

CROWDFUNDING: A NEW FUNDING METHOD FOR TURKISH FINANCIAL MARKET

TÜRK FİNANSAL SİSTEMİNDE YENİ BİR FONLAMA YÖNTEMİ: KİTLESEL FONLAMA

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Abstract

The aim of this study is to investigate the crowdfunding as a new rapidly expanding method of raising a fund at financial markets. The extraordinary improvements in the internet technologies and the increasing use of social media led to this fast expanding in crowdfunding. In this method, entrepreneurs use the web as a platform for securing fund from investors. Crowdfunding platforms are intermediary organizations which bring the fund demanders and suppliers together in the virtual environment. According to some point of view, crowdfunding represents a revolution in finance because of the ways it will transform the financial sector. Some others agree that it is only a new financial balloon. Due to the lack of financing the most business ideas which will be very successful in the future fail at the start-up level in Turkey. Therefore crowdfunding seems to emerge as a good way of overcoming these financial challenges.

Keywords: Crowdfunding, Financial Market, Investor, Entrepreneurship, Venture Capital

Jel Codes: G19, G20, G30

Özet

Bu çalışmanın amacı finansal piyasalarda yeni bir finansman yöntemi olarak hızla yayılmakta olan kitlesel fonlamaya ilişkin araştırma yapmaktır. İnternet teknolojisindeki olağanüstü gelişmeler ve sosyal medyanın artan kullanımı kitlesel fonlamanın bir finansman aracı olarak hızla yayılmasına neden olmuştur. Bu finansman yönteminde girişimciler interneti yatırımcılardan fon temin etmek için bir platform olarak kullanırlar. Kitlesel fonlama platformları fon talep edenlerle fon arz edenleri sanal ortamda bir araya getiren araçlardır. Bazı görüşlere göre kitlesel fonlama yöntemi finansal piyasalarda yol açacağı dönüşüm nedeniyle bir devrim niteliği taşımaktadır. Diğer bazı görüşlere göre ise kitlesel fonlama yöntemi sadece bir finansal balondur. Türkiye’de gelecekte başarılı olabilecek pek çok girişim finansman yetersizliği dolayısıyla daha başlangıç aşamasında başarısızlıkla sonuçlanmaktadır. Bu nedenle kitlesel fonlama sistemi Türkiye’de, girişimcilerin finansman zorluklarının üstesinden gelmek için iyi bir alternatif yaratacak gibi görünüyor.

Anahtar Kelimeler: Kitlesel Fonlama, Finansal Piyasa, Yatırımcı, Girişimcilik, Girişim Sermayesi

Jel Kodları: G19, G20, G30

1. Introduction

Due to their flexible production structure and their contribution to opening new working areas the seed, start-up and emerging companies are important for all economies in the world (Akdeniz, 2005: 1-15). Raising fund is always a challenge for these companies. The funding

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problem of these companies gives rise to the emergence of several new financing methods. One of these methods is crowdfunding. In this method, entrepreneurs use the web as a platform for securing fund from investors (Isler, 2014:50-51).

The needs of funding of the newly established enterprises can be provided via two sources; formal sources or informal sources. The formal sources are; banks, capital markets, credit agencies, government, venture capital firms. On the other hand, the informal sources are like personal savings, family, friends and business angels (Karabayır et al., 2012:70.). While the concept of an individual or groups of people lending money to fund businesses outside of formal financial institutions is not a new phenomenon, the Internet has simply broken down the geographical barriers and virtually brought both sides (fund demanders and suppliers) closer (Baumgardner et al., 2015:4). The Internet brought access and awareness to the “crowd” and defined Crowdfunding as a new type of lending that was different than the lending provided by the traditional financial institutions. The owner of the projects and the entrepreneurs use the online crowdfunding platforms for securing fund in this financing method.

The foundation of crowdfunding is based on microfinance. The intent of the microfinance is to provide funds to the needer of the low-income countries. The platform of Kiva is a good practice of microfinance. In 2005, Kiva was launched as the first platform to allow entrepreneurs to lend money to developing areas across the world. Kiva is now one of the most successful crowdfunding platforms, having risen over \$165 million and with an outstanding 98.83% repayment rate (Castrataro, 2011). By the early 2000s, the Internet revolution gives rise to new models of microfinance, now most commonly known as crowdfunding (Baumgardner et al., 2015:4). Crowdfunding has been around for a long time. Jonathan Swift’s Irish Loan Fund (1700) and Dr. Yunus’s Grameen Bank (1974), are accepted as the pioneers of the Crowdfunding. Afterward Michael Sullivan created the Fundovlog in 2006, a failed attempt for videoblog-related projects and events including a simple funding functionality, but the term crowdfunding only really began to be used by the masses a few years later with the advent of the platform Kickstarter in 2009 (www.socialmediaweek/12.12.2011).

Crowdfunding is an evolutionary response to the age of the internet. It is in a very nascent stage now but it will become ordinary as like online trading in the very near future. It will continue to evolve in terms of how it works or how it can be used. It is also a really important means for mobilizing resources (Assenova et al, 2016:125-127). Crowdfunding is also one vehicle for shared value creation, an accelerated one. It helps to enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates (Baumgardner et al., 2015:2). At the end of 2017, The Capital Board of Turkey has regulated the Crowdfunding for the first time and has provided rules for the safety of the third sides of the applications; fund demanders, suppliers, and the platforms. Thus Turkey has officially accepted the crowdfunding as a new means of financing in the financial markets.

The rest of the paper is organized as follows. **Section 2** gives information about the crowdfunding platforms. The overall characteristics of the system are given in this section. The types of crowdfunding are given in detail in **Section 3**. **Section 4** compares the crowdfunding as a method of raising fund with venture capital. The existences of the problematic issues in crowdfunding are highlighted in **Section 5**. Discussions of the prospective implementation of the crowdfunding are given in **Section 6**. Finally the conclusion comprises a summary of crowdfunding method.

2. Crowdfunding Platform

The intermediary organizations which bring the fund demanders and suppliers together in the virtual environment are called crowdfunding platforms. Crowdfunding platforms enable access to investors anywhere within the world (Hammar, 2015:3). Generally, suppliers have a special interest in the project that they invest in. Crowdfunding platforms charge a commission in exchange for their intermediary services. The payment is possible only on the platform. Platforms don't give any guarantee about the collection of the target amount or about the success of the project. But most platforms don't charge any commission in the event of failure and they pay the raising amount back to the suppliers (Isler, 2014:55-56).

In the Crowdfunding Industry Report (2015), Massolution provides an in-depth analysis of the active 1,250 Crowdfunding platforms on a global scale. According to this report they can be characterized as; general-purpose platforms, specialized platforms, and activity specific platforms.

General-purpose platforms support very different kinds of campaigns that range from individual's weddings to creative projects, to technology start-ups to fund the development of a new, innovative product. Indiegogo, Kickstarter, Gofundme, are the samples of general-purpose platforms.

Specialized platforms aim to promote specific industries such as video games, music recording, or independent television. ArtistShare, an example of a specialized crowdfunding platform, where musicians could seek donations from their fans to produce digital recordings and has evolved into a fundraising platform for film/video and photography projects as well as music.

Activity-specific platforms focus on particular types of projects (e.g., hardware development, technology, or creative projects) in several industries. Examples are DonorsChoose, which features public school teachers who post projects online and funders choose a project and contribute any amount, and Sciflies, which is a micro-donation funding site supporting scientific research projects across medical, technological, environmental, engineering, and other fields (Baumgardner et al., 2015:4-5).

Table 1: Sample of crowdfunding platforms²



The number of active crowdfunding platforms is increasing day by day. Once, crowdfunding is used by fans to finance small-scale music projects. Today it is mentioned as a billion dollar

² Crowdfunding Industry Report, May 2012, www.crowdsourcing.org/02.07.2018

industry with over 1200 active platforms. The majority of them are in North America and Western Europe (Massolution, 2015).

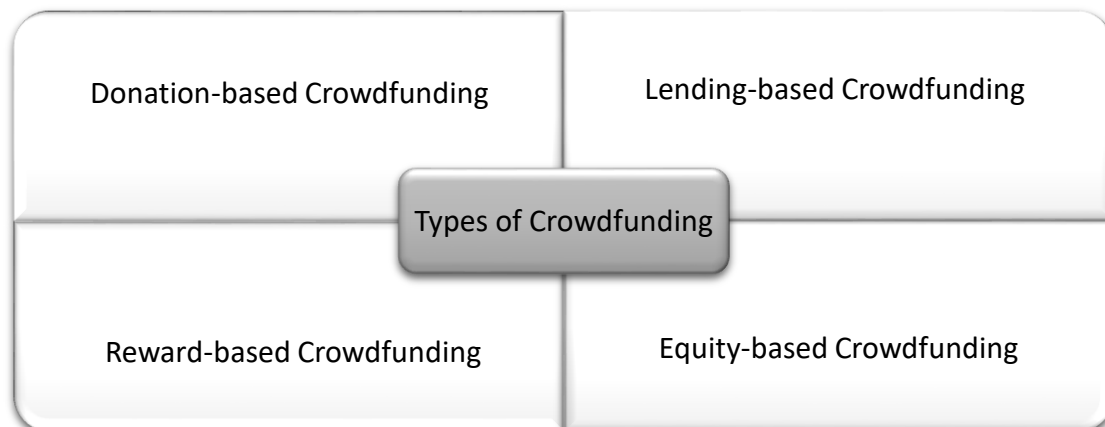
In addition to the platforms, crowdfunding industry organizations that watch over the interests of the platforms by engaging in policy work and standardization have emerged. The European Crowdfunding Network in Europe or the National Crowdfunding Association in the US is the two examples of the organizations (Hammar, 2015:1).

3. Types of Crowdfunding:

Massolution(2012) defines four categories of crowdfunding;

1. Donation-based, in which funders donate to causes that they want to support with no expected compensation;
2. Reward-based, in which funders' objective for funding is to gain a nonfinancial reward such as a token gift or a product, such as a first edition release;
3. Lending-based (Peer to Peer), in which funders receive fixed periodic income and expect repayment of the original principal investment;
4. Equity-based, in which funders receive compensation in the form of a fundraiser's equity-based revenue or profit-share arrangements (Baumgardner et al., 2015:4.)

Table 2: Types of crowdfunding



Equity-based and lending-based crowdfunding raises the largest sum of money per campaign. On the equity crowdfunding, you are investing equity in someone's business, and you are not sure if and when, or how, you are going to get your money out. Will there be a dividend or return of capital? (Assenova et al, 2016:131). Debt crowdfunding is very different than equity crowdfunding. In debt crowdfunding, it's like a fix income instrument; investor lending his money hoping to get back and a yield or return. One of the first lending-based sites is Prosper; was launched in the US in 2006. In 2007, LendingClub launched the second lending-based site.

In a reward and donations crowdfunding the participant of the projects lends her money hoping to get such kinds of returns; rewards, a free of charge commodities or services, the letters of thanks and announcement of her/his contribution to the public (Isler, 2014:54). JustGiving was founded as a charity fundraising site in 2000.

The samples of crowdfunding system outputs (Isler, 2014:51):

- Funding the concert of singers, their album by their fan. The (British rock group Marillion, to finance their US tour using the “Tour Fund.” SellaBand emulated this model, to record an album.)
- Nano Light(the world’s most productive bulb)
- E-paper watch (It reserves applications that are on a computer or smartphone)
- Three-dimensional printers
- Well-known films,
- Computer games or their smartphone applications
- The Academy of cycling,
- Campaign for increasing awareness about cancer

By some estimates, \$34 billion worth of funding across equity, debt and rewards/donation crowdfunding in 2015 (Massolution, 2015).

Table 3: Global crowdfunding industry estimated fundraising volume in 2015³

Lending-based (Peer to Peer)	\$ 25 Billion	%73,5
Reward-based	\$ 2.68 Billion	%7,8
Donation-based	\$ 2.85 Billion	%8,3
Equity-based	\$ 2.5 Billion	%7,3
Other	\$ 1.2 Billion	%3,5
Total	\$ 34 Billion	%100

Total transaction value in the crowdfunding segment amounts to US\$9,370m in 2018. The Crowdfunding segment is expected to show a transaction value growth of 36.7% in 2019.

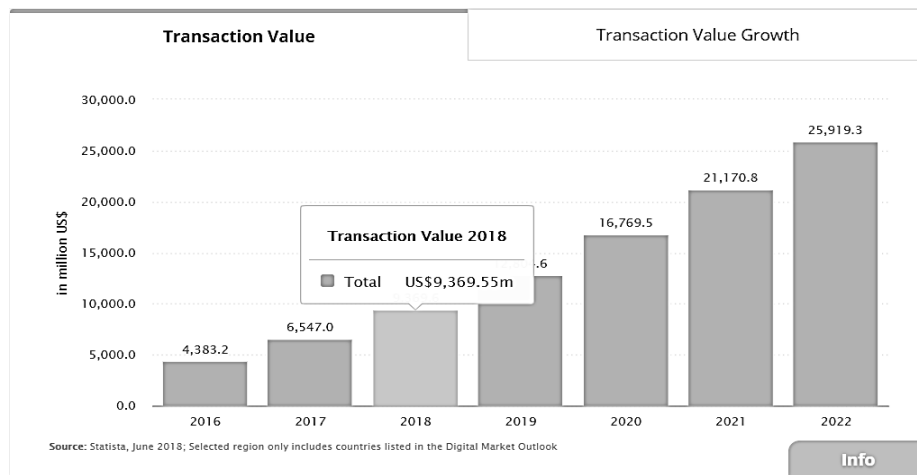


Figure 1: Total transaction value in the crowdfunding segment⁴

The number of funding campaigns is 8,799.5 thousand in 2018. In the Crowdfunding segment, the number of funding campaigns is expected to amount to 17,287.0 thousand by 2022.

³<http://crowdexpert.com/crowdfunding-industry-statistics/03.08.2018>

⁴<https://www.statista.com/outlook/335/100/crowdfunding/worldwide#market-revenue/28.08.2018>

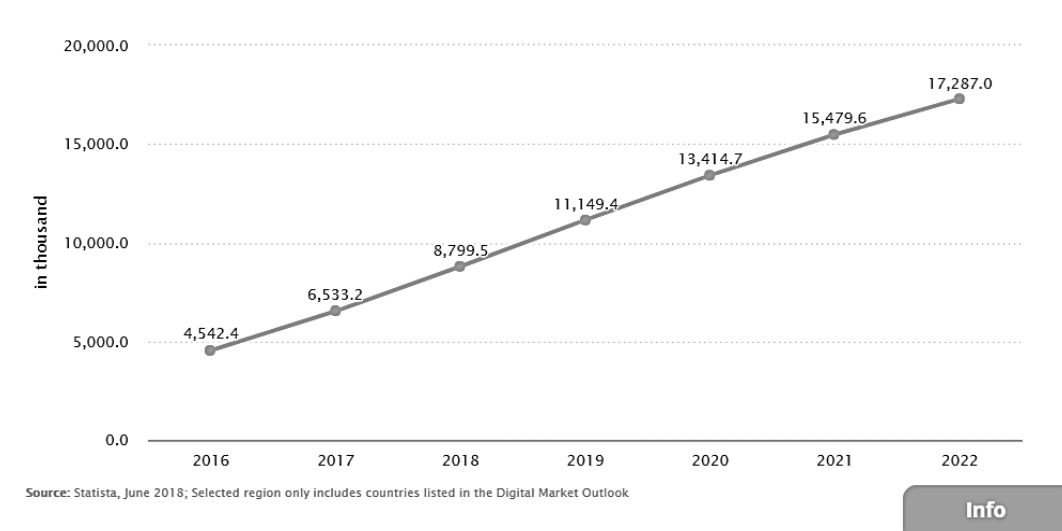


Figure 2: The number of funding campaigns¹

The average funding per campaign in the Crowdfunding segment amounts to US\$1,065 in 2018. With a total transaction value of US\$7,477m in 2018, the highest value worldwide is reached in China.

Table 4: Total transaction value according to countries⁵

Top Countries	
China	US\$7,477m
United States	US\$1,041m
United Kingdom	US\$156m
Japan	US\$94m
France	US\$93m

4. Crowdfunding Versus Traditional Funding Methods

Entrepreneurial finance is rapidly evolving. Whether in mature or developing economies, entrepreneurs are combining traditional debt and equity start-up finance (e.g., friends, family, angel investors, venture capitalists, and occasionally banks) with microfinance, crowdfunding and other financial innovations (Bruton et al, 2015:9). With bank loans you have to be sure to pay back the loan, or face bankruptcy and assets being seized to pay off your debts; with investment angels, you may lose some control of your business and; with family and friends, there is the stress of using their money in a business that can potentially fail. Crowdfunding almost seems risk-free when compared to these options (Moore and Sande, 2014:1-21).

As crowdfunding obtains recognition and understanding, it will be a longer-term threat to traditional methods, because it disintermediates the agents and lowers the costs. Crowdfunding

⁵ <https://www.statista.com/outlook/335/100/crowdfunding/worldwide#market-revenue/28.08.2018>

helps companies to reach a certain size which is desired by other traditional institution for fund-raising.

There are several superiorities of using crowdfunding to traditional funding methods;

- i. Crowdfunding platform enables entrepreneurs to reach a deep pool of capital from all sides of the world and investors can have the chance to discover countless investment opportunities on the platforms. In this regard, the amount of benefit that borrowers and investors are receiving is unprecedented in financial history.
- ii. Crowdfunding is faster (by the means of the web) and requires fewer sanctions than traditional methods.
- iii. In addition, the cost of crowdfunding is lower for both parties (entrepreneurs and investors) of the transaction. Because by investing in a crowdfunding platform you can disintermediate the venture firm and cutting fee (Assenova et al, 2016:125-127).
- iv. Crowdfunding is a financial solution for the entrepreneurs who have the funding challenge via traditional methods because of the constraints like age, work experience, lack of personal assets, lack of fixed income and it is also a solution for people who can get the credit but can't afford to pay back (Isler, 2014:52).

5. Problems with Crowdfunding:

There are problematic issues in crowdfunding. Knowing these problems helps to create successful crowdfunding campaigns and protect from negative effects. There are numerous platforms to help management of the campaigns thus choosing the right platform is essential. Trust is probably the biggest issue when it comes to crowdfunding.

A belief about the crowdfunding is there will be fraudulent crowdfunding and an attempt of fraud can blow up the whole space, as a result, the participants in the market are very much trying to mitigate that risk. Wharton Business School looked at the amount of Fraud that existed on the Kickstarter platform and found less than one-tenth of one percent of all campaigns were fraudulent- so a tiny fraction. The reason for that is crowdfunding platforms have high incentive to find the best quality deals and the more people that look at something, the better the due diligence (Assenove et al., 2016:128).

People need to use portfolio theory as they approach crowdfunding investments. They should put in small amounts; invest in people that they trust and invest in things that they understand. The credibility of the crowdfunding platforms and the owner of the project is essential for the trouble-free operations. The accreditation of both the platforms and the owner of the project by official authorities increase the reliability of the system. Because there is always a risk of fraud and not to fulfill the commitments by the owners of the project and the platforms.

Besides crowdfunding platforms are very open platforms that can cause reputational risks and it is really hard to get rid of it. If you managed your campaign wrongfully you can have a marred reputation online.

6. Crowdfunding in Turkey

The awareness of the crowdfunding is growing in emerging countries as also in Turkey. The vast majority of Turkish firms (nearly%85-90) are SMEs. They really have problems to provide funds from banks and other financial institutions. For taking root in the market crowdfunding is a good way of overcoming this problem and a good alternative to traditional financing methods of our culture like family, friend, personal savings and local banks. Crowdfunding will ensure the unlocking of the capital in Turkey that is currently frozen and put it to work in support of Turkey's

businesses, particularly SMEs. For emerging economies crowdfunding will have a very key role to reach the level of developed economies.

For a stable crowdfunding system, the reliability of the platforms and the transparency of their operation should be ensured by legal institutions. Crowdfunding has just been regulated by The Capital Markets Board of Turkey (CMBT) at the end of the 2017 but there is still a very few practices. The examples of the crowdfunding platforms in Turkey are Crowdfon.com, Biayda.com, Fonlabeni.com, Fongogo.com etc. (Isler, 2014:52).

The act with the number of 7061 went in effect in 28.11.2017 regulates crowdfunding in Turkey for the first time. The act makes amendment in Capital Market Law with the number of 6362 and determines the Capital Board of Turkey as an authorized institution for all arrangements of the crowdfunding system. Permission from The Capital Markets Board of Turkey becomes compulsory for the establishment and the operation of the platforms. Moreover, the maximum limit of the raising fund by the owner of the project or the entrepreneur and the maximum amount of the investment by an investor is going to be determined by the board. The board has given the right to monitor and audit the procedures and principles of the operations by the platforms. One of the tasks of the board is to secure the proper use of the raising funds. In addition, the act regulates the precautions against the illegal applications of the platforms. The operations of the crowdfunding platforms that raised money without the permission of the board will be cut off by The Information and Communication Technologies Authority of Turkey (www.resmigazete.gov.tr, 2017).

After the legal arrangement of this financing method was prepared by the authorized authority of The Capital Markets Board of Turkey, the interest and demand for this method of financing are going to expand rapidly. The official entity provides the sides of this financing method a sense of security. The authority should encourage the establishment of crowdfunding association and behaves as an intermediary entity for matching the investors and entrepreneurs demand in Turkey.

Conclusion

Crowdfunding is a new innovative method of financing for businesses or other organizations to raise money in the form of either donation or investments from retail investor via the internet. Crowdfunding emerged as a result of the increasing use of the internet. It is a way of going to the public in the virtual environment. It ensures to reach a big community for funding and provides the circulation of money from one side of the word to another easily. It differentiates from other methods by providing funds from retail investors. Crowdfunding has four different models; 1.Equity-based, 2.Lending-based, 3.Donation-based and 4.Reward based crowdfunding. On the equity crowdfunding, you are investing equity in someone's business, and investors will have a dividend or return of capital. In debt crowdfunding, it's like a fix income instrument; investor lending his money hoping to get back and a yield or return. In a reward and donations crowdfunding the participant of the projects lends her money hoping to get such kinds of returns; rewards, a free of charge commodities or services, the letters of thanks and announcement of her/his contribution to the public.

Crowdfunding has some superiority to traditional funding methods; it enables entrepreneurs to reach a deep pool of capital from all sides of the world and investors to discover countless investment opportunities on the platforms, Crowdfunding is faster and requires fewer sanctions than traditional methods, also the cost of crowdfunding is lower for both parties (entrepreneurs and investors) of the transaction. The credibility of the crowdfunding platforms and the owner of the project are essential for the trouble-free operations. The accreditation of the platforms

and the owner of the project by official authorities are important. The recognition of crowdfunding is increasing in Turkey as in the other developing countries. The crowdfunding has been regulated very recently in Turkey. The Capital Markets Board of Turkey is authorized for the regulation of the crowdfunding operations and the platforms in 28.11.2017. Permission from The Capital Markets Board of Turkey becomes compulsory for the establishment and the operation of the platforms. The board has given the right to monitor and audit the procedures and principles of the operations by the platforms.

In the near future, the impact of crowdfunding will continue to rise. Due to the lack of financing the most business ideas which will be very successful in the future fail at the start-up level in Turkey. Crowdfunding will ensure the unlocking of the capital in Turkey and put it to work in support of Turkey's businesses, particularly SMEs. Therefore crowdfunding seems to emerge as a good way of overcoming the financial challenges of the entrepreneurs and the SMEs.

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