Crowdequity and Crowdlending: two alternative funding solutions for entrepreneurial ventures

The case of the French firm Gifts for Change

Imen MEJRI
Finance Department
NEOMA Business School
Reims, France
imen.mejri@neoma-bs.fr

Malek HAMOUDA
Finance Department
ISG Business & Management Programme
Paris, France
Malek1.hamouda@isg.fr

Donia TRABELSI
Finance Department
TELECOM Ecole de Management – IMT
Evry, France
Donia.Trabelsi@telecom-em.eu

Abstract: Financial return crowdfunding (crowdlending and equity crowdfunding) has thrived in recent years. It is proposed as an alternative solution to the problem of funding entrepreneurial ventures. This research studies the advantages and drawbacks of financial return crowdfunding, compared with traditional funding. It highlights the special features of crowdlending and equity crowdfunding. The study is based on the case of the firm Gifts for Change - Treez, which is distinctive in that it was funded by both types of financial return crowdfunding. Our analysis shows that financial return crowdfunding uses different mechanisms that are only appropriate for certain projects. Thus, the choice between crowdlending and equity crowdfunding does not arise at the same stage of the firm’s development. We also make several recommendations, based on our study, for entrepreneurs hoping to obtain funding via financial return crowdfunding.

Keywords: Financial return crowdfunding; Equity crowdfunding; Crowdlending; Advantages; Drawbacks.

I. INTRODUCTION

Very small, small and medium enterprises (VSEs and SMEs) find it very difficult to obtain funding through traditional channels. Traditional funding is less and less accessible, because of the current background of economic crisis and restrictive new regulations. To respond to entrepreneurs’ needs, new financing solutions have appeared on the market, including crowdfunding, which uses the power of the internet to ensure proximity between investors and entrepreneurs (Agrawal et al., 2015; Mollick, 2014).

Several types of crowdfunding exist. The most popular one is the donation: pure donation and reward-based (Mollick, 2014; Vulcan, 2016). However, in recent years financial return crowdfunding platforms have appeared. This type of funding includes the purchase of shares (equity crowdfunding) and crowdlending in the form of a loan. The development of these two components of crowdfunding has been rapid. According to the crowdfunding barometer of 21 February 2017, funds raised in France by lending platforms increased by 46% between 2015 and 2016. Over the same period, equity platforms saw an increase of 36%. The highest growth in crowdequity occurred in 2014 (+146%). Meanwhile, crowdlending witnessed its highest growth in 2015 (+122%). At the same time the limits and underlying risks of crowdfunding are increasingly being highlighted. For example, in France, the research department of the consumer association “UFC- Que Choisir” studied 337 firms financed by crowdfunding as well as the platforms they had used. The report, published on 23 February 2017, warns against risk in the sector and wrongdoing on the part of certain players. It condemns “the promise of excessive profits, the partial presentation and random selection of projects to fund, the lack of respect for legal obligations, and a huge number of unfair terms in the platforms’ general conditions of use.”

The development of crowdfunding in the financial landscape, and the growing interest of firms in financial return crowdfunding, despite its possible risks, raises the question of the pertinence of such alternative funding. Thus, this article highlights the two types of financial return crowdfunding: equity crowdfunding and crowdlending. More precisely, we answer the following two research questions: why should an entrepreneur raise funds through crowdfunding than via traditional funding ways? And what are the specific features of crowdlending and equity crowdfunding?

Our article presents an exploratory qualitative study of the firm Gifts for Change (Treez) which twice raised funds via financial return crowdfunding: the first time in the form of a loan via the platform Blue Bees and the second time in the...
form of equity crowdfunding via the platform Wiseed. Our analysis is based on semi-structured interviews with the founder of this firm, and with managers working for the two platforms. The case is an interesting one, because it enables a comparative analysis of crowdlending and crowdequity. To our knowledge, this is the first empirical study to compare these two forms of financial return crowdfunding.

The article is organized as follows: first we present the context in which financial return crowdfunding has developed. Next we detail the advantages and drawbacks of financial return crowdfunding compared with traditional financing. We highlight the special features of crowdlending and equity crowdfunding. Finally, we present our methodology and analysis before concluding.

II. FAVOURABLE CONTEXT FOR THE DEVELOPMENT OF FINANCIAL RETURN CROWDFUNDING IN FRANCE

Financial return crowdfunding appeared at the end of the 2000s. In France, it developed in a context featuring a combination of factors: structural factors linked to changes in the traditional funding sector (banks and venture capitalists) and factors linked specifically to the emergence of the crowdfunding sector itself.

First, there was a fall in the number of VSE and SME bank loans in France (Kremp & Piot, 2014). These firms naturally turn to banks when they need funding, considering them as their principle funding provider as they have limited access to financial markets (Bendriss et al., 2014). However, the two recent financial crises (the 2008 subprime crisis and the 2011 sovereign debt crisis), and the gradual implementation of new prudent regulations post-crisis (Basel III) changed all that. Today, although French companies do not appear to have suffered from a “credit crunch”\(^a\), we note a lack of dynamism in the credit market and a reduction in bank debt, particularly that part related to operating needs (Kremp & Piot, 2014). The authors explain this trend by a fall in the demand from companies. However, they note that “very small or early-stage SMEs find it genuinely difficult to obtain access to bank credit.”\(^b\)

Second, companies, particularly start-ups, are finding it increasingly difficult to obtain funding from venture capitalists, which specialize in financing early-stage unlisted firms. Private equity sector was greatly affected by the most recent economic and financial crisis (Mahieux, 2012). At this time, the sums invested by venture capital and seed capital funds in start-ups and innovative French firms fell after years of significant growth\(^c\). At present, despite the reform of the venture capital sector, its selectivity is increasingly severe and the number of business angels remains insufficient (Kettani & Villemure, 2012). Thus, at the early-stage, projects are finding it difficult to be financed by their traditional sources, because of the high risk involved together with information asymmetry.

\(^a\) According to the survey of European SMEs by the ECB and the European Union (2013) and the INSEE report, “Les entreprises en France” (Firms in France), (2014).

\(^b\) According to the statistics of the Association Française des Investisseurs en Capital (AFIC) (French Association of venture capitalists) in 2008.

Finally, a new type of investor has appeared on the market. Increasingly, investors want to take control of their savings and seek to participate directly in the real economy (Lesur, 2016). The development of the social or participative internet through the notion of the Web 2.0 or the collaborative web (O’Reilly, 2005) has made it possible for this new type of investor to interact with project holders looking for funding (Agrawal et al., 2015). The financial logic of crowdfunding, by which contributors seek to make a profit in the form of interest or capital gains, has gradually established itself alongside the voluntary logic, which refers to crowdfunding in the form of donations (Bertrand & Jakubowski, 2016).

In this context, a new regulatory framework was implemented, aiming to provide more security for contributors and more flexibility for platforms. In France, the authorities detailed the new rules governing crowdfunding\(^d\). Financial return crowdfunding platforms must be listed in the register for insurance, banking and finance intermediaries maintained by ORIAS\(^e\). We distinguish CIP (‘Conseillers en Investissement Participatif’ – Crowdfunding Intermediaries for crowdlending platforms). Platforms for donation crowdfunding do not have to register with ORIAS. They can however choose to register as an IFP. According to Fliche et al. (2016), the new regulatory framework protects investors but also reduces the constraints peculiar to each type of financial return crowdfunding. A label has even been created to identify platforms that respect these new rules.

III. STRENGTHS AND LIMITATIONS OF FINANCIAL RETURN CROWDFUNDING, COMPARED WITH TRADITIONAL FINANCING

Financial return crowdfunding shares some strengths and limitations with community crowdfunding (pure donation and reward-based crowdfunding). However, a number of advantages and drawbacks are unique to crowdlending and equity crowdfunding.

A. Strengths and limitations shared with donation-crowdfunding and reward-based crowdfunding

With regard to the context in which crowdfunding emerged and developed, it is positioned as an alternative way to fund small and very small firms (Fasshauer, 2016). The platform offers entrepreneurs the possibility of obtaining financial resources without having to use established financial sector players. Crowdfunding enables the direct funding of entrepreneurial projects using platforms that facilitate contact between supply and demand and guarantee direct interaction between investors and project holders (Giudici et al., 2012). This financing solution provides various advantages over traditional financing methods (Golić, 2013; Lambert &


\(^e\) This is a non-profit organization under the supervision of the Treasury Department, created in 2007 to approve insurance intermediaries in accordance with a European Union directive dating from 2002. Since 1st October 2014, ORIAS has been responsible for maintaining and updating the Register of Insurance, Banking and Finance Intermediaries.
Schwienbacher, 2010). For example, geographical distance is not an obstacle to financing (Agrawal et al., 2011; Belleflamme et al., 2013; Valanciune et al., 2013). In addition, these platforms mobilise investors who share the values of the entrepreneur and who belong to the same community (Fasshauer, 2016). These investors bear a lesser risk, since each person’s contribution, and therefore risk, is small. The fundraising process also enables the firm to develop its activity (Lambert & Schwienbacher, 2010). The investors are potential clients and project ambassadors (Mollick, 2014). This ambassadorial role is particularly important in the context of financial return crowdfunding, since the investors’ gains are conditioned by the success of the project. Further, obtain finance through crowdfunding gives the entrepreneur a reliable signal with regard to the product’s market potential (Gerber et al., 2013; Valanciune et al., 2013). It also provides competitive advantage and guarantees promotion of the firm and its project (Gajda & Walton, 2013). This results in lower design and marketing costs, and optimises the new product development process (Lambert & Schwienbacher, 2010). Gerber et al. (2012) and Belleflamme et al., (2013) agree that the main reasons for which entrepreneurs use crowdfunding are fundraising, commercial and marketing considerations, and the development of contacts and networks.

However, despite all these advantages, crowdfunding can have its limits. The literature on the drawbacks of crowdfunding is not very well developed, due to the sector’s recent emergence and a corresponding lack of hindsight. The first arguments in this line are the lack of assessment by specialists and the possibility of manipulating donors with marketing discourse and unsubstantiated promises (Blanchard & Sabuncu, 2016). Belanovà (2015) lists a number of drawbacks of crowdfunding. First, crowdfunding generally follows an “All or Nothing” model; if the required sum is not reached the funds collected are returned to the contributors. In addition, the entrepreneurs suffer from a great deal of pressure, particularly with regard to delays in launching the activity. Finally, a failed campaign can block the firm’s future activity development.

B. Specific features of crowdlending and equity crowdfunding

Each of the two components of financial return crowdfunding, crowdlending and equity crowdfunding has its own specific features.

Crowdlending has a number of advantages over bank credit. First, raising funds via platforms gives the entrepreneur access to credit without having to present guarantees (Yum et al. 2012). Second, the operational costs are reduced, and consequently lenders can obtain a more attractive return on their investment (Yum et al. 2012). Finally, internet and social media facilitate communication and information exchanges between borrower and lenders (Maier, 2016), which makes the fundraising process faster than that for traditional bank credit (Lesur, 2015).

However, as Cai et al. (2016), note, one of the main problems of crowdlending is information asymmetry. According to Herzenstein et al. (2011) and Yum et al. (2012), this problem can partly be reduced if the borrower discloses personal and financial information, as this reassures financers and develops trust. Thus, the success of a fundraising campaign via crowdlending depends to a great extent on the information given. Larrimore et al. (2011) specify that the use of extended narratives, concrete descriptions of the project and quantitative terms have more potential for information and persuasion, and increase the likelihood of the campaign being a success. Several authors state that when the platform provides extensive, good quality information about projects, this encourages borrower trust and increases funding (Greiner & Wang, 2010; Herzenstein et al., 2011; Gonzalez & Loureiro, 2014). In addition, to reduce information asymmetry, some lending platforms give each project a credit rating. Emekter et al. (2015) show that the failure rate of fundraising campaigns is negatively related to the firm financial rating, and positively related to their duration. However, despite the fact that the platform assesses each firm’s default risk, project selection ultimately depends on the crowd, and this is one of the main risks with crowdlending.

The process is no longer the responsibility of financial institutions, which increases borrower risk, and consequently lender risk also (Yum et al., 2012).

Meanwhile equity crowdfunding enables the crowd to buy shares in a firm via an online platform in the same way as a venture capital fund. It enables projects to raise more funds than other forms of crowdfunding (Fasshauer, 2016), and the amounts raised are steadily growing (Vulkan et al., 2016). Contributors to equity crowdfunding have the clear aim of obtaining a monetary gain for their investment. This form of crowdfunding implies the existence of a pre-money valuation of each project (Vulkan et al., 2016), to highlight the enterprise’s intrinsic potential.

Equity crowdfunding reduces the principal drawback of venture capital, its high selectivity level. Thus it represents an additional source of seed capital, and is used for the earliest phases of the enterprise funding cycle (Bessière and Stéphany, 2014). It can even be considered as a threat for both venture capital and Business Angels (Vulkan et al., 2016). The latter certainly provide direct financial support for entrepreneurial projects, but there is no structure linking entrepreneurs and investors (Giudici et al., 2012). In addition, the number of investors and the “crowd” effect on equity crowdfunding platforms satisfies the due diligence process that is usual with private equity (Vulkan et al., 2016). The platform strengthens the assessment process by providing financial expertise to fix the offer price (Bessière and Stéphany, 2014). Girard and Deffains-Crapsky (2016) state that crowd equity platforms can consolidate their selection process by using a high price entry ticket and syndicating with experienced investors (business angels and venture capitalists).

However, investors and platforms do not fully accomplish the role played by venture capitalists and business angels (Bessière and Stéphany, 2015). Managing shareholders after fundraising is difficult, because of the large number of investors, their small share in the capital, and the limited support provided by the platform when the campaign closes (Andrieu & Groh, 2013; Fasshauer, 2016). It is true that some
equity crowdfunding platforms adopt a governance method that uses a holding group, which helps to organise interactions between entrepreneur and shareholders during the post-investment phase (Bessière and Stéphany, 2015; Girard and Deffains-Crapsky, 2016). However, often the holding group only has an administrative role (Bessière and Stéphany, 2015; Girard and Deffains-Crapsky, 2016).

Finally, the legal framework for both forms of financial return crowdfunding would benefit from adjustment, particularly to harmonise practices across Europe. Fliche et al. (2016) point out that the current frame does not cover all the new forms of crowdfunding that are emerging. For example, the regulations are not well adapted to equity crowdfunding platforms specializing in real estate, because of the financial instruments used and the legal status of certain real estate firms. In general, the use of cash vouchers or bonds makes it possible to circumvent the constraints on loans proposed by crowdlending platforms. This results in greater risk for investors.

IV. RESEARCH METHODOLOGY AND PRESENTATION OF THE FIRM “GIFTS FOR CHANGE–TREEZ”

Our empirical study takes a qualitative exploratory approach based on a single case study. It aims to be both explanatory and descriptive (according to the definitions of Yin, 1993 and 2014) and instrumental (according to the definition of Stake, 1995). Its aim is not to produce generalizable findings but to highlight particular phenomena (Yin, 2014).

The study examines the company “Gifts for Change – Treez”. “Gifts for Change–Treez” defines itself as a revolutionary firm in the promotional gifts sector. It specializes in designing and distributing promotional objects and fashion accessories. It was launched in 2014 in Paris and, under the brand Treez, sells in particular trendy bracelets that contribute to reforestation. It is an eco-friendly, commercial firm: for every bracelet sold, a tree is planted as part of a reforestation project somewhere in the world. The firm operates in a market worth more than 1.4 billion euros. It differentiates itself from other players in this highly competitive sector (250 manufacturers/importers of promotional objects, including 4% positioned as “Green”) in various ways: French manufacture, support for reforestation, eco-design and eco-innovation. Its founder, Alexis Krycève (A.K.) is particularly committed to social and environmental issues and has significant entrepreneurial training and experience. Figure 1 illustrates the main features of the firm “Gifts for Change – Treez”, as gauged by Wiseed contributors.

The aim of our empirical study was to understand why the firm “Gifts for Change – Treez” used financial return crowdfunding rather than traditional funding, and why it used first crowdlending and then equity crowdfunding. We will highlight the comparative advantages and drawbacks of each type of financial return crowdfunding. “Gifts for Change–Treez” conducted two fundraising campaigns: the first, in 2015 was in the form of lending from the platform Blue Bees; the second, in 2016, was in the form of equity, on the platform Wiseed. Thus, this case is extremely suitable for a comparative analysis of these two types of financing, particularly since it remains very rare for a single firm to use consecutively these two types of financial return crowdfunding.

Moreover, the Gifts for Change fundraising campaigns were a success, its founder using the right strategy at the right time. He considered that purely donation-based crowdfunding was not appropriate for his firm (commercial/for profit) and that when the firm began operating, the range was not wide enough (5 variations of a single bracelet) to justify a campaign in the form of reward-based crowdfunding.

Tables I and II present respectively the funding history of “Gift for Change – Treez”, since its launch, and the characteristics of the two financial return crowdfunding campaigns.

---

**Figure 1 Principal features of the firm “Gifts for Change – Treez”; Source www.wiseed.com**

The aim of our empirical study was to understand why the firm “Gifts for Change – Treez” used financial return crowdfunding rather than traditional funding, and why it used first crowdlending and then equity crowdfunding. We will highlight the comparative advantages and drawbacks of each type of financial return crowdfunding. “Gifts for Change–Treez” conducted two fundraising campaigns: the first, in 2015 was in the form of lending from the platform Blue Bees; the second, in 2016, was in the form of equity, on the platform Wiseed. Thus, this case is extremely suitable for a comparative analysis of these two types of financing, particularly since it remains very rare for a single firm to use consecutively these two types of financial return crowdfunding.

Moreover, the Gifts for Change fundraising campaigns were a success, its founder using the right strategy at the right time. He considered that purely donation-based crowdfunding was not appropriate for his firm (commercial/for profit) and that when the firm began operating, the range was not wide enough (5 variations of a single bracelet) to justify a campaign in the form of reward-based crowdfunding.

Tables I and II present respectively the funding history of “Gift for Change – Treez”, since its launch, and the characteristics of the two financial return crowdfunding campaigns.

---

8 Information provided by the founder of Gifts for Change (A.K.) and available on the website pages of the two fundraising campaigns the firm conducted on Wiseed and Blue Bees.

<table>
<thead>
<tr>
<th>Date</th>
<th>Type of funding</th>
<th>Sums contributed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>Love Money</td>
<td>€25,000</td>
</tr>
<tr>
<td>2014</td>
<td>Personal Funds</td>
<td>€5,000</td>
</tr>
<tr>
<td>2015</td>
<td>Equity crowdfunding</td>
<td>€33,420</td>
</tr>
<tr>
<td>2016</td>
<td>Business Angel</td>
<td>€100,000</td>
</tr>
<tr>
<td>2016</td>
<td>Unsecured Loan</td>
<td>€30,000</td>
</tr>
</tbody>
</table>

TABLE II FEATURES OF THE TWO FINANCIAL RETURN CROWDFUNDING CAMPAIGNS CONDUCTED BY “GIFTS FOR CHANGE – TREEZ”

<table>
<thead>
<tr>
<th>Crowdlending</th>
<th>Equity crowdfunding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>2015</td>
</tr>
<tr>
<td>Amount</td>
<td>€33,420</td>
</tr>
<tr>
<td>Platform</td>
<td>Blue Bees</td>
</tr>
<tr>
<td>Duration of the campaign</td>
<td>70 days</td>
</tr>
<tr>
<td>No. of investors</td>
<td>198</td>
</tr>
<tr>
<td>Investor return</td>
<td>2% Fixed rate</td>
</tr>
<tr>
<td>Payment to platform</td>
<td>5% of sum borrowed (inclusive of tax)</td>
</tr>
<tr>
<td>Investment horizon</td>
<td>Repayment over 3 years in six-monthly instalments: (4 repayments made at 30/03/2017)</td>
</tr>
</tbody>
</table>

We used multiple data sources: primary data collected during semi-structured interviews with the founder of the firm, Alexis Kryève, and with managers from the two platforms Blue Bees and Wiseed (respectively Emmanuelle Paillat and Elodie Manthé). The interviews lasted between 50 and 100 minutes and were transcribed in full (67 pages in all). We collected secondary data from the websites of the platforms.

V. REASONS WHY THE ENTREPRENEUR SOUGHT FUNDING VIA FINANCIAL RETURN CROWDFUNDING

Our analysis reveals that the use of financial return crowdfunding can have different reasons. These reasons are linked to the overall advantages of crowdfunded and to the specific attributes of crowdlending and equity crowdfunding.

First, the primary objective is naturally to raise funds. The firm is at a stage where, to ensure its launch it is essential “to obtain cash right from the start” (A.K.). At this early-stage, access to traditional financiers proves difficult, given the risk and lack of visibility associated with the start-up. In addition to the possibility that banks and venture capital specialists might refuse, the project holder may consider him/herself ineligible. Project holders can exclude themselves (self-censorship), given the nature of the funding needs and the early stage of the project. They may consider that bank loans are more appropriate for material investments (machines, premises, equipment, etc.) rather than for commercial development, working capital or communication, although these are essential expenses for many projects: “The banks can’t finance… It’s very hard or almost impossible for banks” (A.K.). In addition, entrepreneurs may consider that their project is ineligible because of the selectiveness of venture capitalists at this early stage “We were too small; it was too soon; we discarded venture capital at the time... our project would never have been accepted...” (A.K.). Objective criteria exist that make certain firms ineligible for venture capital or a bank loan, but...
any project is eligible for crowdfunding. “An investment fund will have much stricter rules than ours” (Wised); “…we are much more flexible with regard to certain criteria…” (Blue Bees). Crowdfunding is indeed based on subjective criteria. Crowdfunding requires an ability to “get the community on board” by “telling them a story” (A.K.), or else the existence of an extended personal network. This is very different from the requirements of traditional financing, based on the investment’s profitability and risk. The advantage of crowdfunding is that it is accessible without an obligation to “show that you’re irreproachable with regard to solvency” (Blue Bees). Crowdlending requires no personal guarantees or securities. “Unlike banks, we don’t ask entrepreneurs for guarantees, a mortgage or security…if they have them, we accept” (Blue Bees).

In addition to being a source of financing, crowdfunding is a good communication tool, particularly if the project has a relatively strong public dimension. A crowdfunding campaign provides an opportunity for crowd promotion, even though it is not its primary objective. The advantage of this financing method is thus the visibility it gives potential clients. “Thus, they can also benefit from the visibility of the platform”; “The business of visibility, which is relatively important after all…” (Wised).

Furthermore, crowdfunding makes it possible to reach a large number of people and appeal to the community dimension. “Two communities will meet. People who are already on the platform and who belong to the Wiseed community, and people who the entrepreneur brings himself to the project’s web page, and so the two of them will meet… So there is a very strong community dimension” (Wised). Crowdfunding also includes an element of commitment. “People who fund these projects do so because they are committed” (Blue Bees). It appeals to a form of generosity in contributors, who feel that they are helping “the project to be hatched” (A.K.), and an idea to come to fulfillment. This commitment dimension is linked to the entrepreneurial aspect, since investors are associated with the entrepreneurial adventure. “The investors want to take part in the experience indirectly” (Wised). Thus, projects that benefit from crowdfunding have an emotional or innovatory dimension and a high degree of ethical commitment.

Finally, financial return crowdfunding is flexible and fast to set up in a way that traditional finance is not. Start-ups operate in an extremely competitive environment that requires them to react fast. Consequently, entrepreneurs who are looking for fast solutions sometimes go directly to a financial return crowdfunding platform, since the application is easier to complete and the answer arrives sooner. Alexis Krycève praises the ease of completing a loan application on Blue Bees. Thus, busy entrepreneurs do not waste too much time away from their daily activity. The crowdlending platform (here Blue Bees) releases funds more quickly than a bank, where the loan awarding process is more hierarchical: “They release funds much more quickly. In one month you can get €50,000 on Blue Bees”; “at a bank, there are different ranks, it’s hierarchical, they need authorizations and more authorizations.” (Blue Bees). On Wiseed, funding a start-up takes 75 days on average. The Gifts for Change -Treez campaign lasted three months. Wised considers that the overall duration of the process is shorter than for venture capital, and that the platform’s staffs try to shorten the selection stage as much as possible by assisting and advising the project holders: “In terms of time, we are very competitive with regard to capital venture funds, for example” (Wised).

In addition, crowdfunding presents no particular risk for the entrepreneur. Nonetheless, entrepreneurs tend to be apprehensive about their ability to collect the sum required: “…there wasn’t much risk for me…”; “the biggest worry for me was that I might not be able to collect the whole sum” (A.K.). Here, the platforms play an important role managing and advising entrepreneurs. They can be flexible and “work it” so that campaigns succeed, either by reducing the target or by extending the duration of the campaign.

VI. THE CHOICE OF TYPE OF CROWDFUNDING: CROWDLENDING VS. CROWDEQUITY

Pure donation-crowdfunding is not suitable for entrepreneurial projects. It works better for charities, non-profit projects and artistic or cultural ventures. Although the system of reward-based crowdfunding makes it possible to fully use the community and creative aspects of crowdfunding to pre-finance new products, it requires the firm to have or be able to develop specific reward with a broad range of products. Thus, financial return crowdfunding is a good alternative financing method, but the entrepreneur still has to determine which form of financial return crowdfunding is best suited to his/her project.

The choice between crowdlending and equity crowdfunding is not necessarily made at the same stage of the firm’s development or maturity. The choice depends on both the amount to be raised and the type of needs to be financed.

When the financing need is high, but concerns intangible assets (e.g. research and development, communication, or human resources) equity crowdfunding appears more appropriate “We don’t often finance working capital… The aim is more to finance expenses that will create value for the legal entity that the start-up represents; so we finance commercial development, R&D, recruitment…” (Wised). Crowdlending, on the other hand, is a better solution when the sums required are not so high, or if the firm’s activity requires investment for working capital, for example. In the first case, crowdlending appeals to the community of contributors to collect sums necessary for son-off needs. In the second case, crowdlending is a solution for firms that find it difficult to obtain finance from traditional banks because of the type of need they want to fund or their poor creditworthiness: “We more often fund working capital, because banks are reticent to do so” (Blue Bees). If the project is already solvent, or it the entrepreneur can produce the necessary collateral, using a bank loan may prove simpler. Appealing to contributors to borrow high sums requires major efforts to increase visibility, and may wear out the community if it happens too often. In this context, the financial return becomes the main motivation for crowdfunding. Meanwhile, larger sums can be raised through equity crowdfunding (for example Gifts for Change - Treez collected €250,000 and the average sum raised for start-ups on Wiseed is €315,600). Thus, crowdequity may be envisaged for
an important fundraising campaign, alongside other finance players. Co-investment is common in crowdequity, but not in crowdlending “Sometimes project holders are looking for such high sums that a single actor would not be enough.” (Wiseed).

For these reasons, equity crowdfunding is usually the last step of crowdfunding. Anyway, crowdequity and crowdlending seem to provide an opportunity to gain more legitimacy with traditional finance players.

According to Alexis Krycèvè, equity crowdfunding is a kind of hybrid funding, between venture capital and funding by the crowd. It involves combining the relatively modest investment capacities of a large number of people in a format that resembles venture capital. Equity crowdfunding enables the firm to obtain the significant investment its development requires together with a group of shareholders that have the same values. However, equity crowdfunding requires a more sustained effort on the part of the entrepreneur. The process requires more time and energy. It is preferable to have both marketing and financial skills. The entrepreneur must convince both the crowd, who are responsible for the financing decision, and the platform’s specialists, who are responsible for due diligence and set the price.

The investment horizon is different for each type of financial return crowdfunding. Crowdlending platforms have a funding cushion thanks to partial repayments of current loans that they can use to finance new projects. Equity crowdfunding platforms do not benefit from this situation (Wiseed, for example, has so far only one positive investment exit). Consequently, project holders have to appeal to new investors and work very hard at their communication. “For the loan there is no need to communicate very much now... Every goes smoothly, as there is a good cash flow…” (Blue Bees).

Table IV summarizes the main differences between crowdlending and equity crowdfunding.

### TABLE IV PRINCIPAL DIFFERENCES BETWEEN CROWDLENDING AND EQUITY CROWDFUNDING

<table>
<thead>
<tr>
<th>Principal needs funded</th>
<th>Crowdlending</th>
<th>Equity crowdfunding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sums raised</td>
<td>Low to medium</td>
<td>Average or high</td>
</tr>
<tr>
<td>Principal needs funded</td>
<td>Working capital; commercial development; recruitment</td>
<td>R&amp;D ; Développement commercial ; développement à l’international</td>
</tr>
<tr>
<td>Stage of development</td>
<td>Seed capital (before crowdequity)</td>
<td>Seed capital (more developed stage)</td>
</tr>
<tr>
<td>Average duration of investment</td>
<td>3 years (maximum 7 years)</td>
<td>Between 5 and 7 years at least</td>
</tr>
<tr>
<td>Management intervention</td>
<td>Passive</td>
<td>Passive</td>
</tr>
<tr>
<td>Process /effort</td>
<td>Simple process/moderate effort</td>
<td>proactive process/considerable effort (communication, due diligence)</td>
</tr>
<tr>
<td>Risk of capital dilution</td>
<td>No</td>
<td>Yes (moderate)</td>
</tr>
<tr>
<td>Risk of loss of control or flexibility</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

VII. RECOMMENDATIONS FOR SUCCESSFUL CROWDFUNDING OPERATIONS

In absolute terms, crowdfunding is not the best source of financing. “Some schemes available on some platforms are suitable for some projects at some stages of company development.” Alexis Krycèvè speaks of the importance of being able to carry a community along with you. Projects with a strong “general public” or “mainstream” dimension are more appropriate for crowdfunding. In addition, the notion of ethics is also compatible with this type of fundraising, because the crowd often prefers to contribute to the development of projects with social and environmental merits. Our interviews reveal that the community aspect, the sense of shared values and principles, aligns with crowdfunding, even when it is financial return. Crowdfunding enables contributors and firms to work for change through social and environmental action. It is therefore important to choose a specialist platform with a committed community if your project has a strong social or ethical dimension. The objectives of some specialist platforms go beyond traditional investment criteria. For example, the Blue Bees community is extremely committed. For them, crowdfunding is a tool, but their aim is to change agriculture. It is thus very important, when you appeal to a committed community, to demonstrate the social value of the project and to insist on its serious aims. Entrepreneurs can appeal to ethical platforms if their project is in the public interest and aims to raise awareness, even if it has no sustainable business model. On this type of platform, the success factors are closely linked to the emotion the project arouses and how the entrepreneur communicates and presents his project. The contributors are not necessarily looking for profits, even if they are investing in financial return platforms. If the aim of the project is not to create social or environmental value, more speculative crowdlending platforms exist, but the cost of debt can prove higher in this case, since the criteria of risk –return will be preeminent.

Equity crowdfunding requires even more proactivity on the part of the project holder. He/she has to analyse the characteristics and conditions of different platforms so as to choose the best one for the fundraising campaign. The processes used to support and monitor the firm during the different phases of fundraising (pre- and post-investment) are important parameters to take into consideration, along with the professionalism and reputation of the crowdfunding platform. The business model of these platforms is mainly based on commission or management fees paid on the funds collected. Blue Bees takes 8% inclusive of tax on the donation, and 5% on the loan; Wiseed invoices 5 to 9% of the sum raised. Thus, apart from sharing the social, environmental and ethical values of the projects, the platforms have interest to support the entrepreneur because they are only repaid if the campaign is successful.

Once the entrepreneur has chosen the platform, he/she has to go through a selection. The rate of rejection by crowdlending and crowdequity platforms must not be underestimated. Of course, they are less selective than traditional players in the financing system: “A venture capitalist will have much stricter investment rules than ours” (Wiseed), but they are selective nonetheless. For example, the rate of selection by Wiseed...
stands at 3% for start-ups: “We have almost the same selection rates as venture capital funds, so we don’t select them just because they come and see us.” (Wiseed). The director of Blue Bees states that: “We don’t fund everybody; we don’t take excessive risks”. There is less selection with regard to minimum fundraising targets and certain other assessment criteria. The project holder’s commitment and motivation can be considered as a parameter that mitigates the risk of the project. However, these new financial intermediaries also use traditional methods such as financial analysis and credit risk rating. The most eligible start-ups are those that have already launched their activity (with clients and turnover) and that hope to develop more rapidly. Equity crowdfunding can be appropriate in the seed capital phase, but firms in certain sectors, such as biotech, are more suitable for this. In addition, a first source of finance such as love money or self-financing improves a firm’s chances of being chosen by the platforms. Although the process is a rapid one, the entrepreneur can find the pre-investment phase lengthy, because the number of selection stages and because of the campaign duration, since the time required for fundraising must not be forgotten: “...fundraising takes time...while a venture capitalist might take a long time to say yes, once it has said yes the funds are released within a fortnight; here it’s the opposite, we have to raise funds from the crowd since we don’t have any in reserve” (Wiseed).

Negotiating the fundraising conditions is another crucial step. It is important to: 1- set the sum to be raised at a reasonable, justifiable level, 2- ensure the firm’s valuation, since this determines among other things the percentage of control and the percentage of capital dilution, and 3- pay close attention to the clauses in the shareholders’ agreement or loan contract.

Finally, the project holder must be aware that crowdfunding also has its drawbacks, and that he/she must pay particular attention to trying to minimise their effects. Blue Bees mentions their anxiety at the possibility of disappointing a large number of investors. A successful crowdfunding campaign is a sign of encouragement, of support and of trust for the entrepreneur. This gives the latter even more responsibility and places him under psychological pressure. The platform managers we interviewed suggested that it is much easier to disappoint a banker or a venture capitalist than a large number of contributors who have put their trust in the entrepreneur. Furthermore, launching a crowdfunding campaign requires a great deal of involvement on the part of the project holder. The time necessary for fundraising is of course reduced, but it requires a high degree of constant effort. Alexis Krycève considers that: “It is quite time-consuming, and has to be considered as a project in its own right during the year of development”. Thus, a first crowdfunding campaign requires a high level of personal commitment.

VIII. CONCLUSION

This article goes beyond the established advantages of crowdfunding, to contribute to research on the features of financial return crowdfunding by comparing its two forms: equity crowdfunding and crowdlending.

The case study shows that financial return crowdfunding is a more flexible funding resource than traditional financing, and that it is an appropriate financing solution in certain conditions. In addition, it seems to provide an opportunity to gain more legitimacy with traditional finance players.

In absolute terms, crowdfunding is not the best financing solution. “Some schemes available on some platforms are suitable for some projects at some stages of company development.” First, it is a financing solution that aligns with both the social, ethical or innovative dimension of the projects or start-ups it finances, and with the rapid-growth competitive environment in which they operate. With financial return crowdfunding, the project holder frees himself from the self-rejection with regard to the eligibility of his project for financing by established players in the finance sector. Thus, the entrepreneur acquires the legitimacy to finance his project via the crowd without having to rely on donations or develop a particular reward. Nonetheless, financial return crowdfunding is not a miracle solution for funding VSEs and SMEs. The platforms remain selective, even if some of their criteria are subjective and thus more flexible.

In addition, our study shows that the choice between crowdlending and equity crowdfunding depends to some extent on the firm’s stage of development. It also depends on the amount to be raised and on the type of need to be financed. Each type of financial return crowdfunding requires a different degree of effort and commitment on the part of the project holder.

Finally, with regard to research into crowdfunding, our study contributes to discussion of the suitability of this type of financing, by warning entrepreneurs of its limits, and by providing some advices to maximize the chances of organizing a successful campaign.

The limits of this research are mainly related to the inherent limits in the methodology used and to the rapid evolution of the crowdfunding sector. Thus, to complete our recommendations and to generalize our results, we are engaged in a constant process of data collection, and interviews with specialists in the field (managers of different platforms), and are always looking for new testimonies and entrepreneurial experiences.

intérêts et limites consultatif de déontologie et d'éthique de l'IRD sur le crowdfunding :


