervention, such as the promotion of innovation or concentration of companies and platforms in their territory.[210]

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

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

[206] An example of the direct introduction of this prohibition is the USA JOBS Act, while an example of indirect restrain can be found in UK tax law. For more detailed information see paragraph 2.2.3.

[207] HEMINWAY J. M. and HOFFMAN S. R., (2011) P*roceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 892–906

[208] *See* BRADFORD, S. C. (2012) *supra* note 114.

[209] 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 paragraph 2.3.1.2. 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.

[210] 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 rise £279,000.

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 disclosure requirements.[211]

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. [212] This is true with regard both to the 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 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.

2.3.4. Italian regulation: opportunity and limitation.

After defining the rules on equity crowdfunding developed in UK and US, defining which favor and which obstacles equity crowdfunding development, in this paragraph more space will be dedicated to analyzing Italian state of arts regarding equity crowdfunding development.

Indeed, in 2012 Italy was the first European country issuing a specific regulation dedicated to equity crowdfunding. [213] But being the first Member State regulating

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[211] For instance, an example of those requirements is MIFID II "profiling". Because of the perspective adopted, this dissertation deals more with obstacle nearer issuers (such us Prospectus Directive disclosure requirements) than duties such the aforementioned regarding more the Investor's Perspective.

[212] *See* HOPKINS J. and HOPKINS K. (2013) *supra* note 205 p 15.

[213] This introduction has been made with artt. 25 to 30 of Law n. 221/2012, dedicated to "innovative startup". The law was implemented with by Italian Securities and Exchange Commission (*Commissione Nazionale per la Società e la Borsa,* hereinafter CONSOB) on 26 June 2013, with the first draft of CONSOB Regulation 26-06-2013, n. 18592, '*Raccolta di capitali di rischio da parte di start-up innovative tramite portali on-line*', at last amended with CONSOB Resolution n. 20204 of 2017. Updates and innovations followed with Law Decree n. 3/2015 converted into Law n. 33/2015, published on March 2015, with Law n. 232/2016, and, last, with Law Decree n. 50/2017, converted into Law n. 96/2017. For more detailed information, see DE LUCA N. et al. (2017), *Equity Crowdfunding*, in Digesto delle Discipline Civilistiche: Sezione Commerciale, UTET GIURIDICA

equity crowdfunding, for Italy means also being the first Member State limiting the usage of this instrument as will be explained in detail below.

Briefly, two were the main limitations characterizing Italian Legislation: the first regarded "who" could use equity crowdfunding as a financing instrument; the second, instead, the investors, or "who is forced to invest" for the legislative success of the campaign. This two main limitations were the main reason that slowed more Italian equity crowdfunding market. Only in 2017 the first of this two has been removed while the second one has been relaxed as will be reported below.

2.3.4.1 National Law Regulation

2.3.4.1.1 The past limitation on "who" could use equity crowdfunding

In Italy equity crowdfunding has not been introduced to be used by "every-issuer". Indeed, Italian regulation required companies to meet certain "innovative" conditions to have access to this financing instrument. Only when those were fulfilled, the issuer can be enrolled in a special section of the Italian Company Register and so have access to equity crowdfunding. In this way, Italian regulation introduced two new legal companies' statuses: Innovative Startup (ISU) [214] and Innovative Small and Medium-size Enterprises (ISME)[215]. Both status can be acquired by limited [216], public [217] or cooperative companies. With this regulation decision, Italy do not introduced two new legal forms; they are only "titles" that even an *already set-up* enterprise could acquire satisfying the conditions set forth below, just asking for the enrollment in the special section of the Company Register.

The description of this two statuses is important in a way to understand how the evolution of Italian crowdfunding market went together with the relaxing of the rules concerning this instrument.

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

[215] The definition is given by Art 4, comma 1, Law Decree 3/2015

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

[217] *Società per Azioni, SPA*.

The definition of ISU was introduced in 2012 with the first crowdfunding regulation. In 2012 only company fulfilling the following conditions could have access to equity crowdfunding. These are:

1. Have an innovative purpose [218];
2. Satisfy at least *one* of the three following requirements [219]:
    a. At least 15% of the major between the company's expenses and net turnover shall be used for research and development activities;[220]
    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;[221]
    c. Hold, possess or be licensee of high tech patent rights linked with the main purpose of the company.[222]

In addition[223], the company shall have been set up no more than 5 years before filing for the 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, one of the most important aspect to highlight for our purposes is that ISU cannot pay dividends and it has to maintain a net turnover for two fiscal year lower than 5 million euros. These two limitation has a clear influence on equity crowdfunding development. Indeed, financing an ISU through equity crowdfunding means financing a company with a limited possibility to obtain a

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[218] 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*».

[219] 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

[220] Art 25, para. 2, let. H, n. 1, d.l. n. 179/2012

[221] Art 25, para. 2, let. H, n. 2, d.l. n. 179/2012

[222] Art 25, para. 2, let. H, n. 3, d.l. n. 179/2012

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

return from the investment in the short period, given the impossibility to pay dividend.

After three year, considering the underdevelopment of Italian crowdfunding market, it has been decided to wider the group of companies that could have access to this instrument. For this reason, Law Decree n.3 of 2015 introduced a second status, so giving the possibility also to a small group of small-and-medium size enterprise to access equity crowdfunding. However, the innovative requirements was still required. Indeed, a company is considered as an ISME when it satisfies at least *two* of three requirements, similar to the ones provided for the ISU status. Those are[224]:

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) ;
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 company[225]

Moreover [226], 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 Enterprise[227]. 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. Finally, the same regulation error committed for ISU was replicated for I-SME. Indeed, also those company was prohibited from paying dividend while maintain the status of I-SME, in this way limiting their attractiveness for investors.

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[224] *See* ITALIAN MINISTRY OF ECONOMIC DEVELOPMENT (2015) *supra* note 234.

[225] Art. 4, d.l. 3/2015

[226] *See* DE LUCA N. (2015) *supra* note 238.

[227] 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 .

As it could be forecast, also this amendments was not enough for Italian equity crowdfunding market. This was because Italian regulation kept on associating only to 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.[228] All these benefits are the reason why there are so many conditions to fulfill and the discipline is so stringent. The initial intention of the Italian Regulator was to provide innovative companies with some instrument to develop easier their business models. In this vision, equity crowdfunding was *only* one of all this instrument and, for that decision, it was *doomed* to be used only by innovative companies. [229]

Only in 2017, with a delay of four year, with the above mentioned Law Decree n. 50/2017, Italian regulator finally decided that all SMEs could access equity crowdfunding. In reality, this innovation confused the role of the Italian private company (s.r.l.) with the Italian public company (s.p.a.) [230], providing that also the first, traditionally closed companies, could have their share offered to the public while providing a quite complicate mechanism to favor its trading. [231]

2.3.4.1.2 The actual obligation to participate in an equity crowdfunding campaign

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*" [232] subscribe at least the 5% of the offered capital. Fortunately, the definition of professional investor became wider with the following amendments to the first regulation. It currently includes bank foundations, investment companies, financial institutions for

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[228] *See* ITALIAN MINISTRY OF ECONOMIC DEVELOPMENT (2015) *supra* note 234. For more information about these advantages see http://www.sviluppoeconomico.gov.it/index.php/it/impresa/piccole-e-medie-imprese/pmi-innovative.

[229] *See* DE LUCA N. ET AL (2017) *supra note* 228 p. 5.

[230] *See* DE LUCA N. ET AL (2017) *supra note* 228 p. 6 for a specific critic on this matter.

[231] For more information see DE LUCA (2016), *Crowdfunding e quote «dematerializzate» di srl? Prime considerazioni (art. 100 ter, 2° comma bis e 2° comma quinquies, t.u.f. introdotti dall'art. 4, 10° comma, d.l. 24 gennaio 2015 n. 3, conv. dalla l. 24 marzo 2015 n. 33)*, NLCC, 1

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

innovation and development, innovative startup incubators, and "professional investors on request". The last category, introduced in 2016, included also single individuals with proved experience of investment in startup and determined patrimonial requisites. [233] In this ways, this category it is now enough wide so reaching the 5% it is easier that when it was introduced.

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. [234]

One of the other few "obstacles" that an investors has to overcome before being able to contribute to an equity crowdfunding campaign, is the completion of the "path for informed investment" [235]. 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 protects investors granting them a right to withdrawal from the investment, to be exercised within 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 imposing to the issuer an obligation to add 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 expires [236]. In this way, investors are protected against future and sudden changes in the property structure.

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[233] *See* DE LUCA N. ET AL (2017) s*upra* note 228

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

[235] 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

[236] *See* DE LUCA N. (2015) *supra* note 238.

2.3.4.1.3 Regulation of the Platforms

Italian regulation provides a specific regulation also for equity crowdfunding platforms. To exercise their activity, they need to be enrolled in a public register held by CONSOB. Platforms regulation has the main scope to protect investors and this goal is reached providing certain requirements that need to be fulfilled before operate. There is always a need for balancing investors protection with compliance costs. This is more true considering that platforms usually have a very simple business model that consists in a percentage (usually 5%) of the money collected with success in each single campaign.

The regulator 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 companies already hold all the requisites to manage this activity. They are not so much spread in practice, indeed there are only two *de iure* platform. This demonstrate at least two things: the first is that equity crowdfunding market in Italy it is too small to justify an investment of already existing financial intermediaries to enter the market; the second is that intermediaries do not feel the need to enter this market because alternative finance operator are not seen as competitors yet.
2. "*Special Website Managers* (SWMs)" [237], which are mainly designated companies that have to meet the requirements provided by TUF [238] and decide to carry out the business of online funding portals.

As far as the second kind of platform is concerned, a particular discipline, caring for investor's protection, is involved. 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 respect honorable and professional requirements. In addition[239], SWMs cannot hold sums of money or financial instrument belonging to

[237] Definition of DE LUCA in DE LUCA N. (2015) *supra* note 238.

[238] Art. 50-Quinquies

[239] PIATTELLI U. (2014) The Italian legal framework of Equity-based Crowdfunding. *Osborneclark.com* [Online]

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.[240] All this duties are complementary with the disclosure obligations requested to the issuers.

2.3.4.1.4 Implementation of EU Directives

Italy implemented highest threshold exemptions provided by Prospectus Directive, 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. [241]

As seen above, only banks or investment companies can handle the proceedings of the offers with particular reference to the appropriateness of the investment . In doing so, to comply with MiFID II Directive the investors were forced to conclude "physically" the investment in front of an intermediary if the investment exceed a

[240] 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 disapplied) 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*

[241] Attachment 3, Consob Regulation 26-06-2013, n. 18592.

certain amount. With the last legislative innovation, the test of appropriateness can be made directly on-line but the platform it-self.[242]

2.3.4.2 Aspects of Italian regulation that favor equity crowdfunding development.

The following paragraphs finally aim to enlist the aspects of Italian legislation that favor equity crowdfunding market development. These are:

- **Higher exemption from the Prospectus Directive** . In order to make access to equity crowdfunding as easy as possible, the costs of access to this instrument should be minimum. This is the aim of exemptions from the Prospectus Directive, implemented with art. 100-*ter* of TUF. Therefore, it has been a good choice for the Italian regulator 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 paragraph the same choice has been made by the UK, that, as Italy, fixed the exemption threshold at the highest level permitted by the Prospectus Directive: €5 million. In each 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 collected more than €1 million [243] and although higher sum is sought it is the crowd the *determine* the success or not of the campaign. [244]

- **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

[242] AIEC – ASSOCIAZIONE EQUITY CROWDFUNDING ITALIA (2015) I 5 punti di AIEC. *EquityCrowdfundingItalia.org* [Online] Available at: http://www.equitycrowdfundingitalia.org/ [Accessed: 15th December 2017]. See also DE LUCA N. ET AL (2017) *supra note* 228 on this specific point

[243] 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: – SANTELLI F. (2014) Crowdfunding, lo strano caso di Paulownia, *La Repubblica*. [Online] 26th August 2016. Available at: http://www.repubblica.it/rubriche/startup-stories/2014/08/26/news/crowdfunding_caso_paulownia-94459210/?refresh_ce [Accessed: 1st January 2017]

[244] 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.

can be easily understood. 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. As will be exposed in deep in the next paragraph, indeed, investors pay few attention to the information reported in the platforms and they spent really few time in due diligence process. For this reason, the request of lots and complicated information to the issuer could be harmful for the investors.

Italian regulation, in particular CONSOB Regulation 26-06-2013, n. 18592[245], (and such as the German one) introduced a simple rule in line with this principle, providing the obligation for issuers to expose some precise and simple information to the public in no more than four pages. 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.

- **Self-certification.** Another way to reduce disclosure costs is providing self-certification for investors. [246] According to CONSOB Regulation 26-06-2013, n. 18592, this method consists of requiring investors to answer some questions before being able to access the investment, in order to show them only the equity crowdfunding campaigns, if any, that suits the investors capabilities and risks. Apart from Italy, this rules has been also adopted in the UK [247], 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. If the questionnaire is not correctly answered, to the investor is not given the possibility to contribute to the campaign.

The advantages of self-certification are numerous. The investor is *forced* to understand the possible risks of investing in equity crowdfunding by correctly

[245] The details and the model are provided in Attachment 3, CONSOB Regulation 26-06-2013, n. 18592.
[246] *See* HOOGHIEMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 139 p. 155.
[247] For further details see paragraph 2.3.1.2

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. [248] Indeed, as demonstrated by LUSARDI (2006) lots of investors do not pay attention to information disclosure. [249] 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*. [250] 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. [251] The second one is about the investor's job

[248] *See* BRADFORD, S. C. (2012) *supra* note 119.

[249] 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

[250] For further detail about the platform see: www.crowdcube.com

[251] 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

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

and past economic experiences. [252] 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, the platform give the option of investing money in the issuer.

Finally, this mechanism it is a good solution to avoids the imposition of "*a cap per investor/participation*".[253] Indeed, Italian 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 also reduced due to the level of investors' understanding and awareness.

- **Tax relief.** A good system of tax relief is also present in Italy [254] although it is not so strong such as the one provided in UK. [255] For instance, with a relief that reaches, in the worst circumstances [256], 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

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

[252] Here is the second part of the questionnaire.

"<u>*Your Job*</u>

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"

[253] *See* HOOGHIEMSTRA S.N. and DE BUYSERE K. (2015) *supra* note 139 p. 153.

[254] According to Law n. 221/2012, 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%). In addition, Law n. 232/ 2016 enhanced the tax relief mechanism that now is the same for all the kind of investment and it is up to 30% of the investment made through equity crowdfunding.

[255] See paragraph 2.3.1.2.

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

number of campaigns founded and the amount of money collected via equity crowdfunding. [257]

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.

The proposal of a tax relief is a good way to attract investors. As reported in Figure 2.30, the 61% of the investors that participate to the study made by the CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017) declared as important to very important the presence of tax relief as a way to foster their crowdfunding investment. [258]

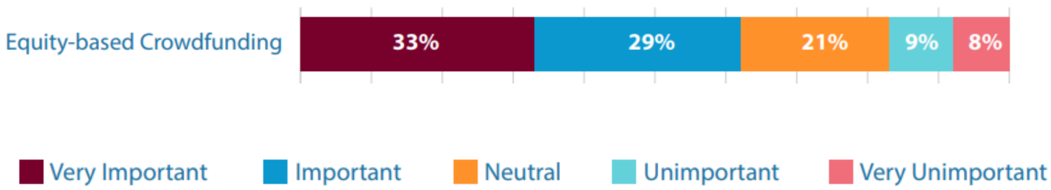

Figure 2.30 The Importance of Tax Incentives (IFISA, SEIS, EIS) to Funders by Model
Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

2.3.4.3 Aspects of Italian regulation that limits equity crowdfunding development.

The real problem of Italian equity crowdfunding legislation was not the non-presence of good rule for the development of equity crowdfunding. What is true is that, until recent, in Italy there were too much rules limiting equity crowdfunding *usage* before equity crowdfunding development. These are:

[257] See the data reported in Chapter 2, paragraph 1.
[258] CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017), p. 40

- **Only ISU and ISME could use crowdfunding** Before the recent reform, according to artt. 25 of Law n. 232/ 2016 equity crowdfunding access was granted only to some kinds of companies together with other advantages such as tax relief, registration duty discounts, and access to advantageous loans. Italian regulation, as pointed out in the previous paragraph, reserved the use of crowdfunding only to “innovative businesses”. Therefore, issuers were forced to acquire a particular status to offer shares on a crowdfunding platform. But while *innovation* can be a particular characteristic of companies signaling its potential profitability, it cannot be viewed as a filter to permit the use of this instrument only to some companies. Indeed, discrimination of this kind could be only a way to make access to this instrument more difficult and to force companies to use crowdfunding in another Member State.

The fact of having this rules for more than two years was perhaps the reason why Italy was the first Member State to regulate crowdfunding but also the last in terms of using it, compared with any other major European country in which such rule has never been introduced. [259]

- **Forcing specific investment**. Contrary to the rule described above, Italian regulation with art. 24 of CONSOB Regulation 26-06-2013, n. 18592 still require, for the success of the campaign, the participation of a specific “classes” of investors. In Italy institutional investors are required to subscribe at least 5% of the amount offered. [260] Without this, the campaign will be declared failed, no matter how much has been subscribed by other investors.

This rules is a strong limitation for equity crowdfunding development. The first reason is that institutional investors follow investment strategies that are different from retail ones. This logic affects the different choices that they take, with the result that a risky investment could be supported by a “professional” investor without that fact representing a guarantee for the others.

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[259] 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: http://www.crowdfundingbuzz.it/come-migliorare-il-regolamento-dellequity-crowdfunding-italia/ [Accessed: 1st January 2017]

[260] A critic of this rule can be found in AIEC(2015) *supra* note 257.

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 or even less 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. [261] In addition, in most cases on the share offered there is a high premium to pay with the result that the participation acquired in concrete will be very low. This is more true in particular in the case in which share offered are without voting right. All these principles reduce the interest of institutional investors in equity crowdfunding campaigns and so reducing also the probability of closing a successful campaign.

Finally, this mechanism is also source of confusion and misinformation during the campaign. Because the rule 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 its last moment. To explain this concept it may be useful to consider the following example. In a campaign in which the funding goal is 100 and the funding limit is 200, when the amount of 100 is reached, all the money collected between 100 and 200 will be taken by the issuer. Now if 95 has been collected only by retail investors and the institutional one invested the required percentage, i.e. 5, if immediately before the closing of the campaign, one retail investor decides to invest whatever amount, the campaign will (absurdly) fail.[262]

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[261] *See* ALLEGRENI F. (2015) 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].

[262] 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.

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.

2.2.4 Entrepreneurship level.

Development of equity crowdfunding market is also influenced by how easy is to start a successful business in a specific country. Indeed, the more it is easy to carry on a successful business according with the condition find out in a considered country, the more are the possibilities that that entrepreneur will use equity crowdfunding to finance its business.

The Global Entrepreneurship and Development Institute (hereinafter GEDI) has developed a specific index to measure the entrepreneurship level of a specific country: the Global Entrepreneurship Index (hereinafter GEI*)* [263]. GEI is "*is a composite indicator of the health of the entrepreneurship ecosystem in a given country*" that "*measures both the quality of entrepreneurship and the extent and depth of the supporting entrepreneurial ecosystem*". [264] The measurement is based on 14 "*pillars*" that according to the GEI are the components of an ecosystem favoring entrepreneurial success. [265] So, GEI considers how much the entrepreneurial ecosystem of a country is developed in a way to facilitate opening and conduction of new business activities.

According to the ranking created by the GEDI Italy is, indeed, quite far from US and UK. As shown in Figure 2.31 below, while US and UK, are, respectively, in the 1st and in the 4th place, Italy occupies only the 42^{sd} position on the 137 countries considered in this research.

[263] For more information, please see https://thegedi.org/global-entrepreneurship-and-development-index/.

[264] ÁCS Z., SZERB L. & LLOYD A. (2018), *Global Entrepreneurship Index 2018,* Global Entrepreneurship and Development Institute, p. 3. Available at: http://thegedi.org/product/2018-global-entrepreneurship-index/

[265] The mentioned pillars are the following: Opportunity Perception, Startup Skills, Risk Acceptance by individuals, Networking, Cultural Support, Opportunity Motivation, Technology Absorption, Human Capital, Competition, Product Innovation, Process Innovation, High Growth, Internationalization, Risk Capital. For more information please see: ÁCS Z., SZERB L. & LLOYD A. (2018) *supra note* 279 or http://thegedi.org/

Rank	Country	Global Entrepreneurship Index
1	**United States**	**83.6**
2	Switzerland	80.4
3	Canada	79.2
4	**United Kingdom**	**77.8**
5	Australia	75.5
…	…	…
40	Tunisia	42.4
41	Puerto Rico	42.1
42	**Italy**	**41.4**

Figure 2.31 - *Global Entrepreneurship Index Ranking 2018*

Source: Adapted from Global Entrepreneurship and Development Institute

The different entrepreneurship level of those countries could be a valid explanation of the different volume of their equity crowdfunding market. Indeed, a part from the above consideration on the "domestic" use of equity crowdfunding platforms, countries with higher entrepreneurship level could act as magnet for foreign companies. Those companies, not only may decide to carry on their business in that country but they could also decide go there only to use equity crowdfunding.

For instance, from an European perspective UK is not only chosen as place of incorporation for its more stable and predictable policy framework, regulations that encourages innovation and enterprise or government policies in support of innovation, such as R&D tax credits and the Patent Box. [266] In some cases, UK it is also chosen for its facility to conduct a successful equity crowdfunding campaign. This is more true after the world wide success and its first mover advantage. Not few are the companies, also Italian, that decided to go funded on Crowdcube instead of on their home country equity crowdfunding platforms. [267]

[266] UK Trade and Investment (2014), *UKTI inward investment report 2013-2014*. Available at: https://www.gov.uk/government/publications/ukti-inward-investment-report-2013-2014

[267] For example, considered the story of Primo, toy maker company, that decided to upload its project of Crowdcube instead of using already existing Italian equity crowdfunding platforms.

2.3. Conclusion and suggestions.

Although its growth rate in some country is already reducing (e.g. USA), equity crowdfunding is still a developing phenomenon. Also for this reason there is still no clear evidence nor enough studies dealing with the direct and concrete determinants of equity crowdfunding development. This dissertation represent one of the first attempt to highlight possible equity crowdfunding relation with banking sector, financial market, regulation and entrepreneurship level of a considered country. The results of the previous paragraphs are summarized in the table of Figure 2.32 below:

Determinant	Relation with equity crowdfunding
Banking sector	Inverse: • lower availability to lend money is related with higher equity crowdfunding growth rate; and • higher banking concentration is associated with lower equity crowdfunding market volume.
Financial market	Direct: • wider financial markets are related with higher equity crowdfunding market volume; and • higher financial literacy is associated with higher equity crowdfunding market volume.
Regulation	Direct: higher investors protection is related with higher equity crowdfunding market volume. Inverse: higher limitations to the issuer are associated with lower equity crowdfunding market volume.
Entrepreneurship Level	Direct: higher entrepreneurship level is related with higher equity crowdfunding market volume.

Figure 2.32 – Summary of the influence on equity crowdfunding market of banking sector, financial market, regulation and entrepreneurship level

Findings suggest that equity crowdfunding is inversely correlated with banking sectors but directly with development of financial market. Banking sectors has been analyzed in terms of SMEs loan availability and market concentration; financial market in terms of its development and population financial literacy. Direct relation exists also with reference to the entrepreneurship level of each interested country. From this point of view, these three variable may be considered as the ground on which equity crowdfunding have to develop. Indeed, both these three elements are conditions that pre-existed the common use of this innovative financial instrument by companies. This also means that it is more difficult for each country to intervene on those elements in order to help equity crowdfunding development.

Differently, this is not the case for equity crowdfunding regulation. As it has been reported in paragraph 2.2.3, new rules has been introduced or old rules has been adapted with the specific aim to address equity crowdfunding functioning. This also means that each country regulator has more power to intervene, trying to enhance equity crowdfunding development. When it is too hard, or even impossible, to intervene in all the other variables, equity crowdfunding regulation amendments could be considered as valid resource to enhance its usage and development.

To conclude with the same metaphor used in the first paragraph of this chapter, it is clear that Italian “soil” it is more arid for the equity crowdfunding seed if compared with the UK or the US one, and maybe it is impossible to change all the soil of the garden. Instead, it is more easy that the interested “farmer”, *id est* regulator, may understand this problem and intervene with apposite operation to “fertilize” the aride fields.

Chapter 3 – Investors of Equity Crowdfunding

The aim of this Chapter is to present who are the typical investors of equity crowdfunding, how they take investment decisions and which drivers favor or obstacle their will of financing an equity crowdfunding campaign, that is to say what an investor look for in an equity crowdfunding campaign presentation before deciding to invest in it.

In doing so, it should not be forgotten the role that crowdfunding regulation has in protecting investors and its slide influence on their behavior. This theme will not be addressed in this chapter but only briefly mentioned hereinafter and in the conclusion. Indeed, equity crowdfunding development should be supported by an effective investor protection, given the high risk associated to this instrument. This shall be made, specially favoring an *aware marketing*, imposing that each marketing campaign should expose the characteristics of the investment in a clear and non-misleading way, showing the risk connected to the investment. This will be the only way to improve investors' trust. Indeed, Internet 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, as already said, it has the potential to become a dangerous fishing net when used with bad intents. Another way to protect investors is by verifying the information published in the crowdfunding platform. But, as seen above in the previous paragraph 2.2.3, not all equity crowdfunding regulations provide that information published must be reviewed by a public authority (e.g. in Italy CONSOB does not review information published as FCA does in the UK).

Starting from the above premises, it is now possible to describe the characteristics of equity crowdfunding investors. Because of a lack of data and of research on this theme, most of the information comes from the countries in which equity crowdfunding is more developed (UK above all), where apposite research has been conducted in this sense. For this reason only those data could be reported looking for differences within the Italian framework, when the relative data are available.

3.1 General characteristics of the typical equity crowdfunding investor

On the base of the data available and on the research on this theme made by CAMBRIDGE CENTER FOR ALTERNATIVE FINANCE (2017) and by the Italian OSSERVATORIO SUL CROWDFUNDING (2017), it was possible to obtain lots of information on equity crowdfunding investors in the countries in which this instrument is already well developed.

The first important data is that although this innovative financing instrument is still not so widespread, the number of people that is approaching equity crowdfunding market is considerably increasing. For instance, in 2016 in UK the number of investors went up by 131%, reaching over 2.5 million. This number includes an estimate participation of 2.500 institutional investors, providing a 139% increase of this class over the previous year. [268] Notwithstanding this, in UK institutional investors participation represents still a little percentage of the total investors participation.

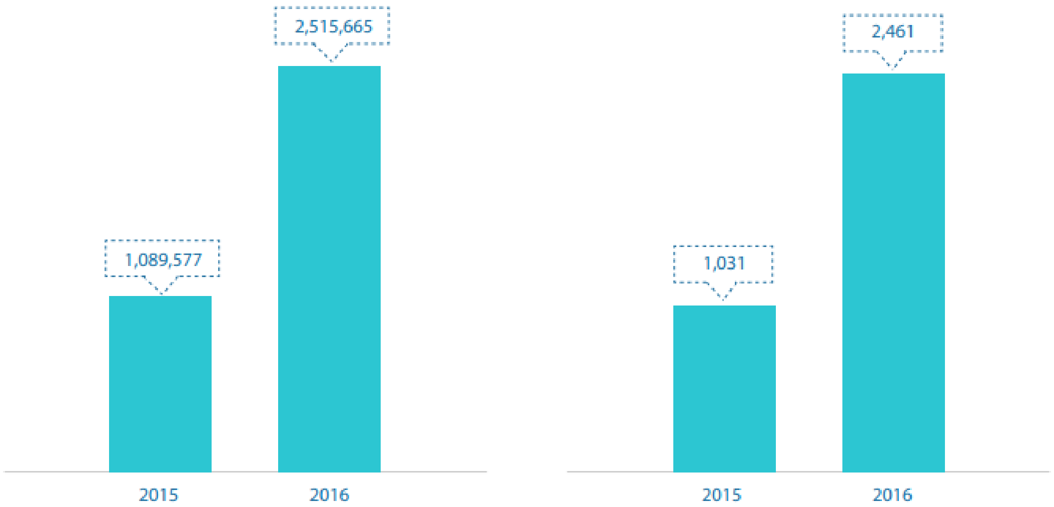


Figure 3.1: Total Number of active retail funders in the UK vs Total Number of active UK institutional funders

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

[268] CAMBRIDGE (2017) p. 27

The same it is not true for US where alternative finance market is dominated by institutional investors [269] providing in 2016 for the 55% of the total US alternative finance volume, although declining from the 66% of the previous year. However, if specific reference it is made to equity crowdfunding, institutional investors participation is lower but still higher than the UK one. Indeed, participation of institutional investors in equity crowdfunding increased from the 21% of 2015 to the 27% of the 2016, although total investors numbers could be inferred only by market volume, because of the fact that a research in this sense has not still been conducted. [270]

The typical equity crowdfunding investors is a male. Against an usual average of 50% of women participation in reward and donation crowdfunding, investors of equity crowdfunding are generally men. This is true in the UK, where only 13% are women, with a slight increase of 5% from the previous year [271]. However, this data slightly changed in terms of invested funds as shown in Figure 3.3, where the proportion of finance from female investors is higher (19%). This also imply that, although female investors are fewer than the male counterpart, considering the single investment *on average* they invest higher sums that man. A similar rate of women participation has been registered also in the USA where female participation is only around the 10%. [272]

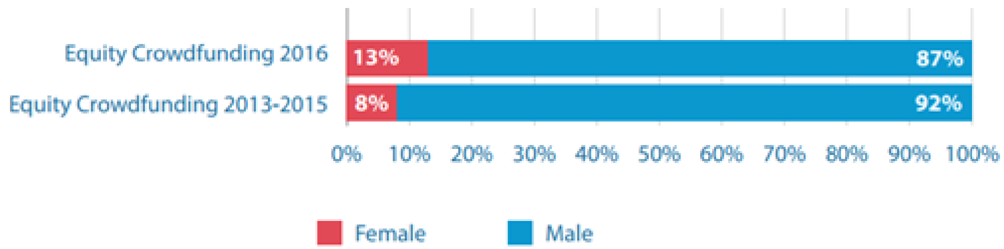


Figure 3.2 - Percentage of Female Fundraisers in UK (2013-2015 vs 2016)
Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

[269] This is a peculiarity of US alternative finance market are stressed by CAMBRIDGE (2017b) p. 46
[270] CAMBRIDGE (2017b) p. 16. The reason could be the existence of more restrictive US privacy law that do not allow platforms to share those kinds of data.
[271] CAMBRIDGE (2017) p. 29
[272] CAMBRIDGE (2017b) p. 53

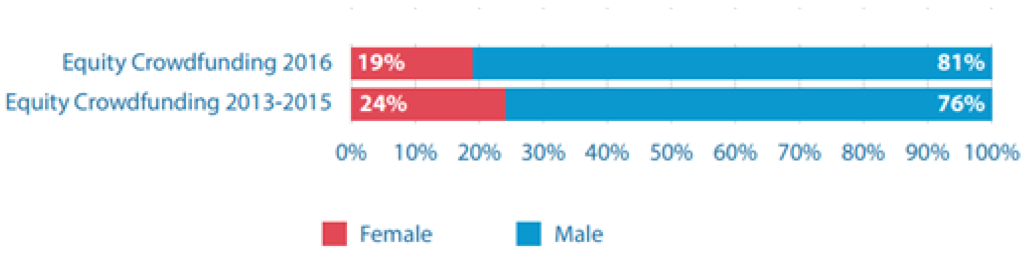


Figure 3.3 - Percentage of Female Funders in UK (2013-2015 vs 2016) Percentage of Female Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

With regard to the age of the funders, data reports that also the average investor age is increasing. In UK, for instance, the 38% of the 2016 equity crowdfunding investors are under 35 years old, up from 28% data of the 2014. This at the detriment of investors between 35 and 54 who decreased from 46% to 36% in just two years as Figure 3.4 below shows.[273]

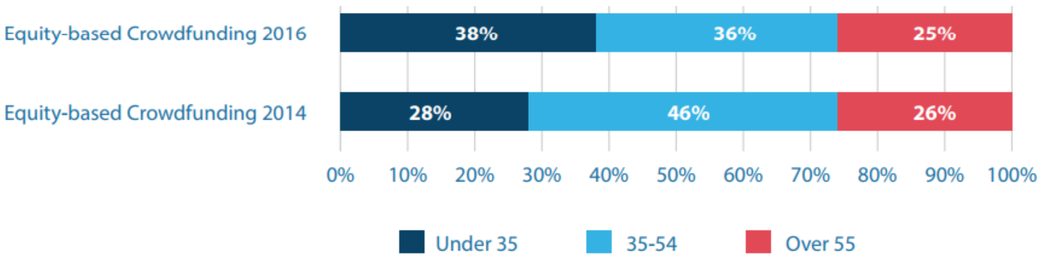


Figure 3.4 - Funder Age by Model, 2014 vs 2016 in UK
Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

Additional data, coming from a research conducted only in the UK, shows investors level of education and their annual income. Only the 17% in the UK do not possess at least a degree in 2014 with a little increase lower that 5% in 2016. There is so a slow movements convening less educated people to approach this innovative financing instrument. Moreover, having regards to investors income, as Figure 3.6 shows, equity-based crowdfunding has a really low proportion (around 17%-16%) of funders with an annual income of less than £25,000.

[273] CAMBRIDGE (2017) p. 31

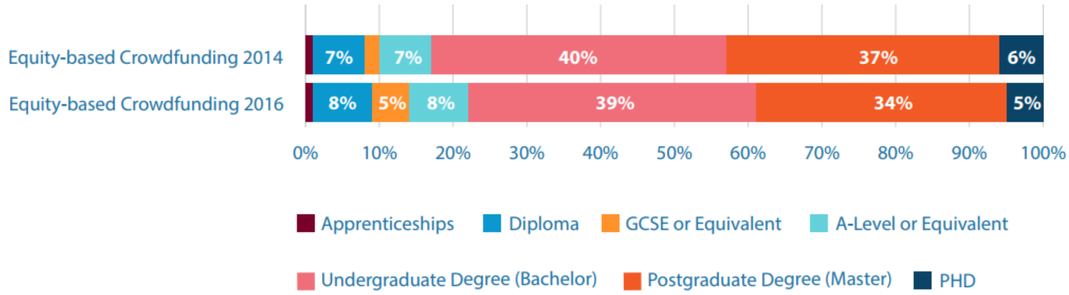


Figure 3.5 - Funder Age by Model, 2014 vs 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

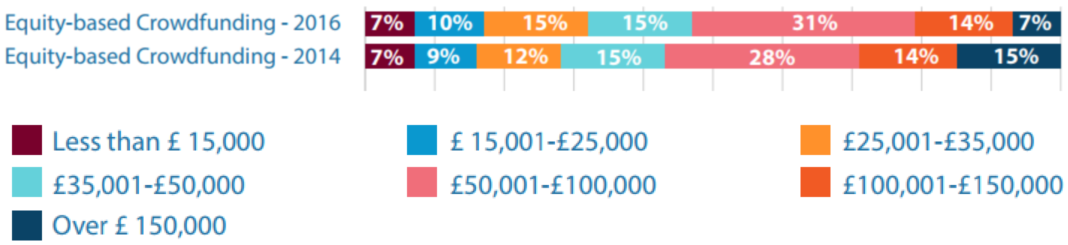


Figure 3.6 - Funder Age by Model, 2014 vs 2016

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

From the last two data reported it is possible to understand that funders of equity crowdfunding typically have high incomes and are well educated. This imply not only their capacity to understand the risks of those investment, that is to say the possibility to lose some money in an illiquidity investment without any dramatic implication for them, but also that in countries with higher financial literary rate, an equity crowdfunding regulation could care less about investor protection. This is more true when issuing a particular rule enhancing investor protection may have negative implication in terms of higher disclosure costs for issuers.

3.2 Italian equity crowdfunding investors

Being Italy a still developing country in terms of equity crowdfunding usage, it could be useful to enlist apart investors' available information to highlight differences or similarities with the ones highlighted above. If similarities will overcome differences, then the researches exposed in paragraph 3.2 on investors decision making process could be generalized also to Italian investors.

In terms of number of investors, until 2016, no. 1.386 shares subscription in equity crowdfunding campaigns has been reported. In this number, 128 are institutional investors, so representing the 9% of total investors as Figure 3.7 shows. This data has to be read together with Italian legislation that forces institutional investor to subscribe at least the 5% of the total shares offered. In this sense, proportionally, participation of institutional investors is higher than in the UK, where, as exposed above, it represents only the 1%.

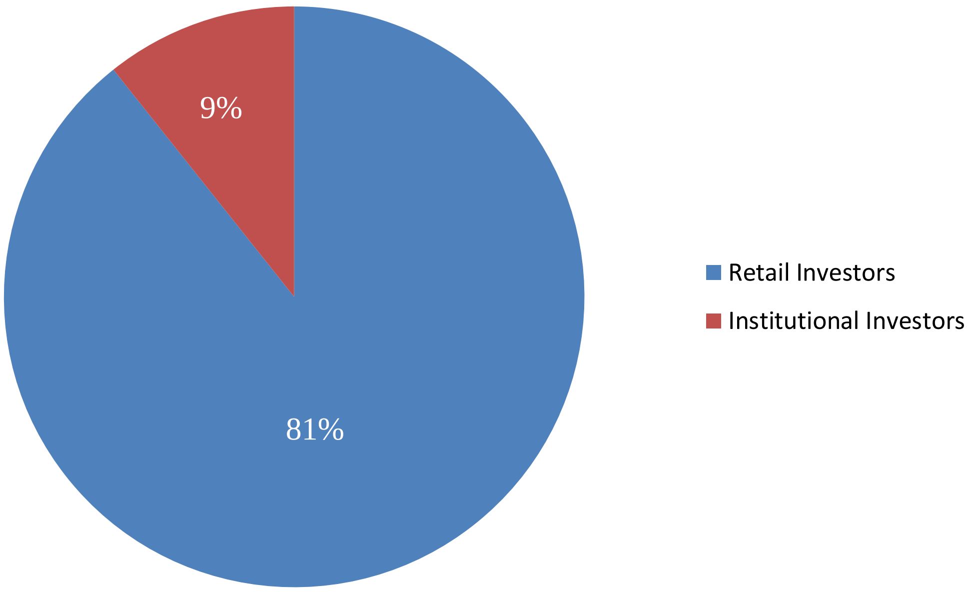


Figure 3.7 - Retail and Institutional investors participation proportion
Source: Adapted from the data provided by OSSERVATORIO SUL CROWDFUNDING (2017)

The average amount of money invested is equal to € 5.995 and the amount of each contribution follows the distribution presented in Figure 3.8 below. The 43% of them is lower than € 500, while the 39% is between € 500 and € 5.000. Only the 18% of investors donated more than € 5.000. But if retail and institutional investors are considered separately, it is possible to notice that both prefers to invest the amount from € 500 to € 5.000. The percentage is, indeed, very similar as Figure 3.9 and 3.10 shows. But apart from this amount, the majority of retail investors prefers to participate in an equity crowdfunding campaign through small contributions. For institutional investors the contrary is true. Indeed, according to the data available, only six retail investors donated more than € 100.000.

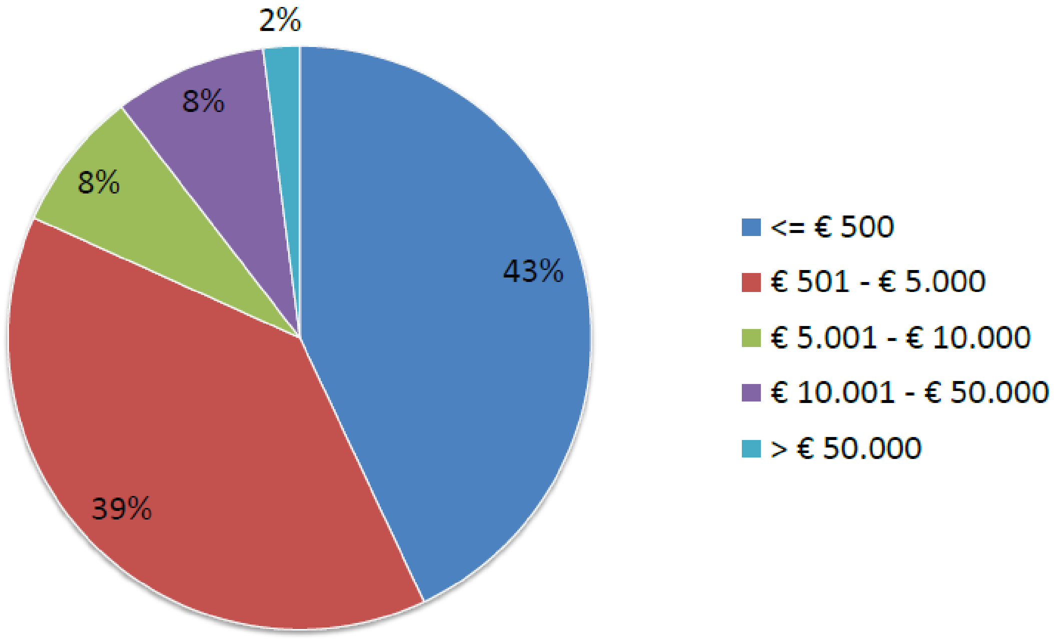
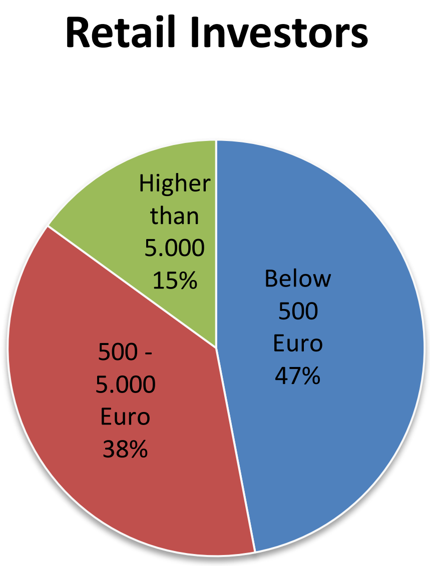


Figure 3.8 – Distribution of equity crowdfunding participation

Source: OSSERVATORIO SUL CROWDFUNDING (2017)



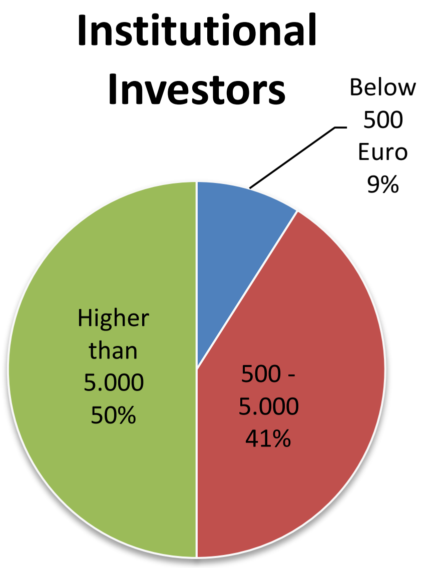


Figure 3.9 – Distribution of equity crowdfuding retail investors participation

Figure 3.10 - Distribution of equity crowdfuding retail investors participation

Source: Adapted from the data provided by OSSERVATORIO SUL CROWDFUNDING (2017)

In line with the developing phase of Italian equity crowdfunding, 2016 have seen an increasing of the 93% of the number of investors previously registered and the data for 2017 are expected to be also higher. Notwithstanding this, data about age and women participation are in line with the UK and US already reported. Indeed, as summarized in Figure 3.11 below, women participation is quite low, reaching a 15% with a reduction of 3% from the previous year. In relation with the age, the major participation comes from adults from 36 to 49 years, while the participation is lower with regards to young and older investors. The first maybe for lack of funds available while the last for difficult in approaching this new and Internet-base financing way.

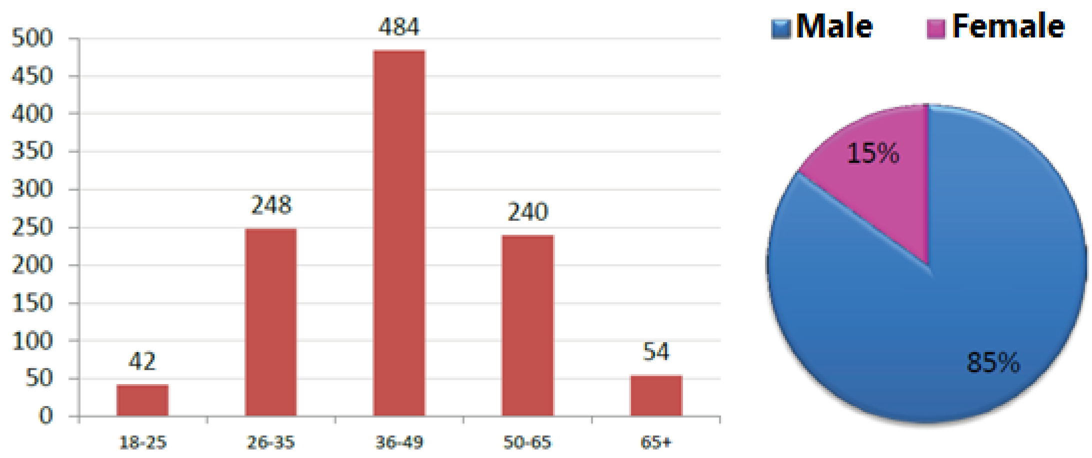


Figure 3.11 - Funder Age by Model and Male and Female participation 2014 vs 2016
Source: OSSERVATORIO SUL CROWDFUNDING (2017)

From the data reported above it is possible to signal a great similarity in the data of Italian investors with the ones of UK and USA, both in terms of man and woman participation than for investors age. But this is not the only precious information that could be extracted from the above analysis. Indeed, those data should be considered before launching an equity crowdfunding campaign. For instance, it is possible to conclude that a male-oriented marketing strategy could be a good choice to promote an equity crowdfunding campaign. In addition, also in planning to which amount confer voting right, Figure 3.8 on amount of money invested should be taken in consideration. For instance, a good threshold to gain the right to vote in the annual general meeting could be set above the amount of €5.000, so reducing the logistic costs connected to dealing with the participation of an high number of retail investors.

3.3. Decision making process

The aim of this paragraph is to identify how investors take investment decisions. To do so it is important to understand which kind of information are usually available to investors before subscribing shares through equity crowdfunding. In general, investors may have access to two kind of information: (i) information made available by the issuer; and (ii) information of public register.

In the second group are comprised all the information that the law of each country requires the company to public annually. These usually comprehend general information on the corporation, such as amount of subscribed capital or number of shareholders, and published economic information i.e. balance sheets.

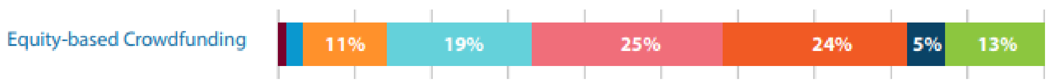
But the issuer has also the opportunity to “self-disclose” some information about its company on the platform. Indeed, as reported in the previous paragraph, regulation usually set up only a minimum and very general set of information that must be disclosed. The reason of this “high level requirement” is in line with the aim of equity crowdfunding regulation to lower disclosure costs that, instead, need to be afforded going public through traditional forms, such as IPO. In addition, usually those information are not even reviewed by the regulatory authorities of that country.

For the reasons exposed above, the business models of company raising money through equity crowdfunding platforms are very simple and contains usually the following information: (i) general presentation of the company and of the project, containing also the reason why an investor should invest; (ii) some historical data, comprehending results reached in terms of clients, growth, products or services sold; (iii) how money requested will be used; (iv) who are the members of the team; (v) and, although not always presented, some other strategical data such as competitors, markets descriptions, target clients and revenue streams. In variety of information, usually there are also some financial information. Financial data that are always present regard: the amount of money requested, i.e. the *funding target*; the percentage of company shares offered for the subscription, i.e. the *equity offered*; the *pre-money valuation* of the company, that is to say its value before the capital increase requested by the equity crowdfunding campaign. Instead, financial information that are not always disclosed are data regarding future revenue streams, costs structure and profits forecasts. Finally, another important information that is always shown in the platform is the number of investors that already subscribed companies shares. Its role in creating herding behaviors will be described in paragraph 3.2.2.

3.3.1. Business model analysis...

After having described the typical equity crowdfunding investor, the following paragraph will present how he takes investment decisions and which factors influence them more.

Given the novelty of this financial instrument, the state of the art does not present important empirical researches analyzing which information are considered by an equity crowdfunding investors before taking investment decision. One of the more completed has been conducted in UK. Its results, exposed in Figures 3.12 and 3.13, shows, at least, two relevant data regarding due diligence procedure. [274] The first reports that time dedicated to due diligence procedure is not so much. Indeed, only the 14% of investors spent more than two hours per weeks studying the documents published in the crowdfunding platforms, while the 49% spent less than one hour. Considering that information published takes not less than 30 minutes to be read with attention, considering four to six minutes of video presentation and eventually financial statements or private research that should be conducted, plus the time to read the discussion and the questions made by other investors, just one hour is real few time to make a fully conscious investment decision or to elaborate companies financial data.



[274] *CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017), p. 35-36*

Figure 3.12 – Time Per Week Spent Picking Potential Investments (2016) in UK
Source: Cambridge Centre for Alternative Finance (2017)

In light of the few time spent on the platform making due diligence, considering also the premises on the quality of the information published, it seem that *typical* equity crowdfunding do not look for strong economic proves before taking investment decision. So, if not in economic data that are considered quite superficially, the question should be *where* investors find the needed trust to participate in a crowdfunding campaign.

To answer this question it should be considered that, according to another research of the *Cambridge Centre for Alternative Finance (2017)*, an high percentage of investors (the 57%) trust the due diligence made by the platform before accepting the crowdfunding campaign promoted by the issuer, although generally those due diligence aim only at avoiding fraud attempt and do not regard financial indicators. However, the real data is represented by the 28% of investors that declared to trust the due diligence made by other investors. A percentage that surpass the number of investors that perform due diligence their-self.

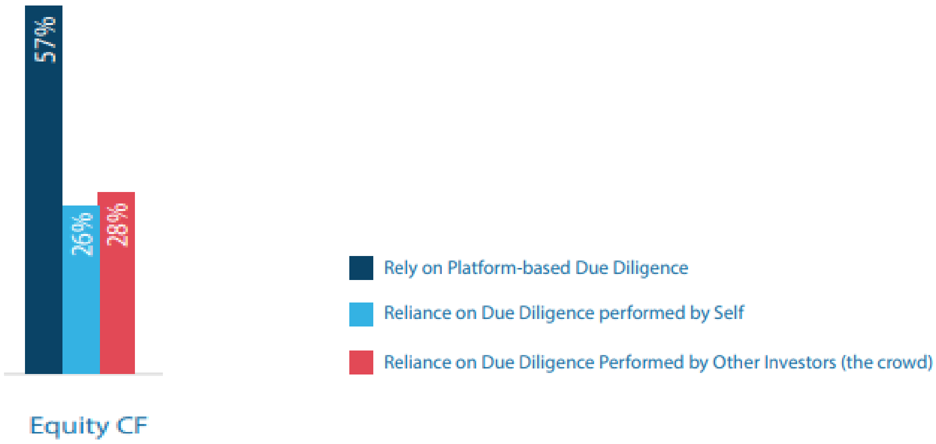


Figure 3.13 – Funder Reliance on Due Diligence When Selecting Investment Opportunity in UK
Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017)*

From the above data, the conclusion that should be drawn is that the typical equity crowdfunding investors is not really interested in checking for economic information before taking investment decision. Differently, the more a crowdfunding campaign attract investors, the more others will invest. This is in line with the exposed mechanism called *wisdom of the crowd*. According to this theory, investors feel more protected although few information on the issuer are available. The crowd is seen as a collector of information, reducing asymmetry risks and highlighting false of wrong information. If a great number of investors have participated in the campaign without highlighting negative reason to invest [275], this is considered as a signal that the issuer is trustworthy and the investment potentially profitable.

3.3.2. ...or herding behavior?

On the other hand, the fact that equity crowdfunding operates in a "crowd-system" could be a source of peril for investors when mechanisms of herding behavior takes place. Indeed, immediately after the launching of the crowdfunding collection only few information are available to investors. Those are usually the ones published on the platform by the issuer itself and that, most of the time, according to the specific regulation of that country, are not subject to any regulatory body approval. In

[275] This could be done publicly thanks to the presence of specific section in the equity crowdfunding platform

addition, usually the list of information that have to be published is not huge, in order to avoid high disclosure costs for the issuer.

In this stage, the *wisdom of the crowd* could not really operate because a crowd does not still exist. It is here that herding behavior may take place. According to ARMOUR and ENRIQUES (2017) [276], the sequential arrival of investors, instead of collecting and producing higher quality information (as the *wisdom* theory would suggest), may cause superficial investment decision.

The herding behavior model described by these authors could be explained simply as follow. Assuming that investors follow sequence investment mechanisms in which the follower, approaching the platform, is able to know who invested before him, but he could not see who have seen the project and decided not to invest. Assuming also that investors have not all the same information about the quality of the investment and that there are some that possess more information than others. In this case, information can be both positive or negative and investors do not invest if the information they are in possess are more negative than positive.

It is clear that the first investor approaching the platform will invest only if he has positive information in regards to the campaign. The second, instead, will invest not only if he has positive information on his own, but also if he has no information. In this case, indeed, he could infer those information from the investment already realized by the first investor. Differently, if he has negative information, he will not invest, without taking in consideration the positive information he could infer form the first.

The same principle is true for the third investor but with an important difference. Indeed, it is possible that he will invest even if he has negative information. This because, from the first and the second investment, the third can infer that there are more positive information than the negative that he may have. In this way, a simple deduction of positive information could prevail on more certain negative information. Moreover, the more are the investors that follow, the more is difficult to

[276] For more information please see ARMOUR, J. and ENRIQUES, L. (2017) *supra* note 12, p. 14-16

distinguish between those who invested on the base of the positive information possessed and those who invested only on a *deduction* base.

This mechanism has two important consequences highlighted also by ARMOUR and ENRIQUES (2017). The first is that the creation of a "momentum" is fundamental for the success of equity crowdfunding campaign. This could also mean that platforms have a great interest in advising issuers in convincing a greater number of investors in participating as soon as the campaign is launched. The second is that this herding behavior will create a "*'bimodal' distribution of funding*".[277] An equity crowdfunding campaign could get a big support, and so succeeding, or very little and so failing. The direct consequence of this mechanism is resource misallocation that maybe be transformed in a reduction of potential return for investors.

3.3.3. Investors motivation

In addition to the above, this paragraph is dedicated to examine which are the reasons that move investors in participating in an equity crowdfunding campaign.

According to Figure 3.14, showing the research conducted by the CAMBRIDGE CENTER FOR ALTERNATIVE FINANCE (2017), the first undiscussed reason shared by the 87% of the interviewed investors is to make a financial return. On this theme, equity crowdfunding, concerning investment in startup or SMEs, attracts investors with the idea of incredible return, although it is not possible to make reliable provisions on the amount of the specific return. This is true for two main reasons: the uncertainty linked with the possibility that in some years the startup may fail and the difficulties in evaluating SMEs or startup for lack of certainty on company cash flows. [278]

Secondly, another important information that could be extracted by the above mentioned research is that investors of equity crowdfunding are aware of the need of diversification connected with so risky investment. Indeed, 80% of them considered at least important diversifying investment portfolio. Finally, it may be important to notice that the 81% gives value to the ease of the investment procedure. This is a signal in favour of the issuer, meaning that equity crowdfunding is more and more

[277] ARMOUR, J. and ENRIQUES, L. (2017) *supra* note 12, p. 16
[278] *CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)*, p. 62

seen as a financing instrument, attracting participation thanks to the facility of surfing the internet looking for ideas to finance.

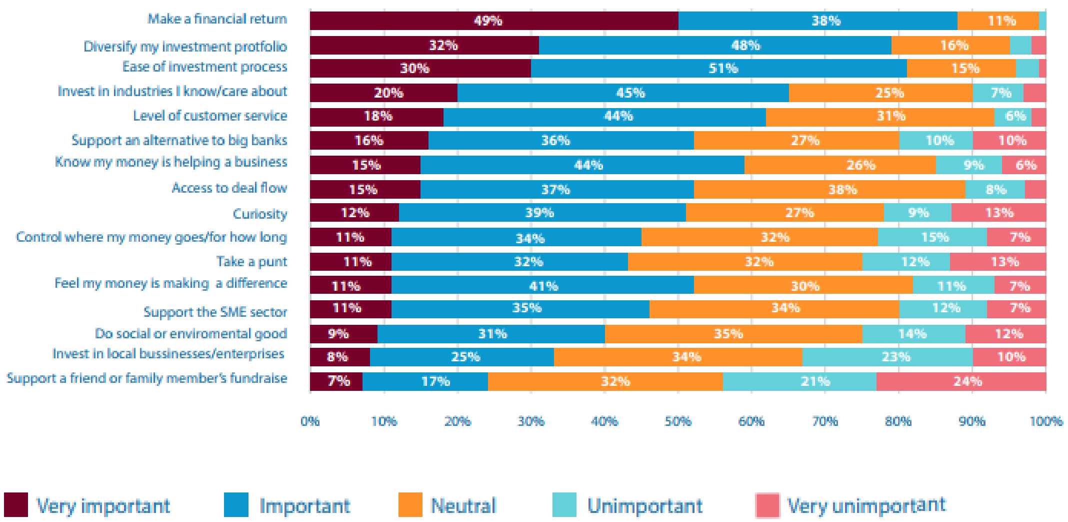


Figure 3.14 – factors that influence investor behavior for equity-based crowdfunding

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE *(2017)*

In this sense, the retail investors role is maybe the most important in an equity crowdfunding campaign. The advantage determining the success of crowdfunding is the fact that the Internet reduces the transaction costs [279] that were, previously, the major obstacle impeding collection of money from a wide public. [280] But this is also possible thanks to crowdsourcing that has modernized the existing relation of the classic forms of financing. Traditionally, retail investors were advised by other "single" people. On the contrary, equity crowdfunding gives people the chance to receive consultation from an entire crowd, lowering fraud or misbehavior during the consultation procedure.

[279] *See* HORNUF, L., and SCHWIENBACHER A. (2015b) *supra* note 22 p. 2.
[280] As reported by HORNUF and SCHWIENBACHER (2015b) p. 5 the initial cost 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.

From the data on investors perception of their funds, shown in Figure 3.15, it is also possible to highlight the high investors awareness in the use of this instrument. Indeed, the absolute major part, more than the 70%, invested in equity crowfunding only money considered as free cash or dedicated to speculative and high-risk investments.

Only a really small part of investors, less than the 14%, considered the investment made with money coming from their savings. Even less are investors that invested in equity crowdfunding money coming from their reteirment savings (less than 13%) or from their pensions (less than 5%). This means that, altough equity crowdfunding is considered for its promised high returns, it also considered as a proper investmet and not as pure gambling. [281]

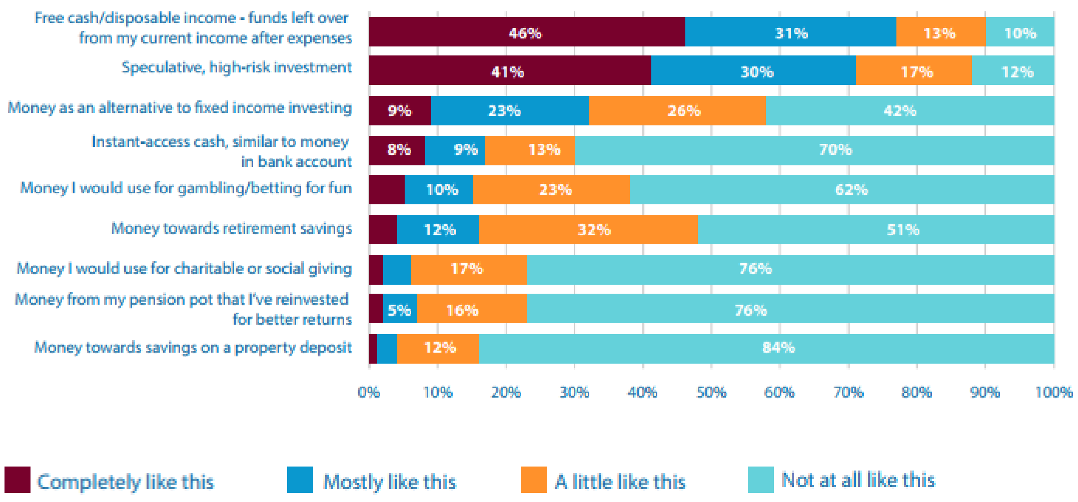


Figure 3.15 – Investor perceptions of their funds relative to their equity-based crowdfunding activity

Source: CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)

Finally, Figure 3.16 below shows a quite modest level of trust *vis-a-vis* the platform and the issuer. Indeed, the 71% of the interviewed investors agree that information showed are clear and transparent, while the 69% indicated that they receive regular communications from the companies they have invested in through the platform. They also know the risks connected with equity crowdfunding investment. Indeed, only the 6% is confident to recover its investment if the company fails.

[281] *CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (2017)*, p. 62

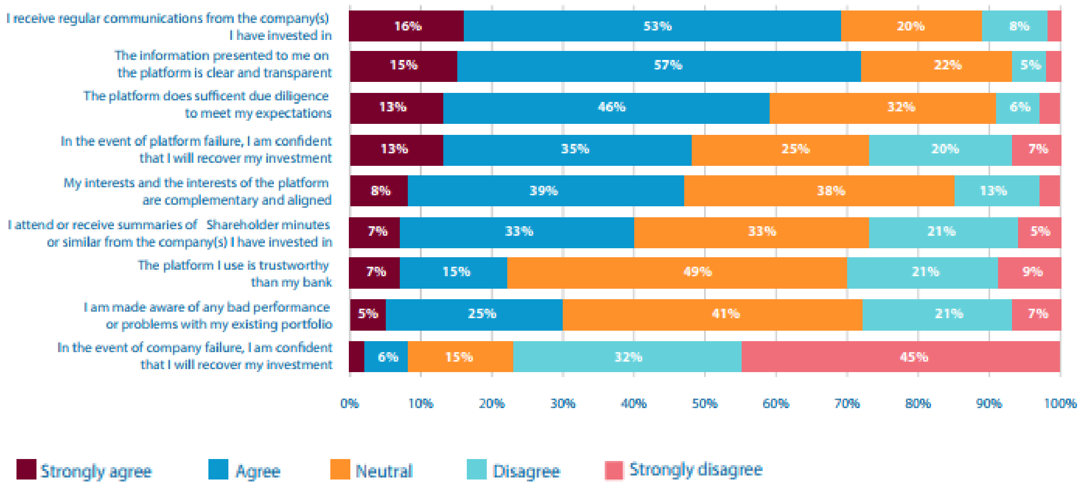


Figure 3.16 – Trust Dynamics Between Lenders and Their Primary Platform

Source: Cambridge Centre for Alternative Finance (2017)

3.4 Success Drivers of Equity Crowdfunding

After having considered the decision making process together with what makes a typical crowdfunding investors take investment decisions, in the last part of this Chapter some of the observable success drivers of an equity crowdfunding campaign in Italy will be defined.

In order to do so, first, some of the determinants identified by the current literature on this theme will be reported. Then, the drivers listed will be taken as starting point and integrated with other potential drivers that an investor could take in consideration before investing, in order to define the ones applicable to the Italian equity crowdfunding markets. Those will be tested and highlighted through a simple case study presented in the final chapter.

An adequate selection is, indeed, necessary because there is still no updated research of this theme analysing Italian framework. The reason could be the scarcity of available data that only in 2017 increased together with the development of Italian market for this instrument. The mentioned selection it is also necessary because the few researches that compose the current literature has been conducted in countries (the principals are the UK, Finland and Australia), where different regulations or different funding mechanism were in force. Finally, in line with the observations reported above, regarding herding behaviour and investors' dedicated time to conduct due diligence, preference will be accorded to those drivers that are linked to information that could be easily observed by the typical equity crowdfunding investor. [282]

In this way, the conclusive Chapter will study the effect of those variables on the success of the equity crowdfunding campaigns conducted on one of the major Italian equity crowdfunding platform: CrowdfundingMe. [283]

3.4.1 Success drivers reported by the current literature

Current literature [284] dealing with equity crowdfunding success drivers analysed the following aspects:

- **Funding target.** According to LUKKARINEN (2016) the definition of the funding target, i.e. the amount of money that issuers want to collect, is positively associated with the number of investors participating in the campaign although it is not significantly related with the amount raised. [285] The reason could be that investors will be more attracted by companies with higher target, because the more is the amount collected, the more are the possibility for the company to grow and to increase in value. In addition, as explained in paragraph 1.2.2, high funding target attracts investors because, according to the AON model mechanism, this increases their trust in the fact that the project presented will be successfully developed. [286]
- **Equity participation offered:** Both RALCHEVA (2016) and AHLERS (2012) recognized that the higher is the participation offered, the lower is the potential

[282] Indeed, the assumption is that the typical crowdfunding retail investor will not be interested in reading information that he have to look for out of the platform or in an easy way. At least he will use its personal knowledge or ask for more information in the Q&A section. Differently, in case of lack of information, he will simply decide to not invest.

[283] For more information on the platforms, please see www.crowdfundingme.it

[284] The major works regarding success drivers of equity crowdfunding are the following: AHLERS G. ET AL. (2012), *Signaling in Equity Crowdfunding*, available at SSRN: https://ssrn.com/abstract=2161587, that concentrated his research on the Australian crowdfunding platform ASSOB; LUKKARINEN A., et al. (2016), *Success drivers of online equity crowdfunding campaigns*, in Decision Support Systems, available at http:// dx.doi.org/10.1016/j.dss.2016.04.006, that analyzed sixty campaigns published in the Finland platform Investdor between May 2012 and September 2014; and RALCHEVA, A. and ROOSENBOOM, P. (2016), *On the Road to Success in Equity Crowdfunding*, available at SSRN: https://ssrn.com/abstract=2727742 that concentrated their research on 541 campaigns launched between January 2012 and March 2015 on the UK platform Crowdcube

[285] *See* LUKKARINEN (2016) *supra note* 300

[286] For more information please see paragraph 1.2.2

investors. Indeed, this fact reduces attractiveness and trust of investors which may think that the issuer do not strongly believe in its success: if he had believed so, he would have retained a bigger slice of his company. Indeed, also according to the traditional principles of the agency theory, the higher is the participation retained by the promoter, the easier will be to align the interests of the crowd with the interests of the promoter itself.

- **Minimum investment.** LUKKARINEN (2016) also argue that the higher is the minimum amount needed to participate in an equity crowdfunding campaign, the fewer are the number of investors and the amount raised. This maybe because requiring potential investors to use a higher amount of liquid funds may discourage investment decision together with increasing difficulties for diversification of one's portfolio.
- **Presence of institutional investors.** Participation in an equity crowdfunding campaign of an institutional investor increases the success possibility of the equity crowdfunding campaign. [287] Retail investors, indeed, could consider this as signal of the value of the presented project and infer positive information acquired by the institutional investor; they may argue that the institutional investor would not have invested without conducting a proper due diligence.
- **Campaign duration.** The duration of an equity crowdfunding campaign, that is to say, the number of days necessary to complete the fund collection is negatively associated with the number of investors, although not significantly related to the amount raised.[288] Indeed, the shorter is the duration the more the issuer could appear determined in carrying on the project and the more the investors will act fast, instead of postponing investment decision.
- **Intellectual property protection.** According to RALCHEVA (2016), forms of protection such as patents, trademarks and copyright participate in incrementing the possibility of success of an equity crowdfunding campaign. Indeed, as exposed in paragraph 1.4, one of the risk of going public is that the product and the business idea could be stolen and then developed by better financed firms. Protection,

[287] *See* RALCHEVA et al (2016) *On the Road to Success in Equity Crowdfunding* (November 1, 2016). Available at SSRN: https://ssrn.com/abstract=2727742 or http://dx.doi.org/10.2139/ssrn.2727742, p. 16
[288] *See* LUKKARINEN (2016) *supra note* 284

therefore, participates in transmitting the idea that the business presented has higher possibility of success.

- **Provisions of financial.** According to LUKKARINEN (2016) showing financial data in the pitch of the crowdfunding campaign is positively associated with the number of investors attracted. This, indeed, may be considered as a signal of credibility and capability, while their lack as dubious and unprofessional. [289] The major regulations do not require the issuer to expose those data. For this reason, they are easily available only if they are disclosed by the issuers. In particular, some platforms show in a clear way only the pre-money valuation of the company. [290] Usually, this is calculated on the basis of the percentage of the share offered and on the target amount, while the data and the procedure followed to made the calculation are not always made available by the issuer.

- **Presence of early investors.** The early presence of investors, convening credibility and reinforcing the confidence of following investors, is positively associated with the number of participant and with the amount raised. [291] According to what has been said in paragraph 3.2, investors that do not want or that are not able to perform a proper due diligence may take investment decisions basing supposing that at least some of the other has already verified the published information. This is more true, considering also the number of investors that only after few days from the launching of the crowdfunding campaign decide to participate in the collection.

- **Social media networks.** Another finding of LUKKARINEN (2016) is that the ability to post and to share its campaign on social network is strongly associated with a higher number of investors and of the amount raised by the issuer.

- **Team composition.** Education, past experience and age of the people composing the operating team of the issuer are strongly taken in consideration by potential investors. So, team composition is strongly related with the campaign success according to AHLERS (2012). Indeed, in particular, the education and the past

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[289] *See* LUKKARINEN (2016) *supra note* 284

[290] 18 on 22 Italian platforms clearly expose pre-money valuation in the equity crowdfunding dedicated page.

[291] *See* LUKKARINEN (2016) *supra note* 284

experience of the team will be a clear signal of the good possibility of success of the presented project. [292]

3.4.2 Selected drivers applicable to the Italian framework

In line with the aim of this dissertation, the drivers that may be taken in consideration by and that may attract an Italian equity crowdfunding investor will be considered in correlation with the success of the campaign.

This success will be defined in terms of *funding ratio*, that is to say the percentage of the funding target reached by the promoter of the campaign. Indeed, as exposed in paragraph 1.2.2, equity crowdfunding lets issuer to overcome the defined funding target. This is possible until the reaching of the funding limit. For this reason, campaign with a funding ratio of less than 100% will be considered failed. Contrary, the difference between the funding ratio and "100%" will be a signal of the success of the campaign.

From an accurate selection of the determinants enlisted by the current literature and in line with what has been exposed above and to the characteristic of Italian framework, the following are the simple determinants (some "economic" and others "social") whose influence on the success of an equity crowdfunding campaign in Italy will be analysed in the following Chapter.

- **Equity offered.** It represents the minimum participation offered by the issuer to the potential investors. This variable has been selected in order to test the conclusion of RALCHEVA (2016) and AHLERS (2012), according to which an higher participation offered has a negative impact on the result of the collection. The first hypothesis for this reason is:

H1: A higher participation offered has a negative impact on the success of the equity crowdfunding campaign.

- **Social interaction.** It is represented by the how much a crowdfunding campaign has been shared through social networks. The campaign is indeed presented with a dedicated video published in the platform page dedicated to

[292] *See* AHLERS (2012) supra note 300, p. 23

each campaign. The video can be shared using issuer social networks: the more it is shared, the more are the views that the video collect. [293] For this reason, the second hypothesis is that:

H2: A higher views of the presentation video has a positive impact on the success of the equity crowdfunding campaign.

- **Pre-money evaluation.** It is the easiest financial data in terms of accessibility and comprehensibility from a retail investor perspective. Indeed, pre-money evaluation of the issuer is always exposed in the page dedicated to each crowdfunding campaign. It gives immediately an idea of the value of the company that is offering its shares. It is generally calculated considering the equity offered and the funding target, although it is not subject to any review and usually the data that conducted to that results are not made available by the company. For the scope of this dissertation, it is assumed that the values showed are mostly correct [294]. This in order to test the third hypothesis that is:

H3: A higher value of the company has a positive impact on the success of the equity crowdfunding campaign.

- **Funding target.** It is one of the most evident financial data that, together with pre-money valuation and funding target, could be considered by investors. The funding target is the amount of money that need to be collected so that a campaign could be concluded with success. In order to test if the conclusion of LUKKARINEN (2016) could be valid not only in terms of investor participation, but also in term of funding ratio, the fourth hypothesis will be:

[293] This appears to be one on the most reliable way to measure sharing of the "only" equity crowdfunding campaign. Indeed, considering other social network related index, such as Facebook pages likes or Twitter followers, this may distort the results because those "likes" and those "follower" could be collected for reasons that are not associated with the crowdfunding campaign.

[294] This assumption is made on the fact that, if the data that conducted to that result are published, at least they will be review by the institutional investors, which in Italy are obligated in investing, or by the crowd that will make it public in the Q&A section of each campaign. Contrary, if the data published are incorrect, the crowd will notice that and will not invest. This case is the case presented in Chapter 4, paragraph 4.2, shown that the 100% of campaign with incomplete information failed.

H4: A higher funding target has a positive impact on the success of the equity crowdfunding campaign

- **Self-disclosed financial information.** As anticipated, regulation do not provide a specific set of financial data that must be published in an equity crowdfunding campaign. For this reason, provisional data on turnover, profits and costs are disclosed only on a voluntary base. The relation between the information disclosed and the success of the campaign will be analyzed and tested with this fifth hypothesis that is:

H5: Disclosing voluntarily precise financial data has a positive impact on the success of the equity crowdfunding campaign

- **Remuneration and exit strategies.** What above said for financial disclosure it is also true for remuneration or exit strategies. They represent how investors could monetize their investment. In general they are: (i) distribution of dividends, although according to Italian regulation ISU and I-SME cannot distribute dividends before five years from their incorporation [295]; (ii) buy out from another company; and (iii) IPO. Also their relation with the success of a campaign will be highlight in the sixth hypothesis that is:

H6: The promise of a remuneration or of an exit strategy has a positive impact on the success of the equity crowdfunding campaign

- **Number of investors after the first 5 and 10 days from the launching of the campaign**. This variable should make possible the validation of herding behaviour mechanism described in paragraph 3.2.2 in the concrete case. Here, it will be proposed a little variation to the assumption made by AHLERS (2012) on participation of early investors. The difference will be that AHLERS (2012) used this variable in crowdfunding campaign adopting the mechanism of the funding rounds, that is to say, in which the issuer could promote another campaign immediately after a previous successfully concluded.[296]

[295] For more information on that specific issue, please see paragraph 3.2.4.2.

[296] In other words, the issuer in those platforms has the possibility to conduct a sequence of more than one equity crowdfunding campaign. The access to the following it is subordinated to the conclusion with success of the ones before. It this ways, the issuer has the possibility to offer first low percentage

But, being the funding rounds mechanism not used by Italian equity crowdfunding platforms, the attempt will be to test this principle considering the number of investors that decide to invest after the first 5 and after the first 10 days from the beginning of the campaign. The assumption is that each campaign is preceded by a long preparation, including also some marketing. This implies that before going public, the issuers had some investors ready to participate in the crowdfunding campaign that will invest as soon as the campaign is published on the platform. Therefore, the last hypothesis is that:

H7: A higher number of investors after the first five and ten days from the publishing of the campaign has a positive impact on the success of the equity crowdfunding campaign.

Other potential determinants have been excluded for the impossibility to be tested in our case study or for lack of data available until now. For example, although it would have been interesting, it is not possible to consider the effect of the minimum participation on the success of an equity crowdfunding campaign. The reason is simply that the 95% of all the campaign analysed had the same minimum amount of 250 €. The same reason is valid for the participation of an institutional investors. The data, indeed, will be distorted because of the provision of the Italian regulation that forces institutional investors participation. The same principle applies to "investment speed" that is to say how much funding rounds has been chosen by the issuers. This data cannot be considered because this model it is not used in Italy. Finally patents, grants, or team's education are not always displayed in equity crowdfunding platforms and, in particular, in the data set that we are going to consider for our case study there is little incidence of them. For instance, only one of the 27 analysed campaign declared to have a patent for its product.

The next chapter will test and analyse the reported hypothesis, to define if information coming from study conducted in country in which equity crowdfunding is more developed are true also for Italian equity crowdfunding. This will led to

---

of its share asking for a fewer amount of money initially. If he concludes with success the first collection, the issuer could start "another round" where he could offer more shares at a price that, proportionally, is higher than the one of the previous.

recognize which drivers are taken in consideration by an Italian equity crowdfunding investor.

Chapter 4 – Case study

In this final chapter, success drivers identified in paragraph 3.4 will be analysed and tested on a data set composed of all the equity crowdfunding campaigns published in one of the biggest Italian equity crowdfunding platform.

As anticipated in the Chapter 3, the chosen platforms is CrowdfundMe, because it is one of the first platforms operating in Italy after that the first regulation of equity crowdfunding has been enacted. In addition, it is the first Italian platform for number of published projects and the second for the amount of money raised.

Differently from the other equity crowdfunding platforms operating in Italy, CrowdfundMe is one of the best for number of projects published and for quality of information disclosed. Considering that every equity crowdfunding platform has some freedom in deciding which are issuer information that must be published, therefore it is difficult to make comparison between different campaigns published in different platforms.[297] In addition, CrowdfundMe makes available information of a crowdfunding campaign also years later after its conclusion. It is the only that makes clearly available data on investors participation, recording and showing the day and the amount invested by them. As explained in paragraph 3.2.2, those are fundamental information that enhance the probability to avoid herding behaviour.

CrowdfundMe has a simple functioning. The platform gives the possibility to the issuer to promote his campaign on the platform. The issuer sent a summary of the idea to the platform that, after a screening of its potentiality[298] decides if the project could be published or not. After this first screening, a campaign is published on the platform and, if it is completed with success, the platforms retain the 7% of the amount collected.

[297] In other case this is worthless because the major parts of Italian equity crowdfunding platform has no or only few projects published in it which information has been removed after the end of the crowdfunding campaign.
[298] The screening includes the control that the proposed is a true entrepreneurial project and not a fraud.

4.1 Descriptive statistics

The data set contains data of 27 crowdfunding campaigns published and concluded on CrowdfundMe from 2014 to 2017. The total amount collected with success is € 3.49 million [299] while 1.955 is the number of participating investors with no. 2.281 share subscription. [300] On CrowdfundMe, of the 27 published campaigns 18 has been successfully closed while 9 failed to reach the funding target.

The average amount raised by the 18 successful campaigns is € 193.820,78, while the average number of participating investors is 100. Considering also the failed campaigns, the average amount collected by the 27 analysed campaigns is € 136.292,05 and the average number of participant investors is 72. The greatest amount collected by a single campaign is € 391.500,00 while the greatest number of participant investors is 192. Only 3 companies offered only B shares [301] and all the four companies that published incomplete documentation or errors noted by the investors in the Q&A section failed.

The successful projects analysed went over-funded by an average rate of 236%, with the maximum overfunding volume reached of 400%. To confirm what already said by ARMOUR and ENRIQUES (2017), [302] the unsuccessful projects where very far from reaching the target amount, with a low average funding of 17%, with only 2 failed campaigns on 9 collecting more that 30% of the requested funds.

	No. observation	Sum	Average	Min	Max
	General				
Amount collected	27	€ 3.679.885,22	€ 136.292,05	€ 1.000,00	€ 391.500,00
Participant investors	27	1955	72	1	192
Funding ratio	27	--	163%	1%	400%

[299] The total collection, including money regarding failed projects is € 3.679.885,22. It useful to remember that when an equity crowdfunding campaign is concluded without success, money invested comes back to the relevant investors.
[300] Only data regarding investors are updated to the 10 January 2018 with the aim of giving an idea of the importance of the selected platform.
[301] With B shares the platforms refers to shares without voting right.
[302] For further information see paragraph 3.3.2

	Successful				
Amount collected	18	€ 3.488.774,00	€ 193.820,78	€ 63.000,00	€ 391.500,00
Participant investors	18	1794	100	30	192
Funding ratio	18	--	236%	100%	400%
	Failed				
Amount collected	9	€ 191.111,22	€ 21.234,58	€ 1.000,00	€ 88.000,00
Participant investors	9	161	18	1	38
Funding ratio	9	--	17%	1%	44%

Figure 4.1- Descriptive statistics

With regards to sectors or industries in which the companies of the data set operate, some of the consideration made in the market analysis of paragraph 2.1 on could be confirmed. Indeed, in the list of the top five industries and sectors funded, ICT is in the top five. Peculiar of Italian framework it is the fact of finding also 5 on 27 companies operating in the Food and Beverage sector, while an important position is occupied by Tourism and Sharing economy.

In the considered market, only a modest percentage of the presented projects could be considered as first mover. Those were 6 on 27, representing the 22% of the total data set. Moreover, first mover companies have a positive success rate of 66,6%. [303]

Sector	No. of observation	Percentage of success
Food and Beverage	5	60%
ICT	5	60%
Sharing Economy	4	100%
Tourism	3	100%
Real Estate	2	50%
Other sectors	8	50%
Total	27	66,6%

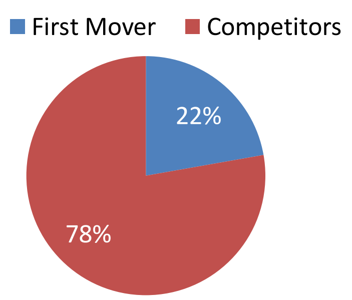

Figure 4.2- Sectors and competition

[303] Considering that the data set contains only 6 "first mover", those data has been considered too few to create and study a dedicated hypothesis as the one presented in paragraph 4.3.

Project Name	First mover	Success
ANDERSWINST	--	--
BABAIOLA	--	Yes
BLOOVERY	--	Yes
BORSINORIFIUTI	--	Yes
CLEANBNB	Yes	Yes
COCO	Yes	Yes
CROWDFUNDME	--	Yes
CYNNY	Yes	Yes
DIAMASS	--	Yes
GLASS TO POWER	--	Yes
GOBIMBO	--	--
HOME3D	--	--
MANAGEMENT INNOVATION	Yes	Yes
MONELLINI	--	--
MY COOKING BOX	--	Yes
MYCHEFFY	--	--
OREEGANO	--	Yes
PALADIN	--	Yes
PETZOLLA	Yes	--
SHAREWOOD	--	Yes
STREETEAT	--	--
SWEETHIVE	Yes	--
TALKWAY	--	Yes
TASKHUNTERS	--	Yes
TOC TOC BOX	--	Yes
WATCHY TALKY	--	--
WINELIVERY	--	Yes
Total	6	18

Figure 4.3 **-** *Fist mover projects on the total succeeded*

An important fact that needs to be highlighted is that being no current obligation in equity crowdfunding regulation to show financial information, those are not always disclosed by the issuer. Specifically, it is necessary to distinguish between financial data that are always shown because they are requested by the platform, and financial data that could be only voluntarily disclosed. In the first group, there are very basic information such as amount of equity offered, target ratio and pre-money valuation of the company. In the second group, instead, there are usually provisional data on turnover, profits and costs that are disclosed only on a voluntary basis. With respect to this second group, Figure 4.4 below shows the list of financial information presented in the considered dataset, showing that less than half of the considered project (14) disclosed more specific financial data than the one requested by the platforms.

Name	*Equity offered*	*Funding target*	*Pre-money valuation*	*Other financial data*[304]
ANDERSWINST	5,60%	€ 100.000	€ 1.700.000	--
BABAIOLA	3,40%	€ 60.000	€ 1.700.000	--
BLOOVERY	8,50%	€ 60.000	€ 650.000	--
BORSINORIFIUTI	6,30%	€ 80.000	€ 1.200.000	Yes
CLEANBNB	11,00%	€ 50.000	€ 404.545	--
COCO	4,80%	€ 50.000	€ 1.000.000	Yes
CROWDFUNDME	5,70%	€ 150.000	€ 2.500.000	--
CYNNY	0,10%	(€ 250)/€100.000[305]	€ 100.000.000	--
DIAMASS	2,00%	€ 100.000	€ 5.000.000	--
GLASS TO POWER	10,90%	€ 183.750	€ 1.500.000	Yes
GOBIMBO	11,00%	€ 72.187	€ 582.000	--
HOME3D	6,30%	€ 100.000	€ 1.500.000	Yes
MANAGEMENT INNOVATION	9,10%	€100.000	€ 1.000.390	Yes
MONELLINI	13,80%	€ 200.000	€ 1.250.165	Yes
MY COOKING BOX	6,00%	€ 50.000	€ 783.333	Yes
MYCHEFFY	11,80%	€ 60.000	€ 450.000	Yes
OREEGANO	6,40%	€ 80.000	€ 1.160.700	Yes
PALADIN	4,80%	€ 50.000	€ 1.000.000	--
PETZOLLA	9,10%	€ 80.000	€ 800.000	Yes
SHAREWOOD	2,40%	€ 75.000	€ 3.000.000	--
STREETEAT	4,80%	€ 100.000	€ 2.000.000	Yes
SWEETHIVE	2,40%	€ 75.000	€ 3.000.000	Yes
TALKWAY	2,90%	€ 150.000	€ 5.000.000	Yes
TASKHUNTERS	5,40%	€ 80.000	€ 1.400.000	--
TOC TOC BOX	39,00%	€ 80.000	€ 125.128	--
WATCHY TALKY	44,00%	€ 162.000	€ 206.182	--
WINELIVERY	4,00%	€ 50.000	€ 1.200.000	Yes
			Total Yes	14/27

Figure 4.4- Financial information contained in the dataset

[304] This group usually contains forecasts on revenues, on costs and on profits.
[305] In this case the minimum target amount showed in the platform was different from the minimum amount, in brackets, that could be collected according to the company general meeting.

Finally, another important missing “mandatory” information regards the provision on which kind of remuneration could be acquired by a single investor. In other word, which exit strategies company intends to adopt in the future. While in other important international platforms there is usually a section dedicated to it [306], nor the regulation nor the considered platforms required the issuer to show which exit strategy has been considered by the promoting team. Indeed, information on this regards could be often found out only in the Q&A section, being disclosed only on investor request. [307] In the analyzed data set only 10 companies on 27 gave such information. Even though some companies published more than one exit proposal, the “buy out” it is the most common way out proposal by the issuer, being present in the 33% of the campaigns. The provision of a future IPO or of dividend distribution is less common, presented both by only 2 companies on 27.

Investment remuneration	**Absolute frequency**	**Relative frequency**
Dividends distribution[308]	2	7,4%
Buy out	9	33,3%
IPO	2	7,4%
No provisions	14	51,9%

Figure 4.5- Presence of exit strategies

4.2 Data analysis

In this section, data collected will be analysed with the final purpose of testing the hypothesis anticipated and formulated in paragraph 3.4.2. The considered data set is based only on 22 campaigns of the 27 described above. Indeed, to study the correlation between funding ratio and, respectively, equity offered (H1), video view (H2) and pre-money valuation (H3) it was necessary to clean the data set from the presence of 5 outliers. The following table shows the result of the correlation matrix between all of the considered variables without a dichotomous value. As Figure 4.6

[306] See for example the campaign descriptions of UK platform Crowdcube.
[307] For the purpose of this dissertation no difference has been made on the fact that the information is given on investors request or not.
[308] It is important to remember that ISU and I-SME, as described in paragraph 2.3.4, could not distribute dividends until 5 years from their incorporation.

shows, apart from the relation between funding ratio and number of participant investors, correlation between data presented is not very strong.

	Funding Ratio	*H1. Equity offered*	*H2. Video Views*	*H3. Pre-money valuation*	*H4. Funding target*	*H7. No. of investors after the first 5 days*	*H7. No. of investors after the first 10 days*	*H7. Total no. of investors*
Funding Ratio	1							
H1. Equity offered	-0,46	1						
H2. Video Views	0,43	-0,02	1					
H3. Pre-money valuation	0,20	-0,62	-0,07	1				
H4. Funding target	-0,31	0,28	-0,24	0,39	1			
H7. No. of investors after the first 5 days	0,31	-0,04	0,21	0,25	-0,09	1		
H7. No. of investors after the first 10 days	0,37	0,01	0,11	0,22	0,07	0,93	1	
H7. Total no. of investors	0,86	-0,42	0,35	0,22	-0,14	0,21	0,36	1

Figure 4.6- Correlation between selected variables and funding ratio.

A more complete analysis of the relation between the funding ratio and the selected drivers will now follow, in order to analyse the hypothesis expressed in paragraph 3.3.2 to identify the drivers followed by an equity crowdfunding investor before making investment decisions.

H1: A higher participation offered has a negative impact on the success of the equity crowdfunding campaign.

The first hypothesis analysed comes from agency theory’s principle. According to this theory, in order to make the agent work in the interest of the principal, avoiding moral hazard and bad behaviours, it is necessary to align agent and principal interests. Applying this principle to equity crowdfunding, the issuer should be interested in retaining for him a great part of his company if he think that the value of the company will increase in the future. So, when this not happen investors may infer that the chances the company will increase in value are not high and may decide not to invest.

Notwithstanding the theory, this hypothesis finds little evidence in the analysed data as already anticipated with the correlation matrix presented in Figure 4.6. Indeed, correlation between equity offered and funding ratio it is only -0,46. The result suggest the existence of an inverse relation between equity offered and funding ratio, although this is not strong. Indeed, the dispersion of data around the line is still evident, explaining why the correlation remains quite low.

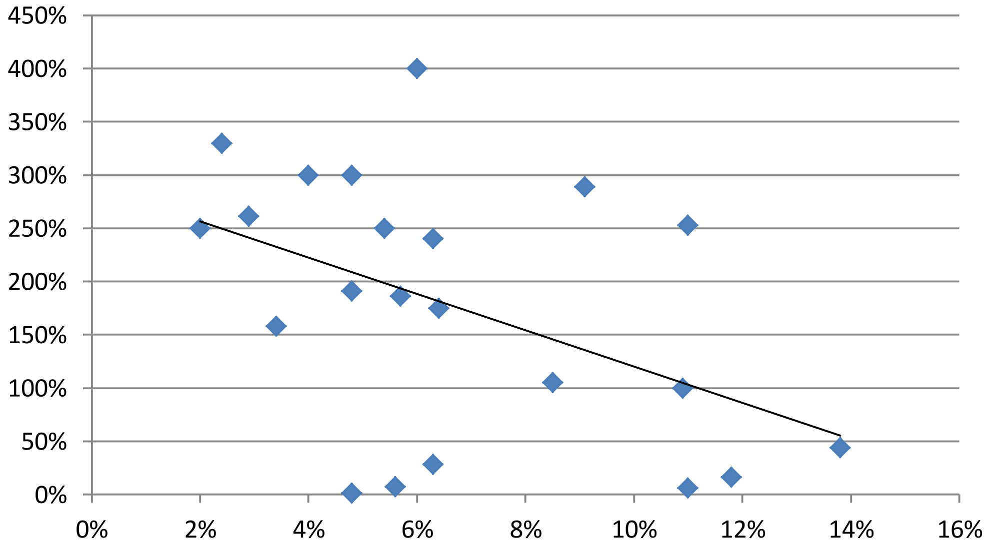

Figure 4.7- Relation between funding ratio and equity offered.

From the above it possible to conclude that the first considered hypothesis may find some demonstration in the data proposed, although the correlation between those data it is not so strong. This means that the amount of share offered is a financial information that, being one of the major financial information investors could easily have access before investing, is taken in consideration by the investors, although it is not so significant to be used to attract investors participation.

H2: A higher views of the presentation video has a positive impact on the success of the equity crowdfunding campaign.

Figure 4.8 below presents the relation between video views and funding ratio. As confirmed by the correlation value (0,43) reported in the matrix of Figure 4.6, the analysis of the data suggests a positive relation between these two variables.

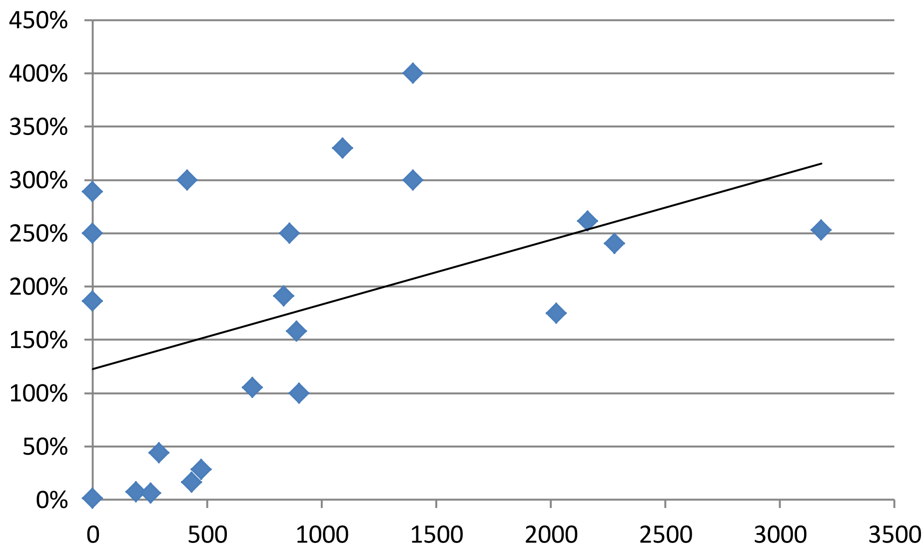

Figure 4.8- Relation between funding ratio and views of the presentation video

Notwithstanding the value of the correlation found out it is not so high, it is still possible to make at least some important empirical observation on the direct relation emerged. For instance there is a concentration of failed campaign under the 500 views, while the higher concentration of successful collection, is concentrated between 750 and 2250 views.

These results may suggest that although data may be still too few to recognized a strong relation between views of the presentation video and funding ratio, there is a minimum threshold of visibility that need to be overcome (750 in our case) to increase the probability of success of a crowdfunding campaign. Social interaction, although it may be not fundamental, remains an important driver to increase attraction of investors of an equity crowdfunding campaign.

H3: A higher pre-money valuation of the company has a positive impact on the success of the equity crowdfunding campaign.

Figure 4.9 below shows the relation between pre-money valuation and funding ratio of each campaign. However, also form the presented data it is not possible to highlight a significant relation of the two considered variables, being the correlation value of 0,20. Indeed, the major parts of the considered campaigns (18 of 22) had a pre-money valuation under or equal to € 2 million and, in this group, 12 of 18 (the 66%) has been concluded with success, while only 6 of 18 (the 33%) failed.

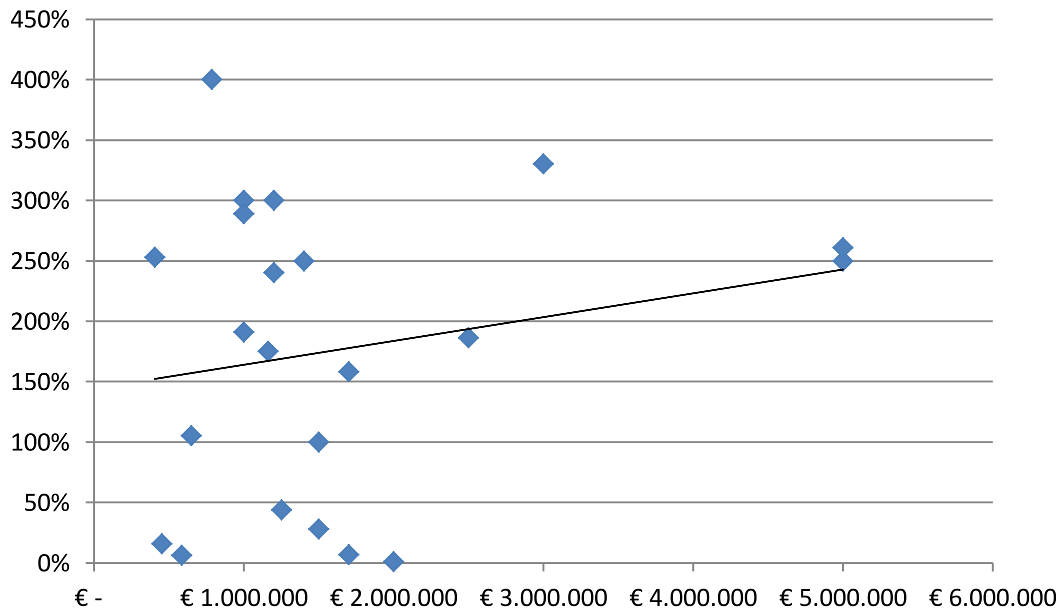

Figure 4.9- Relation between pre-money valuation and funding ratio

From the above results it is possible to conclude that the third hypothesis do not find enough evidence in the case study of this dissertation. This may suggest that high level economic drivers, such as the value of the company, are not so effective in determining investors participation. As already recognized under hypothesis H1, high level financial information that are always disclosed to investors, although they may be important, do not play a fundamental role in determining investor's interest in a specific campaign.

H4: A higher funding target has a positive impact on the success of the equity crowdfunding campaign

Figure 4.10 below shows the relation between the amount of money sought by the issuer and the success of the campaign in terms of funding ratio. The aim of this hypothesis is to demonstrate that, also partially in contrast with the research conducted by LUKKARINEN (2016), investors will be attracted by the fact that a company look for a high amount of money. Indeed, in coherence with some principles highlighted in paragraph 1.2.2 on AON dynamics, the fact that the issuer set higher minimum target should be considered in a better way by investors, giving them more trust in the fact that the project would be carried on with success.

However, as reported in the correlation matrix of Figure 4.6, not only the relation between these two set of data it is not very strong, but, in addition, they are inversely correlated (correlation value is -0,31).

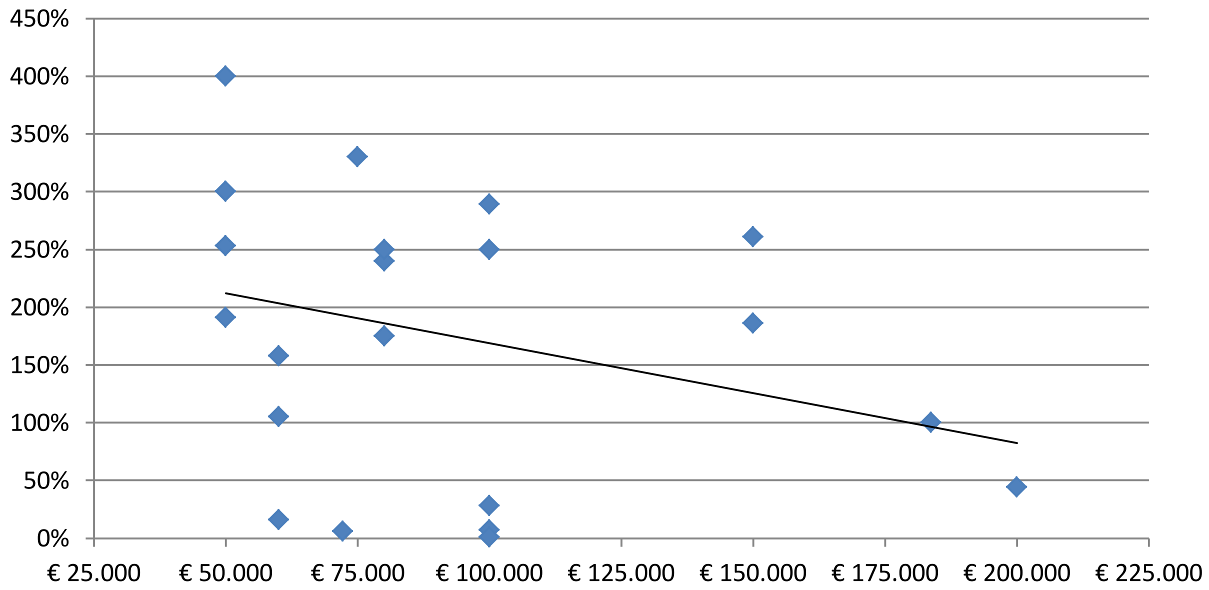

Figure 4.10- Relation between funding target and funding ratio

This result will suggest that the formulated hypothesis seems not demonstrated, in full accordance with the research of LUKKARINEN (2016), mentioned in paragraph 3.4, according to which there is no strong correlation between funding target and funding ratio.

A simple explanation for the result of the reported analysis is that a lower amount of money could be easier collected than a higher one. This could be an interesting driver considered by investors that may prefer to invest in projects with higher chance to reach their funding target, and so having all the necessary resource to be developed and became remunerative. This means also that AON theory do not find enough application in the concrete case.[309]

H5: Disclosing voluntarily financial data has a positive impact on the success of the equity crowdfunding campaign

As anticipated in the previous paragraph, in general equity crowdfunding investors give importance to voluntary information disclosure. Indeed, as already reported while describing the dataset in paragraph 4.1, lack of basic information it is always related with the failure of the campaign. The aim of the considered hypothesis is to test if the same principle it is also true with regards to disclosure of not-mandatory financial information.

The relation between disclosure of more financial information, success and funding ratio, is exposed in the table of Figure 4.11 below.

Name	***Other financial data***	***Success***	***Funding ratio***
ANDERSWINST	--	--	7%
BABAIOLA	--	Yes	158%
BLOOVERY	--	Yes	105%
BORSINORIFIUTI	Yes	Yes	240%
CLEANBNB	--	Yes	253%
COCO	Yes	Yes	300%
CROWDFUNDME	--	Yes	186%
DIAMASS	--	Yes	250%
GLASS TO POWER	Yes	Yes	100%
GOBIMBO	--	--	6%
HOME3D	Yes	--	28%
MANAGEMENT INNOVATION	Yes	Yes	289%

[309] This is a reference to what already exposed in paragraph 1.2.2, *id est* AON campaigns are riskier for the promoter, because he bear all the risks related to the not reaching of the funding target, but at the same time let him to gain more confidence and trust by its potential investors

MONELLINI	Yes	--	44%
MY COOKING BOX	Yes	Yes	400%
MYCHEFFY	Yes	--	16%
OREEGANO	Yes	Yes	175%
PALADIN	--	Yes	191%
SHAREWOOD	--	Yes	330%
STREETEAT	Yes	--	1%
TALKWAY	Yes	Yes	261%
TASKHUNTERS	--	Yes	250%
WINELIVERY	Yes	Yes	300%
Total	12	16	

Figure 4.11- Relation between disclosure of additional information and success

Sector	**Absolute frequency**	**Relative frequency**	**Rate of success**	**Rate of failure**
Presence of other financial data	12	54,5%	66,6%	33,3%
No other financial data showed	10	45,5%	80%	20%
Total	22	100%		

Figure 4.12- Relation between disclosure of additional information and success

In particular, Figure 4.12 gives aggregate important empirical information, highlighting the relation between information disclosure and presence or non-presence of specific financial data. Indeed, on the 22 campaigns considered, only 12 decided to show specific financial data regarding profit or revenue forecasts. In this group, the 66,6% succeeded, while the group of non-disclosing companies presents a higher success rate (80%).

To explain these unintuitive results, it is necessary to considered that equity crowdfunding environment is composed by SMEs and startup, companies that usually do not have the resource to hire professional consultant to review information published. [310] This means also the impossibility to validate data published, in a way to avoid errors of incautious data disclosing.

Therefore the fact that disclosing companies presents a lower success rate if compared with the "non-disclosing", simply highlight the importance of disclosing

[310] Indeed, from in the consider dataset, only one company disclosed the consultant hired by the team to have support for the equity crowdfunding campaign.

correct data. In other word, disclosures activities does not *per se* increase success rate if this is not properly carried on. This because, if the data disclosed are not correct or they do not reflect investors expectation, this may clearly determine the failure of the campaign.

The assumption demonstrates that investors give importance and value to financial information disclosure, although this does not imply that for the sole fact of having disclosed some data the company may attract more investors. Indeed, investors gives importance to the fact that the information disclosed are correct. If data shared are "bad", or simply does not reflect investors expectation this may create a boomerang effect for the company. The aforementioned *wisdom of the crowd* could help in detecting those bad information, influencing the success of the campaign.

H6: The promise of a remuneration has a positive impact on the success of the equity crowdfunding campaign

Figure 4.13 below shows that on the 22 campaigns composing the data set, only 8 decided to present at least one exit strategy to its investors. In this group, only 2 issuers decided to present two exist strategies, while no campaign presented all three of them.

Name	***Dividends distribution***	***Buy out***	***IPO***	**Success**	**Total Founding**
ANDERSWINST	--	--	--	--	7%
BABAIOLA	--	Yes	--	Yes	158%
BLOOVERY	--	Yes	--	Yes	105%
BORSINORIFIUTI	--	--	--	Yes	240%
CLEANBNB	--	--	--	Yes	253%
COCO	--	Yes	--	Yes	300%
CROWDFUNDME	--	Yes	Yes	Yes	186%
DIAMASS	--	--	--	Yes	250%
GLASS TO POWER	--	--	--	Yes	100%
GOBIMBO	--	--	--	--	6%
HOME3D	--	Yes	--	--	28%
MANAGEMENT INNOVATION	Yes	Yes	--	Yes	289%
MONELLINI	--	--	--	--	44%
MY COOKING BOX	--	--	--	Yes	400%
MYCHEFFY	--	--	--	--	16%

OREEGANO	--	Yes	--	Yes	175%
PALADIN	--	--	--	Yes	191%
SHAREWOOD	--	--	--	Yes	330%
STREETEAT	--	--	--	--	1%
TALKWAY	Yes	--	--	Yes	261%
TASKHUNTERS	--	--	--	Yes	250%
WINELIVERY	--	--	--	Yes	300%
Total "Yes"	2	7	1	16	--

Figure 4.13- Relation between disclosing potential remuneration and success rate.

Figure 4.14 shows a positive relation, in terms of success rate, for companies that decided to show at least one or two exit strategies. Indeed, the success rate of the former is 87,5%; the success rate of the latter, is, instead, of 100%. However, this rate it not so far from the one on companies that do not present a way out. Indeed, those companies had a success rate of 65%.

Sector	**Absolute frequency**	**Relative frequency**	**Rate of success**	**Rate of failure**
Presence of at least one exit strategies	8	36,3%	87,5%	12,5%
Presence of two exit strategies	2	9,1%	100%	0
Presence of no exit strategies	14	63,7%	64,3%	35,7%

Figure 4.14- Relation between presence of exit strategies and success

The result highlighted below suggests that giving information on possible exit strategies it is very important although it may be not fundamental as demonstrated by the still high success rate of company not giving information on possible way out. However, this does not means that the presence of exit strategies it is not a driver to attract investors. Indeed, no presence of exit strategies could increase probability of failure as demonstrated by the fact that 4 on 6 of the company that failed had not given to the investors information about possibilities to gain from the investment completed.

H7: A higher number of investors after the first five and ten days from the publishing of the campaign has a positive impact on the success of the equity crowdfunding campaign.

As a confirmation of the importance of "crowd" dynamics in equity crowdfunding, there is a strong correlation between number of investors and success of the campaign. To make clearer this relation, the analysis has been conducted in three different moments of each campaign: after the first 5 days, after the first 10 days and at its end. Figures 4.15 below shows the correlation between total number of investors adhering to each of the 22 campaigns composing the data set and the funding ratio of each of them. It is possible to observe that there is a clear relation between the number of investors and the total amount raised. This could imply that the more are the *single number* of investors that participate in a crowdfunding campaign and the more are the possibilities to outreach the minimum target.

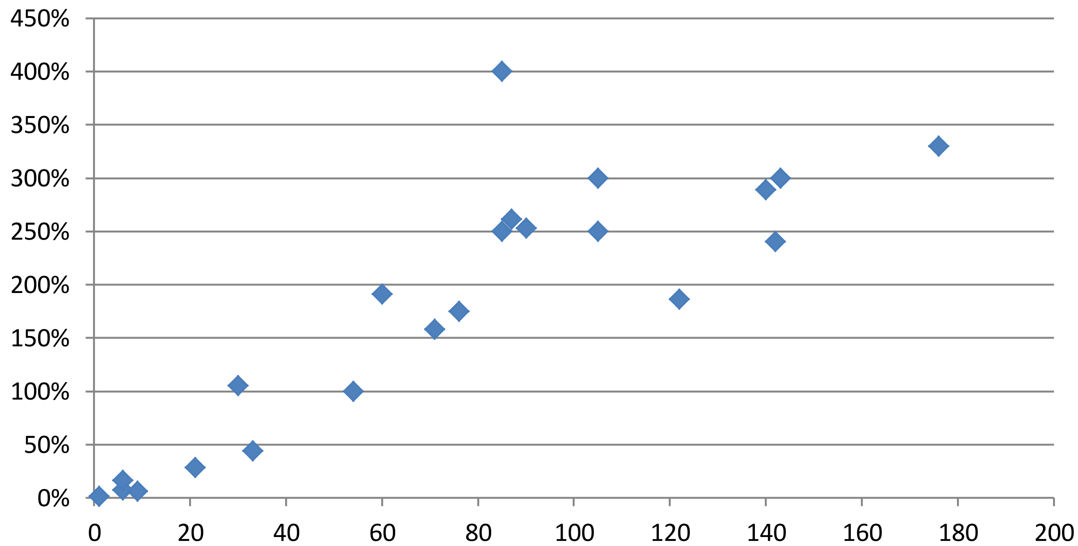

Figure 4.15- Number of total investors that invested in the company in relation with the funding ratio.

But, what is also possible to highlight from the reported data is that the more are the investors that participate in the first days from the launching of the campaign and the more are the possibilities to succeed. Indeed, as shown in the Figures 4.16 and 4.17 below, the major parts of the failing campaigns were unable to attract more than two investors within the first 5 days from the launching of the campaign, or more than three after the first 10 days. Contrary, issuers that was able to attract more than five investors after only the first 5 days then succeeded and the same it is true for the other that attracted more than 10 investors after the first 10 days.

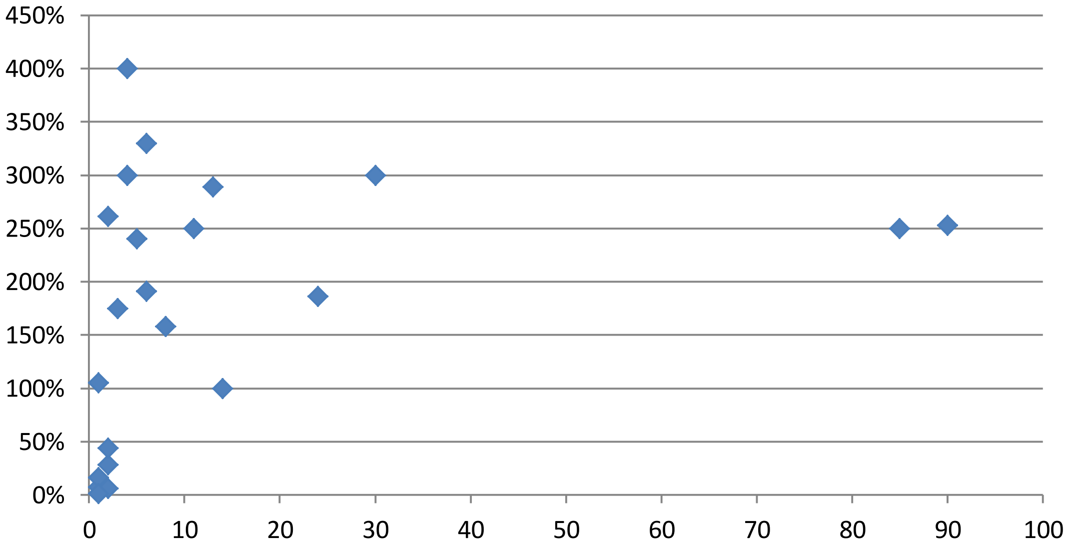

Figure 4.16- Number of investors that invested in the company within the first <u>five</u> days from the beginning of the collection

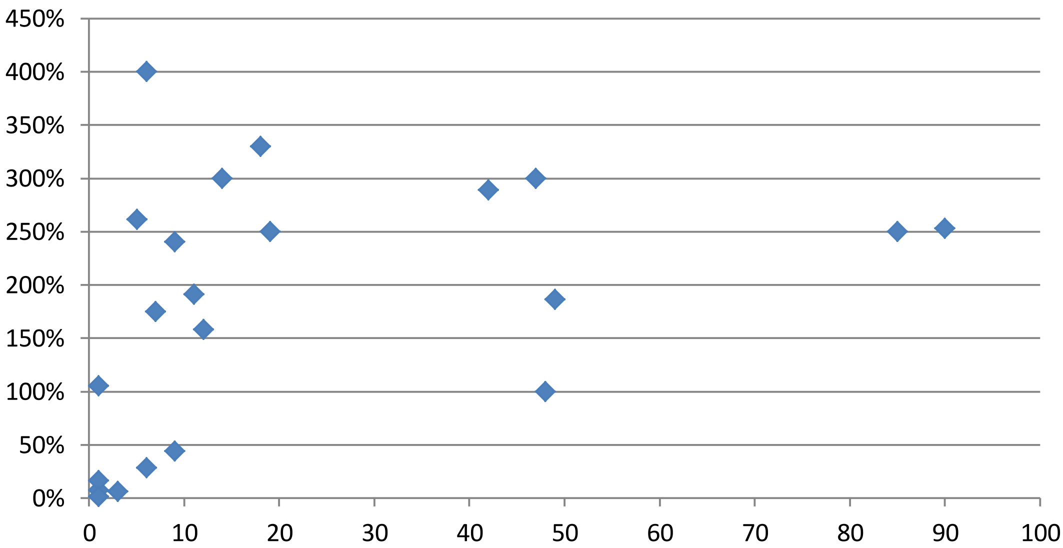

Figure 4.17- Number of investors that invested in the company within the first <u>ten</u> days from the beginning of the collection

The results presented above could be considered as valid proof of the presence of herding behaviour in attracting investors of equity crowdfunding campaign. This is a confirmation of the existence, beside its financial nature, of another one, more "social", determined by direct crowd participation.

4.3 Conclusion

After the data analysis conducted above, it is possible to recognized at least three different nature of equity crowdfunding. The first is the *financing* nature that is connected with its function as a financing instrument for SMEs and for startups, as it is has been demonstrated in Chapter 2, also considering its inverse relation with the established banking sector.

The second, it is equity crowdfunding *financial* nature, that is linked to the fact that it is based on the subscribing and trading of companies shares. To this regards, in Chapter 2 the direct relation with financial markets has been described and in Chapter 4 the importance of sharing precise and correct financial information to enhance success probability has been reported.

The last one, it is equity crowdfunding *social* nature, connected with the most "disintermediated" (and so direct) crowd participation. From this point of view, as described in Chapter 1, equity crowdfunding in some cases it is considered as an opportunity to directly invest in projects that are near to investor knowledge, giving him also the possibility to be an active part of a community. However, this nature implies also negative aspects, as it has been described, such as the perils linked with herding behaviour that may cause funds misallocation, as reported in Chapter 3 and partially demonstrated in Chapter 4.

In order to enhance equity crowdfunding market development, it is necessary to balance and to oversee all these different natures. This role, could be assigned only to *regulation* that should always have as a main purpose the reduction of risks for investors avoiding the imposition of excessive costs on issuers and platforms. This could be done, for instance, by inducing issuers in disclosing more financial data, in a way that investors may take more precise and informed decisions. To do so, in order to avoid the introduction of new costs for issuers, a more valid solution could be to provide a mechanism of grants or tax relief to compensate the *disclosing issuers* of the costs of hiring specific consultants.

In addition, from the describe natures it is clear that there are two major classes of drivers that attracts investors participation. One is composed by *financial drivers*, while the second contains *social drivers.* This means also that investors decisions making process will depends on which of the two set of drivers will be preferred in the concrete case. In this way, an investment could be determined by a business model analysis or it could be the result of a herding behavior.

The analysis conducted in this dissertation provide evidences of the fact that at the current state of the art the so-mentioned *social drivers* may prevail on the *financial drivers,* as it has been demonstrate considering the correlation between funding ratio and financial drivers (see H1 and from H3 to H6), on the one hand, and social drivers (see H2 and H7) on the other, although financial drivers could be more numerous of the social one. Indeed, financial information are important for the investors, although social information have a stronger correlation with the success of the campaign.

However, predominance of social drivers on financial ones, may cause some risks for investors. As it has been demonstrated, although social mechanism could be useful to identify fraud attempt or information incoherence, they could also bring misallocation of funds. Indeed, it has not been demonstrated that, in absence of frauds of incoherencies, social drivers makes investors choose always the more profitable project. Indeed, this will be impossible if detailed financial information are not available.

To solve this potential risk of misallocation of funds, the more efficient solution is to impose a minimum set of financial information that need to be disclosed and that will the validated before the launching of an equity campaign.

In this way, not only investors may take more efficient decisions but also the *wisdom of the crowd* will help in enhancing information quality, notwithstanding the not so deep level of disclosure that could be imposed to the issuer to not increase disclosure costs. In this sense, the crowd system, that before could be considered as a source of peril, could now function as a *catalyst* to turn low level financial information in high quality one.

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Summary

This dissertation aims at identifying which are the determinants of equity crowdfunding development from two different points of view: (i) the one of market; and (ii) the investor one. To do so, the first chapter describes equity crowdfunding and its most relevant dynamics; the second deals with factors determining equity crowdfunding market development; and, finally, the third identifies the drivers that attract investors participation, testing its theoretical findings in the case study of the fourth chapter.

More in particular, the first chapter describes equity crowdfunding and its characteristics, together with the advantages and the drawbacks related with the usage of this instrument for issuers and investors.

Equity crowdfunding it is based on a simple mechanism: *crowdsourcing* that is to say the possibility to use the participation of a high number of people to develop a specific project. The principal assumption behind crowdsourcing is that group's aggregate answers are better than the answers given by any of the single individual that is part of the group. When crowd participation consists in giving money to a promoter, this is a type of crowdsourcing known as *crowdfunding*.

There are at least four traditional different financing models using crowdsourcing to satisfy the financial need of an enterprise. These are: donation, reward, lending and equity crowdfunding. Each model differs from the others on the basis of what an investor receives in exchange to its participation.

Equity crowdfunding is the only model that lets investors effectively become a shareholders of the undertaking they are giving money to, through the use of an online portal (the equity crowdfunding platform) where the issuer has the possibility to present its projects, looking for investors.

Starting an equity crowdfunding campaign requires amendments to the company's bylaws and article of incorporation, with possible influences on the company's financial structure. Indeed, the company has to decide: (i) the *equity offered*, that is the percentage of company's capital to be offered for subscription; and (ii) the *funding target*, i.e. the minimum amount of money that it is going to give in

exchange for the above selected percentage of company’s capital. These decisions involve the convey of an extraordinary shareholders meeting voting on the issuance of new shares and so on the above mentioned amendments to the company’s bylaws and article of incorporation. At the end of a successful equity crowdfunding campaign, the financial structure of the company will be modified to take in consideration the increase of company’s equity.

Crowdfunding campaign can also be distinguished on the basis of what happens if the issuers manage to reach or not the established funding target. There are two principal schemes: Keep-It-All (KIA) or All-Or-Nothing (AON). In AON model, the entrepreneur receives the money collected from the crowd only if the funding target is reached before 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 these two models brings a risk-return trade-off at the entrepreneurial level: KIA campaigns are less risky for the issuer but generate also lower returns and expected rate of success; AON involves that the risk is all borne by the company, although there are higher chances of reaching the funding goal. All equity crowdfunding campaigns follow the AON model, although there are ways by which the issuer could substantially create a KIA campaign, that is to say setting a funding goal so low that could be reached with a minimum participation. The amount of money that overcome the funding target is defined as *funding ratio* and it is one of the most useful determinants of a company success.

Moreover, the dissertation reports equity crowdfunding advantages and disadvantages. In the list of the advantages, it has been highlighted how crowdfunding is not only a mere financing instrument for the issuer - less costly and one of the few available for SMEs – or a way to acquire a financial return for investors. There are also other advantages in using equity crowdfunding such as the one generated by community participation, risk reduction, market validation and marketing. In regard to the disadvantages, for the issuer, these are mostly caused, by the public exposition of its entrepreneurial idea or by the increasing of administrative costs related to the need of dealing with a high number of new shareholders. For investors, equity crowdfunding represents a really risky activity. Indeed, major risks of investing in equity crowdfunding are: (i) risk of fraud, enhanced by the possibility of using Internet to hide promoter identity; (ii) risk of failure, given the financial instability of SMEs and startups and their high failure rate; and (ii) illiquidity, that is to say the impossibility to find a secondary market for the share acquired.

The second chapter starts presenting the equity crowdfunding market analysis of UK, USA and Italy, describing also which factors are the causes for the differences find out after the market analysis.

Difference between US, UK and Italian equity crowdfunding markets regards more different amounts of money collected using this innovative financing instrument. For instance, in US in 2016 around $ 570 million were collected through equity crowdfunding. In UK the same data in the same year is equal to $ 400 million, while in Italy, equity crowdfunding in 2016 collected less than $ 5 million (see Figure 1 below).

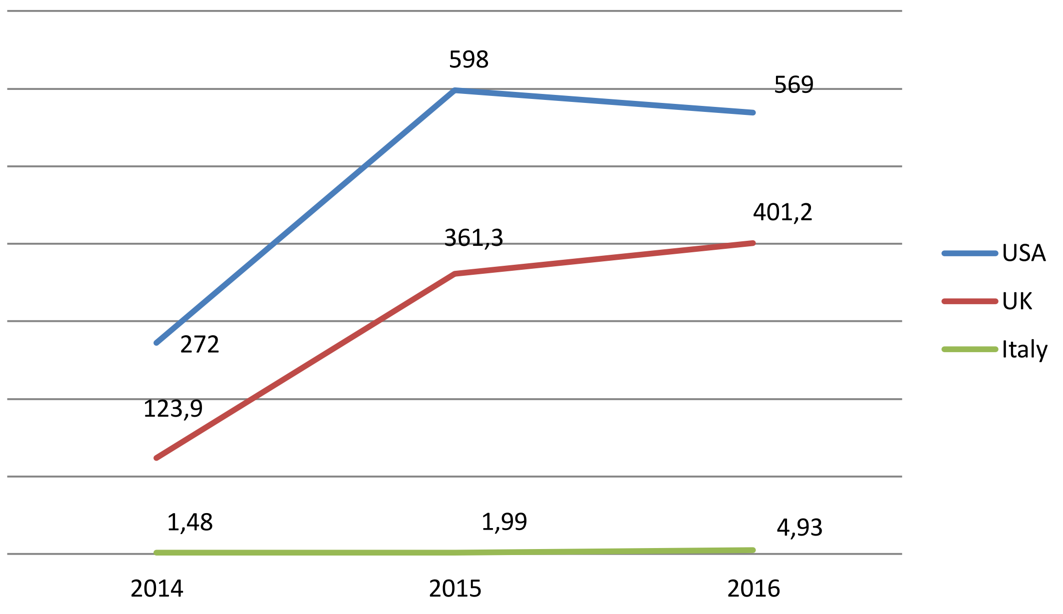

Figure 1 - Amount of money collected 2014-2016 ($ million).

In terms of growth rate, instead, data are similar. Indeed, from 2013-2015 equity crowdfunding both in US and in UK registered incredible growth rates. The same could be considered true for Italy, with the difference that similar high growth rate has been observed only two years later. The immediate suggestion of this late development could be found out in the fact that only recently, Italian equity crowdfunding regulation has been amended in a way to unlock the potentiality of this instrument.

To understand the causes of the differences between UK and US equity crowdfunding market, on the one hand, and the Italian one, on the other, the relations between equity crowdfunding and, in the order, (i) banking sectors, (ii) financial markets, (iii) regulation of this instrument, and (iv) entrepreneurship level of each country has been studied. The result of this research shows how each of the above mentioned factors influenced the development of equity crowdfunding market.

The first finding is that equity crowdfunding volume of a considered country is inversely correlated with the activity of its banking sector. This activity has been measured in terms of SMEs loan availability and market concentration. Indeed the more banks are available in issuing loans to startups and SMEs, the less those companies will consider equity crowdfunding as alternative finance instrument for their entrepreneurial projects. Moreover, it has been found out that concentration of banking industry could be also inversely correlated with the growth rate of this instrument in a selected country.

Instead, with reference to financial markets, correlation with equity crowdfunding is direct. Comparison of UK, US and Italian financial market volumes with the volume of their respective equity crowdfunding market gave the possibility to observe that the dimension of the financial market of each country is positively correlated with equity crowdfunding market dimension. The same direct correlation has been found out comparing equity crowdfunding market volume with the financial literacy level of the population of the considered country. The intuition is that the more the population of a considered country knows how to make financial decision regarding their savings, the more are the people that would considering equity crowdfunding investments.

In the relation between equity crowdfunding market and its regulation two different kinds of correlation could be found , instead,. Indeed, there is a positive relation with rules favoring investor protection. This is the case of UK where regulation protects investors during each phase of the investment process. For instance, equity crowdfunding campaigns are supervised and require FCA acceptance before being published in the platform; platforms require FCA approval to operate as if they were financial intermediaries; and investment is stimulated by a wide mechanism of tax relief that protects investors also in case of failure of the company. Conversely, no such rules has been enacted in Italy, where: campaigns and information published therein do not require CONSOB approval; platforms need only to file for the registration in a special section of the enterprise register; and tax reliefs for investment in equity crowdfunding are limited to the 23-27% of the investment and only if the investment is made in an innovative company.

In addition, the correlation between equity crowdfunding development and rules limiting the access to this instrument is negative. This could be demonstrated considering Italian framework where until few years ago, only "innovative" companies could use equity crowdfunding. These were companies that, possessing specific innovation requisites, registered in a special section of the company register, acquiring the status of Innovative Start-Up (ISU) or Innovative Small and Medium size Enterprise (I-SME). Therefore only after having registered in a special section of the company register, those companies could undertake an equity crowdfunding campaign. It is maybe not a coincidence that after the removal of such limitation, also in Italy equity crowdfunding growth rate considerably increased.

Finally, equity crowdfunding market development would be directly related with the entrepreneurship level of a considered country. This level has been measured using a specific international index (the Global Entrepreneurship Index) that takes in consideration the complete framework in which companies carry out their businesses in a considered country. To each country it is associated a certain score, on the base of its entrepreneurship environmental characteristic. From the ranking created on the above mentioned score, it is possible to observe that, while US and UK occupy, respectively, the first and the fourth position, Italy is only in the 42^{sd} place of the 137 considered country, after Tunisia and Puerto Rico.

Determinant	Relation with equity crowdfunding
Banking sector	Inverse: • lower availability to lend money is related with higher equity crowdfunding growth rate; and • higher banking concentration is associated with lower equity crowdfunding market volume.
Financial market	Direct: • wider financial markets are related with higher equity crowdfunding market volume; and • higher financial literacy is associated with higher equity crowdfunding market volume.
Regulation	Direct: higher investors protection is related with higher equity crowdfunding market volume. Inverse: higher limitations imposed to the issuer are associated with lower equity crowdfunding market volume.
Entrepreneurship Level	Direct: higher entrepreneurship level is related with higher equity crowdfunding market volume.

Figure 2– Summary of the influence on equity crowdfunding market of banking sector, financial market, regulation and entrepreneurship level

Therefore, banking sector activity, financial market development and entrepreneurial level of each considered country may be considered as the ground on which equity crowdfunding may or may not develop. In fact, all these three elements are conditions that pre-existed the widespread use of this innovative financial instrument by companies. This also means that it would be more difficult for each country to intervene on those elements in order to help equity crowdfunding development. Differently, this is not the case for equity crowdfunding regulation. Indeed, new rules can be introduced and old rules can be adapted with the specific aim to address equity crowdfunding functioning. This also means that each country regulator may have the power to enhance equity crowdfunding development through regulation, while an intervention to modify other variables it would be too hard, or even impossible.

The third chapter conducts an analysis on who is the typical equity crowdfunding investor, how he takes investment decisions and which drivers favor or obstacle his will of financing an equity crowdfunding campaign.

From the analysis conducted, it is possible to signal a great similarity between characteristics of Italian investors, on the one hand, and the UK and the US ones on the other. This is true if data on institutional investors are not considered. Indeed, participation by institutional investors in 2016, it was bigger in the US (26%) and in Italy (9%) than in the UK (1%).

Therefore, similarities regard more retail investor characteristics. In all the mentioned countries the typical equity crowdfunding investor is a male, being woman participation still around 20%. In addition, funders of equity crowdfunding typically have high incomes and are well educated. This imply not only their capacity to understand risks related to equity crowdfunding investment, but also that in countries with high financial literary rate, an equity crowdfunding regulation could care less about investor protection.

However, the most important data on retail investors regards (i) investors' time dedicated to due diligence of an equity crowdfunding campaign and (ii) trust in due diligence carried by others (platforms or other investors). Indeed, reported researches suggest that the time spent in carrying out self-due diligence it is relatively few on average (two hours per week). What is more, these researches also show that investors rely more, not only in the due diligence conducted by the platform than in the one carried out by themselves, but, was it is worst, on due diligence carried out by other investors.

This research permits to draw some assumptions on how typical equity crowdfunding investors takes investment decisions. Indeed, from some research conducted on equity crowdfunding investors and from the current literature, it is possible to define two different decision making processes that investors could follow: (i) business model analysis; or (ii) herding behavior. The latter is strongly demonstrated in the current literature. (ARMOUR and ENRIQUES (2017)). This means that, being equity crowdfunding substantially a "social" phenomenon, based on crowd participation, an investor decision is strongly influenced by the decisions of other investors. As described in the current literature, this may be a peril for equity crowdfunding investors. Indeed, sometimes, this could make an investor participate in an equity crowdfunding campaign for the sole fact that other investors participated, without taking in consideration the real profitability of the issuer (and of the investment), generating fund misallocation.

After having considered the decision making process together with what makes a typical crowdfunding investor takes investment decision, in the last part of the third chapter some of the observable success drivers of an equity crowdfunding campaign identified by the current literature have been reported.

Indeed, according to the literature:

(i) funding target is positively associated with the number of investors participating in the campaign although it is not significantly related with the amount raised (LUKKARINEN (2016));

(ii) equity participation offered is inversely correlated with the number of potential investors (RALCHEVA (2016) and AHLERS (2012));

(iii) minimum investment is inversely correlated with the number of investors and with the amount of money raised (LUKKARINEN (2016));

(iv) presence of institutional investors increases the probability of success of an equity crowdfunding campaign;

(v) campaign duration is negatively associated with the number of investors, although not significantly related to the amount raised;

(vi) intellectual property protection increases the possibility of success of an equity crowdfunding campaign (RALCHEVA (2016));

(vii) disclosure of financial information is positively associated with the number of investors attracted (LUKKARINEN (2016));

(viii) presence of early investors is positively associated with the number of participants and with the amount raised;

(ix) social media networks, that is to say the possibility to post and share its campaign on social network, is strongly associated with a higher number of investors and of the amount raised by the issuer (LUKKARINEN (2016)); and

(x) team composition, i.e. education, past experience and age of the people composing the operating team of the issuer, is strongly taken in consideration by potential investors.

From the listed drivers, an accurate selection has been conducted in order to define which drivers could find application within Italian framework. Therefore some hypothesis on what attracts investors participation in Italy has been drawn. For the analysis, success of an equity crowdfunding campaign has been measured in terms of *funding ratio*, i.e. the percentage of the funding target reached by the promoter of the campaign. The considered variables and the related hypothesis are the following:

(h1) *equity offered*: in order to test the conclusions of RALCHEVA (2016) and AHLERS (2012), according to which an higher participation offered has a negative impact on the result of the collection;

(h2) *social interaction*: it is represented by how much a crowdfunding campaign has been shared through social networks, to test if it is true that a higher view of the presentation video has a positive impact on the success of the equity crowdfunding campaign;

(h3) *pre-money evaluation*: it is the value of the company showed in the equity crowdfunding campaign, in order to test if a higher value of the company has a positive impact on the success of the equity crowdfunding campaign;

(h4) *funding target*: in order to test if it is true that a higher funding target has a positive impact on the success of the equity crowdfunding campaign;

(h5) *self-disclosed financial information*: to verify if disclosing voluntarily precise financial data has a positive impact on the success of the equity crowdfunding campaign;

(h6) *remuneration and exit strategies*: representing how investors could monetize their investment (in general they are: (i) distribution of dividends; (ii) buy out from another company; and (iii) IPO), in order to verify if the promise of a remuneration or of an exit strategy has a positive impact on the success of the equity crowdfunding campaign; and

(h7) *total number of investors and their number after the first 5 and 10 days from the launching of the campaign*: in order to validate if herding behaviour mechanisms find application in the concrete case and so if a higher number of investors after the first five and ten days from the publishing of the campaign has a positive impact on the success of the equity crowdfunding campaign.

Other potential determinants have been excluded for the impossibility to be tested in our case study or for lack of data available until now. For example, although it would have been interesting, it is not possible to consider the effect of the minimum participation on the success of an equity crowdfunding campaign. The reason is simply that the 95% of all the campaign composing the data set had the same minimum amount of € 250. The same reason is valid for the participation of an institutional investors. The data, indeed, will be distorted because of the provision of the Italian regulation that forces institutional investors participation. Finally patents, grants, or team's education are not always displayed in equity crowdfunding platforms and, in particular, in the data set that we are going to consider for our case study there is little incidence of them. For instance, only one of the 27 analysed campaigns declared to have a patent for its product.

The afore mentioned hypothesis has been tested through a simple case study presented in the final chapter. The aim was to recognize which drivers are taken in consideration by an Italian equity crowdfunding investor. In order to do so, a specific data set has been composed with all the 27 crowdfunding campaigns conducted on the Italian equity crowdfunding platform CrowdfundMe from 2014 to 2017. The data set that has been used to demonstrate the mentioned hypothesis is based only on 22 campaigns of the 27 described above. Indeed, to study the correlation between funding ratio and, respectively, equity offered (h1), video view (h2) and pre-money valuation (h3) it was necessary to clean the data set from the presence of 5 outliers.

From the mentioned analysis was possible to draw the following conclusions: all the considered hypothesis, with the exception of the H4, are confirmed by the selected dataset.

More in particular, it is demonstrated that:

(H1) there is an inverse correlation between equity offered and funding ratio;

(H2) views of the presentation video are directly correlated to the success of the campaign;

(H3) there is a direct correlation between equity offered and funding ratio, although the correlation it is not strong;

(H5) disclosure of financial information is positively correlated with the success of the campaign;

(H6) the more are the information on possible exit strategies, the more are the probability that the campaign will be successfully completed; and

(H7) number of participant investors are strongly correlated with the success of the equity crowdfunding campaign.

With reference to H4, instead, it was not possible to demonstrate that the request of a high amount has a positive impact on the success of the campaign. Indeed, the data set suggests that there is an inverse correlation between these two variables.

The analysis conducted in this dissertation provides evidences of the fact that at current state of the art the so-mentioned *social drivers* may prevails on the *financial drivers,* as it has been demonstrated considering the correlation between funding ratio and financial drivers (see H1 and from H3 to H7), on the one hand, and social drivers (see H2 and H7) on the other, although financial drivers could be more numerous than the social one. Indeed, financial information are important for investors, although social ones have a stronger correlation with the success of the campaign.

However, predominance of social drivers on the financial ones, may cause some risks for investors. As it has been demonstrated, although social mechanism could be useful to identify fraud attempt or information incoherence, they could also bring misallocation of funds. Indeed, it has not been demonstrated that, in absence of fraud of incoherencies, social drivers could make investors choose always the more profitable project. Indeed, this will be impossible if detailed financial information are not available.

To solve this potential risk of misallocation of funds, the more efficient solution is to impose a minimum set of financial information that need to be disclosed and that will be validated before the launching of an equity campaign. In this way, not only investors may take more efficient decisions but also the *wisdom of the crowd* will help in enhancing information quality, notwithstanding the not so deep level of disclosure that could be imposed to the issuer to not increase disclosure cost. In this sense, the crowd system, that before has been considered as a source of peril, could now function as a *catalyst* to turn low level financial information in high quality one.