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Common types of Crowdfunding Models, Related Concepts and Its Impact on Business: A Brief Literature Review

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The sole author designed, analysed, interpreted and prepared the manuscript.

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ABSTRACT

Crowdfunding is one of the tactics of raising finance by asking a large number of people each for a small amount of money to support innovative business ideas like new projects via the internet through various models. However, how individuals demonstrate readiness or solicitation on strategic networks in a virtual environment is much less clear and there is no comprehensive overview of literature review on different crowdfunding models. The present review puts an attempt to address these gaps and explored the impacts and the foremost crowdfunding concepts like funder, project creator and platform. This is an independent article based on a bibliographic search conducted using electronic databases such as EBSCO, DOAJ, RESEARCH LIFE, EMBASE, and Google Scholar. The result disclosed that the most universally applicable models of crowdfunding websites are; the equity-based model, donation/social based, lending model, and reward-based model. Interestingly, the review revealed that the lending and rewards models are leading in terms of funds raised across the globe and mostly adopted by investors. It also indicated the rapid growth of crowdfunding is helping small and medium businesses to create job opportunities for young people despite an increasingly challenging environment and its negative impacts on business. Finally, the review recommends researching crowd-funding and the impact of social media in the changing modern technologies and the legality of crowd-funding platforms in various nations.

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1. INTRODUCTION

In the modern era of technology, undoubtedly, different crowdfunding models play a pivotal role to promote entrepreneurial activities and economic development programs all over the globe. Such a platform has become so indispensable for an entrepreneur, particularly in the European countries to create a new investment scheme. It acts as an interactive forum for bringing all enthusiastic investors together to fulfil their common goals. In addition, the online investment habits of people have increased phenomenally as modern technology grows at a greater speed.

The emergence of crowdfunding was dated back to 1997 when the first internet connection was introduced in the US market. In the same year, the first crowdfunding campaign had started in British when Fans of the British rock group known as "Marillion" raised a fund through a fan-based internet campaign without the involvement of any bands [1]. More popularly, in 2006 Michael Sullivan first popularized the word crowdfunding in fundavlog.6 in the United States of America. Thereafter, many business entrepreneurs in America grasped this opportunity to improve the profitability of business via the internet. While in 2008, this approach has further gained more popularity during the presidential election of the US. The politicians have used this platform to raise the funds from the supporters and to garner votes from the people across the nation. Similarly, most crowdfunding websites like Equity Net, Pledgegie, Sellaband, IndieGoGo, GiveForward, FundRazr and so forth appeared before 2009. However, these platforms have been managed successfully to earn many funds from supporters across the world. Subsequently, from 2009 onwards, most crowdfunding websites appeared in the market for promoting their products, ideas, creativities and innovation in the market until today. These shreds of evidence demonstrate that most crowdfunding is successful and effective in European countries. From there on, the crowd-funding concept grew and spread widely across the world among the businessman, NGOs, companies and private individuals [2]. For instance, Kickstarter and Indiegogo are the two largest sustainability crowdfunding platforms in the world. As of October 12, 2019, 458,733 projects had been started on Kickstarter and more than 650,000 projects had been started on Indiegogo [3]. This further proves the growing trend of crowdfunding in modern markets.

Dushnitsky et al. [4] also stated that the creation of crowdfunding platforms varies from country to country and there are different national patterns for crowdfunding activities in general. They also claimed that country-level factors influence platform creation in European countries, with interesting variations in four crowdfunding models: donation, reward, loans, and equity. Liang, Hu & Jiang [2] stated that the advent of a Kickstarter website in the US had further commercialized this concept of fundraising through the internet as the starter's website could raise around $750 million annually.

In addition, [5] indicated that crowdfunding attracts the attention of technological starts in the recent year. It has become a good alternative to easily raise capital, especially in the early stages of a startup. Similarly, OECD [6] demonstrated that online alternative financing has grown and expanded significantly to investment, non-investment and credit models based on what was promised to investors in response to their contributions. Of the total global volume of alternative online financing, 96.4% accounts for lending, 3% is for investment while 0.6% for non-investment activities.

The present review emphasizes the operation of different crowdfunding models and key parties involved in promoting the various crowdfunding activities based on the findings of the past research papers and the information gathered from the different electronics databases and websites. Besides, the various findings on crowdfunding models in the market have been also discussed to focus on the significance of its operation in this digital age.

2. CROWDFUNDING CONCEPTS

Worner [7] gave an explicit definition that "crowdfunding is an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organizations, to fund a project, a business or personal loan, and other needs through an online web-based platform" Moreover, he also categorized crowdfunding into four main areas as Donation Crowdfunding, Reward crowdfunding, Peer-Peer crowdfunding and Equity crowdfunding. He coined that it is purely a form of market-based finance and refers to it as "Financial return crowdfunding" or FR crowdfunding". Equally, [2] also expressed that it has four categories, namely trust-based crowdfunding, credit-based crowdfunding, rewards-based crowdfunding, and share-based crowdfunding.

Hassion (2017) stated that crowdfunding is a new phenomenon that is of great interest to both academics and practitioners, mainly due to its attractiveness as an alternative source of funding. However, in reality, as crowdfunding has grown exponentially, so are the challenges and opportunities it offers. In addition, crowdfunding in itself is a real financing alternative, which can promote social and economic development. It is mainly for start-ups, small businesses, cooperatives, associations and any other economic institution that is difficult to raise funds in the early stages of risky and complex projects in the eyes of banks [8].

Through crowdfunding, the development of modern internet facilities has created the interest of the investors because it increases the involvement of many crowd funders. It breaks the barriers of geographic dispersion of the investors and saves time and cost in making investments.

3. REWARD-BASED MODEL

The rewards-based model uses a flexible financing model as a project can keep the money even if they have not reached a target amount. However, some projects also focus on sustainable economic growth mostly related to environmental protection and climate change [9]. The project owner used this business model to seek donations for a specific project and can give (often small) non-financial rewards in return. The rewards are of a symbolic value and are provided by the investee. The reward value is smaller than the donation amount because the owner needs to ensure adequate money left for the project [10].

According to Liang, Hu, & Jiang [2] the reward-based model is also popular in the market. Sponsors can get rewards through their investment. The reward can be a product, a piece of art or any other bonus they offer to depend on the size of the investment. There are two reward-based crowdfunding mechanisms: "all or nothing" or "retain all". The first means that creators can only receive money when the goal is reached; for the latter, the creator can keep all the money raised, whether or not the goal is reached.

4. SOCIAL/DONATION-BASED MODEL

Wojciechowski [11] concluded that the social underpinning phenomenon deserves closer consideration because its success depends strongly on the ability to build a distinctive or persistent group of people who share their beliefs and are willing to support external institutions or individuals. Mostly, this sort of model is used by NGOs to attract donations for specific projects online and raise funds from the funders for the good cause. A project creator updates every piece of information about the project and maintains accountability and transparency to the donors. A donor tends to be more loyal in the long term when the NGOs will keep them updated about the progress of the project to ensure future donations. For the social cause, it motivates the donors. It is intrinsic motivation, which is usually a good base for a long-term donor relationship.

It serves as a two-way platform that connects donors for good causes with three types of beneficiaries: charities, corporations, and private individuals. A charity can create a personalized web page with information about the organization and the good causes it is working on, as well as buttons that allow visitors to donate to the charity or organize a fundraising campaign on its behalf. Additionally, charities can set up fundraising campaigns for specific purposes [9].

4.1 Peer-to-Peer Lending (P2P)

Financial Conduct Authority [12] reported that P2P lending is the new financing model for loans and it is not real crowdfunding, however, it possesses the characteristics of crowdfunding lending, but the difference is that the lenders and borrowers do not know each other. In this platform, the funder expects higher returns and the interest rate is calculated based on the risk factors available in the financial data and personal securities. Normally, this model is used by borrowers who are looking for a loan with a lower interest rate than financial institutions. Unlike banks, there is no money creation within the platforms because only the money provided by the funders is being lent out and the risk is limited in this lending. Huang, Li & Meng [13] reported that after exploring more than 178,000 loan listings in China's online P2P lending business, borrowers with a better track record were able to get loans with higher probability and at a lower cost. Owing to that, lenders take the borrower's reputation as a key signal in their lending decisions. In addition, they concluded that in P2P lending, there is an effective reputational mechanism that can discipline the behaviour of the borrower.

In the United States, the P2P lending acts as an arranger, distributor and approval authority for debt obligations - that is, a type of debt instrument that is not backed by real assets or collateral and is instead only backed by the overall creditworthiness and issuer reputation issued by projects that are hosted on the platform. In addition, P2P lending hosts a digital market for debenture related projects that have been successfully funded on a platform and users can exchange their investments with each other [9].

4.2 Equity-Based Model

Equity crowdfunding allows SMEs to raise capital from investors through an internet platform operated by a third-party intermediary. One of the main advantages of this process is that it provides access to equity capital for companies that have difficulty raising funds from the public or borrowing funds from the traditional financial sector. However, this process raises several challenges, including the risk of financial loss for vulnerable retail investors [14].

Yasar [15] stated that equity crowdfunding has become a new landscape for financing ideas and innovation. While many countries have come a long way and have developed publicly-traded crowdfunding platforms, many countries are progressing slower. Despite the risk controversy, equity crowdfunding appears to be a promising avenue for financing entrepreneurs, democratizing investment supply and demand, and contributing to economic growth. He also coined that equity crowdfunding in different geographic regions, donor motivation, donor-entrepreneur matching, the effects of regulations, and the development of potential success factors for campaigns are very important to the development of the field [2].

Reichenbach and Walther [16] claimed that post-offering success is measured as the probability of survival in equity-based crowdfunding. This finding was as per the updates from a well-established German Equity-Based - Crowdfunding platform called Companisto in which the data were collected from 88 campaigns with over 64,000 investments and 742 updates.

Although the size of equity crowdfunding is very small compared to debt-based models, it is increasingly receiving the attention of regulators and policymakers. When properly regulated, the equity crowdfunding market can become an important source of finance for small and medium-sized enterprises (SMEs) [15]. On contrary, there are concerns about potential fraud, unrealistic investor expectations, inexperienced entrepreneurs, and the opportunity cost of losing professional advice from angels or venture capitalists [17].

To attract people for investment in a company, the sources of funds are an essential part of a company. In this model, it offers securities in a business to a group of people for investment instead of going by business angels and other private investors which are called Equity Crowdfunding or crowd investing. This type of equity crowdfunding is subjected to securities and financial regulation. It has been growing widely around the world as an important financing instrument for startups by attracting a new group of investors to company financing. By providing early-stage capital that is vital to supporting innovation and funding valuable ideas that could not otherwise be funded, equity crowdfunding is likely to contribute to job creation and economic growth.

5. IMPACTS OF CROWDFUNDING

Internet-based crowdfunding is a relatively new phenomenon, more campaigns and studies on crowdfunding are necessary because such a platform offers valuable information about the future success of the financed ventures [16]. Crowdfunding becomes a new as well as an alternative source of funding for an entrepreneur. It reduces the cost of capital and creates convenient points for investors despite emerging issues. It may help large companies to review market demand and makes it easier for companies to improve their products. Meanwhile, crowdfunding can help small and micro businesses raise funds and bring products to market. Therefore, crowdfunding has become an indispensable tool for solving problems for societies.

Maehle et al. [9] emphasized the importance of the crowdfunding models in the European countries by stressing more on sustainability-oriented crowdfunding platforms. They coined the essential roles of crowdfunding in moving towards a sustainable society and better access to adequate funding for the new ventures. William [18] expressed the importance of crowdfunding in this digital age amid many new technologies and advances in almost every field. The development of an increasingly complex digital world has also given rise to new service models in the financial sector. A new financial services model that takes advantage of technological maturity, commonly known as fintech, mobile banking, online banking and online transactions are some examples of innovation and use of technology in the financial sector which make it easier for users to meet their financial service needs. Digitization can also be used for project financing. For instance, in Asia alone, alternative financing mechanisms such as fintech, are emerging to provide financing or infrastructure. Such platforms, including crowdfunding, may help go beyond the limitations of traditional banks and provide retail investors with lower entry costs.

Financial Conduct Authority [12] reported that the most benefits the investors enjoy is equal access to capital with the help of crowdfunding and reduces friction in the process of investment as well as able to enhance better communication between entrepreneurs and the crowd(investors). In addition, it promises accountability, transparency, market information and efficiency too. Another reason mentioned by Julie, crowdfunding platforms act as an appealing vehicle between individual and institutional investors, and other public sectors that focus on small and medium-sized enterprises. Too much information can increase the complexity of understanding crowdfunding projects, which cause aversion of backers and reduce the rate of crowdfunding success [2].

Zhang and Liu [19] mentioned the success stories of how ArtistShare in the US managed a website to raise the fund for the artist's albums between 2000-2001. Another researcher Worner [7] mentioned six advantages for going crowd-funding platform. The first benefit is, it helps the real economy and SMEs grow through new and increasing flows of credit, the second benefit is, such platform fills a gap left by financial institutions, third is the lower cost of capital, fourth is, such platform provides a new product for portfolio diversification, five is cost-efficient and six is a convenient way of raising fund. Moreover, Kristof De [20] also supplemented that crowdfunding can offer unique support for budding and existing entrepreneurs on multiple levels. No other investment form, be it debt or equity, can provide the benefits of pre-sales, market research, word–of–mouth promotion, and crowd wisdom without additional cost. However, there are some issues such as violating intellectual property rights, the complication of operating the platform, lack of participants, website security and so forth till this model becomes a popular mode of marketing for companies and individuals. Similarly, Liang, Hu, & Jiang [2] urged that crowdfunding risk includes illegal fundraising, credit risk, platform operational risk, technical risk, and so on.

Sauermann, Franzoni, and Shafi [21] concluded that crowdfunding for scientific research expands access to resources for groups excluded or disadvantaged in traditional financing systems, similar to what has been demonstrated in active crowdfunding operations. However, the number of resources currently raised, whether at the level of a single project or the level of the entire platform, is not enough to replace traditional financing mechanisms. Crowdfunding seems to be particularly useful for students and postdocs who do not have the track record required by most traditional funding agencies and may be suitable for smaller projects and early research where there is no preliminary evidence. In these areas, even relatively small grants can keep the project going, and can also have long-term effects by allowing researchers to increase their chances of obtaining follow-up funding under the traditional system. Moreover, they also mentioned that to raise a lot of money, event creators must go beyond family and friends to attract a wider audience. However, to reach a wide audience requires tremendous effort, such as developing videos, writing convincing notes, or responding to sponsor comments and suggestions. Some creators may realize that the relatively small amount of money that can be raised does not offset these time and energy costs.

According to Jason Best (2015), in the US and UK, most of the consumers find it rewarding to be involved in a crowdfunding business and they feel that it is the best alternative way to support a local initiative or other individuals. He stated in his article, "*Entrepreneurship without Boundaries*" that the crowdfunding platforms like reward and lending offer the investors a higher rate of returns than those available financial products. Another researcher [22] also supported stated that crowdfunding creates the organization or support individuals to access finance that banks or other lenders are not prepared to offer or only offer at a high cost. Owing to which such arrangement is the best alternatives source of finance that benefit the wider economy or a local economy.

Bockel, Horishch, and Tenner (2020) also coined that donation-based crowdfunding has received the highest level of attention as compared to other models. In their findings, only 8% of the global market is crowdfunding based on donations, 16% is based on reward-based crowdfunding and 76% of market share is based on loan-based crowdfunding. On the other hand, Mollick [23] indicated the finding based on the success and failure of crowdfunding projects, there are many failures and few successes. The average financing amount for failed projects is 10.3% of the target. The failed projects received an average of US$900 in pledges, while the pledges for successful projects were US$7,825. Moreover, he coined that successful projects tend to have relatively small profits and only about 1 out of 9 projects achieved 200% of the target.

In addition, Kristof De [20], coined that P2P lending helps smooth consumption and income fluctuations, and can provide SMEs funds for business expansion, production, and other activities. He, thus, concludes that this is a compelling alternative to traditional lending products because of which most people nowadays opt to lend directly from them. Since reward-based is also common in these countries as he points out that most of the business entrepreneurs use creative business or smaller consumer products very frequently as the basic pre-financing for production is linked to an initial demand-test. In the US, reward-based crowdfunding has been used for a wide range of purposes, including civic projects, motion picture promotion, free software development scientific research and invention development. The most common model for crowd-funding has been rewards-based platforms like Kickstarter or Indiegogo. Through these platforms, many supporters of a film project received an autographed DVD in exchange for their $100 contributions. Another example is the lending model like Funding Circle in UK based allows investors to lend money at specified interest rates and terms.

The very reasons for increased capital in the lending and reward-based crowd-funding could be due to the increasing number of more innovative entrepreneurs in the US and UK. These entrepreneurs, with the help of modern technologies, create numerous astonishing business ideas and display them online to attract various investors.

The success or failure of crowdfunding will be determined by the personal network (number of Facebook friends of the founders), the fundamental quality of the project (videos, typos, daily updates) and geography. The results showed that the founder's number of friends, videos, and updates on Facebook are all positively related to fundraising success, while typos reduced the chances of fundraising success [2]. Moreover, individual investors have a positive attitude towards investing through the crowdfunding model when they find that the information provided by a group of scientific experts is useful. We found that the perceived usefulness of information from scientists and engineers is influenced by the perceived quality of the information and the perceived reliability of scientists and engineers [5]. However, Bockel, Horish and Tenner (2020) reported that the failure rate of financing ranges from 69% for Kickstarter while to 87% for Indiegogo. This is also an indication that not all crowdfunding platforms are performing well. [24] argued that although crowdfunding helps remove demand uncertainty and avoid over-investment, it also has negative impacts on social performance, causing under-investment and inefficiently high product prices.

6. CONCLUSION

The review concludes that the operation of crowdfunding may be made possible with the support of a website, which serves as a platform between the project initiators and the crowd-funders investing money in projects. From the review, it is discovered that most of the best crowdfunding sites in the world originate from the US and UK due to the tremendous development of modern technology and economic activities over the last few decades. Entrepreneurs in the US and UK have been using crowdfunding platforms to raise funds for their innovative projects, services and products as an alternative funding source since 2001. Likewise, crowdfunding is more appropriate than a direct investment when new products are very expensive (high fixed or variable costs) and consumer pricing dispersion is low [25]. For example, it raised over $ 1 million, according to crowdfunding platform Kickstarter, with 37% of gaming campaigns succeeding and tech campaigns accounting for 30% of successful campaigns [10]. Another instance is that on 24 July 2013, Indiegogo supported Canonical Ltd to launch a crowdfunding campaign and could raise $32 million which is considered as the highest target set for any crowdfunding campaign [26].

According to Liang Hu & Jiang [2] coined that in the early stages of funding, investors often follow the trend of investing in projects, and the herd effect is very strong. However, when funding is halfway through, the investor's liability increases and the passing effect becomes significant. In addition, maintaining continuous communication plays an important role in the success of crowdfunding. Frequently updating the project description is the best way to communicate with the sponsors so that the developers can show the new development of the projects. This can increase the confidence of funders and create opportunities to attract potential investors. Comments convey supporter's ratings, opinions, or attitudes, and additional comments indicate popularity and good word of mouth of the project. In addition, sponsors often choose to invest in the projects with the most comments. Therefore, having more comments is beneficial for the success of crowdfunding [2].

Moreover, amongst all crowdfunding models, it was found that the lending and rewards models are leading in terms of funds raised in 2020 across the globe. The rapid growth of crowdfunding is helping small and medium businesses thrive especially in the UK and creating huge job opportunities for young people. In addition, there are many advantages such as filling the gap left by financial institutions, low capital costs bringing new products to diversify investment portfolios, efficient and convenient ways to raise capital for entrepreneurs and investors. Although crowdfunding models suffer from some flaws such as violating copyright, server crime and hackers, these help most participants achieve their dreams. According to [22], entrepreneurs assess opportunities through psychological and environmental factors such as one’s risk aversion and employment status and they used the crowdfunding platform to finance their creative ideas. Besides, it was urged that due diligence is required while selecting the websites because it has to fit with the project, product and services which has developed.

In the present review, not much is discovered about crowdfunding other than the different types of models, concepts and the impacts on business. There are numerous aspects of crowdfunding that need to be explored. It is difficult to cover everything in one study in a short period. However, this study recommends future studies such as crowdfunding and the impact of social media on the evolution of ICT, crowdfunding to help develop SMEs and other economic activities, crowdfunding with risk and return in global markets the legitimacy of crowdfunding platforms in multiple countries and innovative community crowdfunding ideas. These are the main areas where most aspects of crowdfunding will be explored if research is conducted in the future.

COMPETING INTERESTS

Author has declared that no competing interests exist.

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