

Tuomas Tavi

Equity-Based Crowdfunding in Finland

The Emerging Funding Phenomenon

Helsinki Metropolia University of Applied Sciences

European Management

BBA Thesis

Date 28.4.2014

Author(s) Title Number of Pages Date	Tuomas Tavi Equity-Based Crowdfunding in Finland The Emerging Finance Phenomenon 54 pages + 2 appendices 28 April 2014
Degree	Double Degree BBA
Degree Programme	European Management
Instructor(s)	Kevin McIntire
Abstract	<p>The purpose of this thesis is twofold; first it is an attempt to describe the concept of equity-based crowdfunding in both theoretical and practical terms. Secondly this paper includes a discussion & analysis section where the main current issues about the topic are discussed with an attempt to make a prediction about the possible future developments.</p> <p>Equity-based crowdfunding is a new concept; start-up companies looking for equity funding via internet platforms. The companies that are using equity-based crowdfunding try to find the large crowds of usually non-professional investors, who would be interested in their endeavour. The internet 2.0 is an enabling element for the industry. Equity-based crowdfunding is an emerging phenomenon that can be seen as a complementary form of funding. It offers a good possibility for SMEs when the more traditional channels of capital have become scarce. At the moment the industry is strongly in the developing phase and its possibilities for the economy are being studied. Currently there are 3-4 main platforms operating in Finland but growth is expected. Since the phenomenon is new there is no legislation that covers solely the activities under crowdfunding scheme.</p> <p>The main issues for the future deal with, <i>development of the Finnish market, clear separation with the other forms of crowdfunding, regulation policy & aftermarket places for the issued shares</i>. All these topics play a relevant role in the upcoming development that is seen to be significant. At the moment there is a strong belief that equity-based crowdfunding can become an important funding tool for SMEs.</p>
Keywords: crowdfunding, crowdsourcing, financing, funding, equity-based, limited company, start-up, SMEs, aftermarket platform, non-professional investor, venture capitalism	

Contents

1. Introduction	1
2. Conceptual Model	3
3. Methodology	4
4. Findings & Literature Review	6
4.1. Crowdfunding in General	6
4.2. Starting to Define Equity-Based Crowdfunding	9
4.3. Main Academic Studies with More Detailed Concept Defining	11
4.3.1. The Situation in Finland	13
4.4. Comparing Equity-Based Crowdfunding With Other Investment Forms	14
4.4.1. Venture Capital Firms	15
4.4.2. Private Equity Firms	15
4.4.3. Institutional Investors	16
4.4.4. Corporate Investors	16
4.4.5. Angel Investors	17
4.4.6. Initial Public Offerings	18
4.4.7. Crowdfunding as Challenger for Traditional Venture Capitalism?	18
4.5. Issued Shares and Voting Rights in Equity-Based Crowdfunding	20
4.6. Valuation of a Startup and Targeted Investors	21
4.7. Legislation Dealing with Equity-Based Crowdfunding	23
5. Equity-Based Crowdfunding in Practice in Finland	26
5.1. The Industry in Finland with Examples of Crowdfunding Platforms.	26
6. Analysis and Discussion	30
6.1. The Future of Equity-Based Crowdfunding	30
6.1.1. European Developments	32
6.1.2. Development of the Market in Finland	35
6.1.3. Division with Other Forms of Crowdfunding	40
6.1.4. Regulatory View	42
6.1.5. Aftermarket for Crowdfunded Shares	44
7. Conclusion	48
8. References:	51

Figures:

Figure 1. *Industries Looking for Equity-Based Crowdfunding in Finland* on page 37

Appendices:

1. Main interview questions in the field study
2. Links to the Articles in 7.1.2.

1. Introduction

This paper deals the concept of equity-based crowdfunding and its current state in Finland. The concept is relatively new worldwide and this paper tries to give an extensive and thorough picture of it and the main discussions that are currently related to it. Equity-based crowdfunding is a form of crowdfunding where companies look for equity-funding from large public crowds. Traditionally speaking these companies are SMEs looking for equity. Common way to do equity-based crowdfunding is via internet platforms where companies can market their own business to possible investors. Internet and especially web 2.0 have been remarkable enablers for this practice to develop. At the moment the practice is becoming more and popular among the Finnish players. The public discussion addresses usually all the forms of crowdfunding, this paper focuses only on the equity-based type which is fundamentally separate from the other forms of crowdfunding. The common factor is that in crowdfunding activities the “greater public” is seen as the value creator for many endeavors or projects.

This paper tries to give proper insight to the main questions raised about the topic, and also make a prediction about the future developments by discussing some of the most important issues in more detail. Currently the knowledge that people have about the phenomenon is very limited and the paper tries to at least partially close this gap. The current buzz about the concept is getting larger all the time. It is widely expected that crowdfunding will become bigger in the future, the recent market developments have been significant and this paper tries to enlighten this development with additional comments. The more ambitious goal of this study is to make predictions about the future developments in relation to a couple of main issues around the topic.

The industry is strongly in the emerging phase with only a few players in the market. However the potential that it is expected to have is substantial. At the moment with the current economic situation in Europe, we are living in interesting times. Crowdfunding can possibly increase its significance greatly at this moment when the more traditional ways of funding are harder to reach. The potential or wisdom of the crowds is also an aspect that provided motivation for the development of this work. The internet era where anybody can become an investor with even a relatively small amount of capital is an interesting concept. This paper is a current insight into this rising phenomenon.

This thesis is divided into three main sections;

1. Literature Review & Findings
2. Crowdfunding in Practice in Finland
3. Analysis & Discussion

The Literature “Review & Findings” focus on explaining the concept of the equity-based crowdfunding. This is done with descriptive approach that is based on the most relevant theoretical academic publications and discussions. This part of the study explains the fundamental matters and issues behind the concept, and puts it in comparison with more traditional forms of investing.

After the theoretical description a more practical approach is applied in “Crowdfunding in Practice in Finland”. The current situation in Finland is enlightened by giving a brief description about the industry. The main players’ actions and characteristics are described to connect the previous theoretical discussion with practice.

In the final part “Analysis & Discussion”, the focus is on the current topics that are present in the crowdfunding industry. This is the analysis part of the paper where estimations about the future developments are made based on a combination of secondary source research and primary source field study results.

2. Conceptual Model

The purpose of this paper is twofold;

First it is a descriptive study of equity-based crowdfunding in Finland. One element of this description is to compare equity-based crowdfunding with the more traditional ways of funding startup businesses. In principle the aim is to explain the phenomenon; where does equity-based crowdfunding come from, what is it essentially about and, what are the critical aspects to take into consideration when understanding the concept.

Secondly this paper tries to give an objective idea of what the future development of equity-based crowdfunding in Finland might look like. This is very relevant question because at the moment we are living a period where the concept of crowdfunding is becoming more and more widespread and common people. To see where we stand at the moment and where we are possibly heading in the future is an interesting and current idea. Naturally this kind of study is very limited because there is ongoing change occurring all the time in the field. The industry is developing extremely fast. The purpose of the future prediction is to give a good understanding of the current state and in addition to that estimation about possible developments and trends that are present. This is done in order to give an enlightened present perspective at moment of change. The task is a very ambitious and challenging, with the inevitable downside that the information included in this study is likely to be outdated soon.

The precise dependent variable or object of the study is equity-based crowdfunding, its current state in Finland and possible developments in the near future. The independent variables that have an effect on the studied matter and results are:

1. The rationale behind the crowdfunding activities (globally); how people see the possibilities that the concept can offer for them.
2. The everyday developing industry (globally) and the decisions that are made in the field. These offer direct access to understanding the ongoing situation.
3. All the legislation and regulations (in Finland) that are related to the concept and all the possible future changes to the regulations.

3. Methodology

The goal of this paper is to extensively provide information about the topic and present it in a comprehensive and concise way. Extra value to the paper was sought by interpreting the current state of crowdfunding in Finland and providing a fair estimation about the possible future developments.

The methodology in the study consisted of three main approaches:

1. The provision of an in-depth literature review about the main academic findings and discussions. Part of this review is done in order to understand the concept. Since the actual academic research that has been conducted about the topic is still quite limited, it turned out that too much focus cannot be concentrated to this method. At the moment when broad and long ongoing academic discussion does not really exist, the first public surveys and investigations about the topic are also seen relevant sources for the methodology. All these material can be considered to provide an objective idea about equity-based crowdfunding. In addition to the strictly crowdfunding related material, part of the used literature deals with more general concepts in the broad field of finance business. This is then related to the concept of crowdfunding with comparative analysis, to give a more thorough picture of how crowdfunding is situated in the whole economy.
2. Systematic research about the current situation of crowdfunding in Finland by going through the public discussion that is going on about the topic. This includes several articles and opinion papers about the topic. Also studying the current players in the field (crowdfunding platforms & interest groups), and how they are operating in relation to the academic discussion provides, a connection between theory and practice. The findings from his method have to be gathered with caution because the public information from the industry may not be objective.
3. Interviewing Finnish crowdfunding professionals in order to receive an insight view to the industry. This is crucial for any study when the amount of relevant, strictly crowdfunding related, literature is very limited. Here the interviews are a must. For this paper the interviews were conducted via an email. The focus was on the current state of crowdfunding in Finland, and its possible future developments in

relation to a couple of carefully selected current topics. The sample of interviewees consisted of 3 individual professionals who were in managerial position in their organization. Considering the size of the industry in Finland, the size of the sample can be considered to be reasonable for qualitative research.

This methodology aims at making a relevant descriptive picture of the concept of equity-based crowdfunding in Finland. In addition to this it offers good basis to make a fair estimation about how the situation can develop in the future and what are the essential topics in this development. The approach of the entire study is qualitative and interpretation plays a great role in the findings. Some quantitative elements are included in the study. But since there is not enough experience of the concept, and significant, concentrated open data about the topic does not exist, the explanatory approach was seen more relevant for this paper. This is necessary when we try to meaningfully grasp the current, and constantly changing, state of equity-based crowdfunding.

4. Findings & Literature Review

This is the descriptive part of the study where the concept of equity-based crowdfunding is explained from several different perspectives. An in-depth literature review approach is applied in order to give the reader a proper idea about the concept. The aim is to explain the basic ideas behind the phenomenon (global approach) and the practical situation in Finland (local approach). This part of the paper with “Crowdfunding in Finland in Practice”, create the base for the section “Analysis & Discussion” where estimations about possible future developments with equity-based crowdfunding are made in relation to the most current and relevant topics in the industry. The paper study starts off by explaining the umbrella term “crowdfunding”, of which equity-based crowdfunding is part of.

4.1. Crowdfunding in General

The concept of crowdfunding is generally new worldwide, and it is even newer in Finland. The concept of funding is again ancient. Broadly speaking crowdfunding deals with the ways and possibilities on how to find money for any project or business by using the potential that exists in large crowds of people. When looked at from this perspective, crowdfunding does not seem to be much different from the other forms of funding; people and ventures have always existed and the fund seeking party has had the problem of finding the initial capital. Bank loans, business angels and venture capitalists are the classic examples of this kind of action. What can be considered making the difference with crowdfunding is the Internet and web 2.0 (O’Reilly, 2005). The new interactive platform approach that fosters the idea of involvement and networking online has made it possible to get more people more easily involved in funding endeavors. On the other hand we can ask that was it not possible to do crowdfunding before the internet era? The answer is yes, it would have been possible and it was possible. The classic and most known example of a form of crowdfunding happened already in the 19th century when the Statue of Liberty was built in New York (BBC, 2013). Basically what happened was that the people responsible for erecting the statue in New York ran out of money when they were financing the granite pedestal on which the statue would have been standing. They eventually came up with an idea; they launched a public fundraising campaign in a newspaper (The New York World) which turned out to be a huge success and the capital for the project was gathered successfully. This example in mind we can say that fundamentally speaking

crowdfunding is not a new phenomenon.

Even though the internet plays a great role in the development of the concept, it is not the only requirement for crowdfunding to exist. The present economic situation, how easily companies have access to capital plays equally big role in the relevance of crowdfunding. If there was not a need for this kind of funding, the internet would not create the need by itself. A good example about how the concept is not dependable on the internet is *Kansalaisrahoitus*. It is one of the biggest equity-based crowdfunding platforms in Finland and they do a great deal of their marketing and networking via phone, and the final investment decisions are in face-to-face sales meetings. Naturally the internet offers a great platform for other sort of marketing, but the point here was that crowdfunding in its very nature is not ultimately welded together with the internet. It is clear that there is a strong correlation with the development of the web 2.0 concept and the birth of the crowdfunding activities. But in the end internet-based crowdfunding is just a way to find these crowds more easily. The internet is merely a tool that has opened many doors for many opportunities and made it possible for crowdfunding to possibly blossom.

To understand where crowdfunding comes from we have to have a look at its foundations which are inevitably related to a very similar sounding term, *crowdsourcing*. Crowdsourcing can be seen as the mother term under which crowdfunding has developed. Jeff Howe explains this phenomenon quite well in his book *Crowdsourcing* (2008). Howe comes up with a term called *collective intelligence* (Howe 2008: 133). Collective intelligence is a way of understanding and harnessing the intelligence of several individuals. When similarly thinking people with slightly differing views work together on a single project, this can lead to excellent results. In practice crowdsourcing allows normal people to get involved in the production process according to the idea of collective intelligence. For companies this means that they ask individual users to create something for them. This can be anything from product development to reorganizing the structure of the company. Howe states that *“Crowdsourcing is rooted in fundamentally egalitarian principle: every individual possesses some knowledge or talent that some other individual will find valuable”* (Howe, 2008: 134). When we apply this to crowdfunding the idea is the same with an added twist; any individual can possess information and interest that can be applied in any project, in addition to this they may possess capital that can be used in the project. This is an idealistic view about crowdfunding because it is nowhere stated that the

people investing through crowdfunding are or should be involved in the business with other than monetary means, but the potential for this behavior exists.

At the moment crowdfunding is in the state of finding its place in the field of business financing. It has grown and become much stronger in a year (Kauppalehti, 26.2.2014). It is not a trivial mechanism anymore but a source for capital that more and more people find appealing when they are looking for funding for their projects. With the case of equity-based crowdfunding, the new Securities Markets Act (Finlex, 14.12.2012/746) that was launched in the early 2013, made it possible also for smaller companies to more easily get involved in crowdfunding business. It can be argued that this legislation has greatly contributed to the fast development of the business.

When defining the concept of crowdfunding we have to understand and strongly highlight that crowdfunding is merely an umbrella term for a much broader concept. There exist 4 different types of crowdfunding: *donation based, reward-based, lending-based and equity-based crowdfunding*. This paper focuses on equity-based crowdfunding but to make it easier to understand the big picture, the other 3 types are shortly explained here as well. The *European Crowdfunding Network (ECN)* has created an explanatory white paper that concisely explains all the different forms of crowdfunding. The following definitions of the different types are based on the document *A Framework for European Crowdfunding* (ECN, 2012). This document can be considered to be base for the European crowdfunding industry. When going through these examples it is good to keep in mind that from the legal perspective all these forms of funding are handled differently from each other. The common thing and the essence for all these models is that they are targeting “normal” individual people, the crowds, instead of organizations or professional investors.

- *Donation based crowdfunding* is a form of crowdfunding where money is asked for a project in a purely philanthropist spirit. This means that the capital is given to a project without any concrete reward for the donation. A good example of this can be any sort of charity that looks for donations. Usually with the case of crowdfunding, the final purpose and destination of the donation is known.
- *Reward-based crowdfunding* again, unlike donation-based, includes an actual reward in turn of the money that is given to the project. This form of crowdfunding is very closely connected to the idea of a normal transaction; the investor basically

buys some predetermined item or service. Preselling of a product in its development phase is a good example of this sort of crowdfunding.

- *Lending-based crowdfunding* deals with the simple idea of trading money between different parties. This can come in many forms; from people to business or from people to people. The interest that the operating platform has in the lending processes can differ, and the role of interest varies as well. Some lending is more interested in the philanthropist side and some is purely driven by the profit.
- *Equity-based crowdfunding* is always attached to some kind of company that is looking for investors for their business venture. The conditions and terms of the relationship between the investor and the company can differ greatly depending on what kind of investors they are looking for. Usually these companies are startups who are looking for equity from people who want to be involved in that specific business.

The same document that was used in defining the above mentioned 4 forms of crowdfunding has also triangle model where the different motives behind all the forms of crowdfunding actions have been explained (ECN 2012: 12). The motives are divided into *financial, social and material* and they describe the motives that people normally have when they get involved in crowdfunding. Equity & lending based crowdfunding are considered to be closest to the financial motivation (profit), donation based again is closest to the social motivation (philanthropist) and reward-based is seen to be near to the material motivation (obtaining a product or service). Naturally these motivations mix in reality and it is very possible that the social motivation is present also in the equity & lending based crowdfunding, in the form of micro loans for instance.

4.2. Starting to Define Equity-Based Crowdfunding

The previous section focused on crowdfunding in general. Here the concept of equity-based crowdfunding is unfolded. The introduction of this study gave already a brief definition of the concept; companies looking for equity from the crowds via internet platforms. To address the motives behind the crowdfunding actions it is important to understand the basics in business financing.

The fundamental issue that any starting business or project faces is the problem of finding the initial outside capital to start the endeavor (Cumming 2012: 369). Usually when the persons involved in the initiative do not have any real assets but only the idea or business plan, it is inevitable that the starting capital has to be sought outside the organization; a third party has to be involved in the business. This party can be anybody from family members to professional investors or banks. It is commonly known that the sought capital can come in two different forms; debt or equity (Cumming 2012: 375). This means that company can either look for equity capital from investors or they can apply a loan. The loan has to be paid back whereas the invested capital belongs solely to the equity of the company. In practice it is common that companies decide to use both debt and equity. The term for the balance between debt and equity is called the *capital structure* of a firm (Clayman 2012 p.199-200). Depending on the unique needs of the company, the managers decide how they want the ratio to be. The more debt is involved the more *leverage* the company has. High leverage means possibly higher return but the debt involved can make the business riskier as well. Debt financing is a fast way to receive the required capital, the lending party is only interested in getting their money back with the correct interest. Equity funding is again fundamentally different; in equity funding the investors get more involved in the business when they insert money in the company. In return for the investment the investor normally receives some share(s) of the company which again can entitle him to a certain degree of control over the decision making. Therefore when looking for funding via the equity channel, in principle the company invites people to join them. In order to find these people and equity the business has to be appealing, in this sense debt financing can be easier to achieve since debt is senior to equity. This is normally the case with both public and private companies. Cumming (2012 p.11) explains the benefits for small businesses that usually come with equity when compared to debt. Usually debt financing occurs via banks and for small start-ups it can be extremely difficult to convince the bank that their business will be successful and that they can pay the money back.

But what is equity? A simple glossary definition that Berk & DeMarzo offer in a standard corporate finance textbook states that equity is "*the collection of all the outstanding shares of a corporation*" (Berk & DeMarzo, 2013). Equity financing means that a company asks different people or organizations to invest in their endeavor. By doing this they are normally entitled to some sort of benefit. Ahlers gives a good definition of equity in equity-based crowdfunding by saying that "investors receive some

form of equity or equity-like arrangements (e.g., profit-sharing) in the venture they support” (Ahlers 2013). Put simplified, when company does equity-based crowdfunding they increase the amount of equity in their capital structure. This is practically always done in the form of selling shares to potential investors who are interested in the particular business and see there an opportunity that suits their needs. In Finland, when one goes through the different platforms that offer equity-based crowdfunding, it can be said that practically all the investment opportunities that are launched there consist of selling and issuing of private shares. When the investors come from a broad (usually unidentified) crowd of people who are considered to be “less professional” investors, we are talking about equity-based crowdfunding.

Ahlers also defines equity-based crowdfunding as follows “*Equity crowdfunding is a method of financing whereby an entrepreneur sells equity or equity-like shares in a company to a group of (small) investors through an open call for funding on Internet-based platforms.*” (Ahlers 2013).

4.3. Main Academic Studies with More Detailed Concept Defining

Since the topic of crowdfunding is relatively new, the amount of significant studies that have been made about it is still very limited. Since this paper is perceiving the phenomenon in Finland the volume of relevant literature is even smaller because crowdfunding has properly arrived to Finland only in the last few year(s).

In the past year some bachelor level studies about crowdfunding have been carried out in Finland. In this paper these previous papers will be used according to their relevance and significance and this study is aiming at enlightening more the phenomenon.

One of the first articles, *Crowdfunding of Small Entrepreneurial Ventures*, about the topic was a chapter in the Handbook of Entrepreneurial Finance by Armin Schwienbacher & Benjamin Larralde (2010). This article quite well describes what equity-based crowdfunding is about. They trace back the origins of crowdfunding to crowdsourcing and mention Kleeman’s idea about the “rise of the working consumer” [Kleeman, 2008]. The value of the consumer is seen as part of the era of internet 2.0 which can be considered to be a prerequisite for the modern crowdfunding networks to exist. The focus is on the normal consumer acting as an investor, instead of more professional investors involved in crowdfunding. It can be argued that this public aspect

of crowdfunding is what essentially makes it different from the other forms of funding or investing. An important aspect to this notion is to consider the information asymmetry that is evidently present with crowdfunding. It is normal that the funded party has clearly deeper understanding about the endeavor but with the case of crowdfunding, where the investor is likely to be a person who has a very limited professional view about the subject, this asymmetry is even greater. The fact that the volumes of capital that crowdfunders insert in the business are relatively small, means that the size of their share ownership stays relevantly small as well. This means that the investors are not likely to receive any great authority or decision making power in the company. To show the potential that the crowd might have in the business practices Schwirnbacher & Larralde make the reference to the “wisdom of the crowd”; there can be potential in the crowd when we think about the possibilities and insights that several people might have when developing the business further. In the paper Schwienbacher & Larralde also make the notion that research that has been conducted about the topic is still very limited and a lot of their references are linked to the concept of crowdsourcing, the preceding phenomenon of crowdfunding.

Equity Crowdfunding (Ahlers, Cumming, Gunther, Schweizer, 2013) is one of the first empirical studies that has been carried out about equity-based crowdfunding. The paper tries to explain the factors that make people to get involved in crowdfunding activities. The results were empirical acknowledgements about these different signals. The study was made from the point of view of the signaling party (fund seeking company). The study used data from the *Australian Small Scale Offerings Board* (ASSOB) that has been running since 2006. This is possibly the best source for empirical information about successful crowdfunding activities since the phenomenon is so new. Globally speaking there is yet not enough experience in crowdfunding to make extensive studies elsewhere. In the USA for instance crowdfunding became possible only after the JOBS Act launched in 2012 (Forbes, 2013). The next studies about crowdfunding are possible only after relevant data and evidence emerge. The outcome of the ASSOB study was that the success of a crowdfunding activity is closely connected to clear signaling from the company side. They highlight the importance that potential investors give to uncertainty. Openness and signaling investors properly about all the financial forecasts, the equity being offered, human capital and networks of the company are important factors when investors make the final investing decisions (Ahlers et al: 35). These notions can be seen aligning with the importance that Schwienbacher & Larralde give to the idea about “consumer investor”. In crowdfunding

the investors usually are not professional investors but people with less knowledge and experience. Therefore they may require clear signaling in order to make them get involved. The so called “cheap talk”, for instance the future exit channels for investors, are not as important as the other uncertainty factors because they are not seen as binding (Ahlers et al: 21).

4.3.1. The Situation in Finland

As it has turned out already, crowdfunding in Finland is definitely a new phenomenon. But this field of financing that has no tailored legislation is becoming more and more present in Finland. Several articles in different newspapers and magazines are constantly published and the buzz around the phenomenon is growing. Because crowdfunding has not stabilized its position yet, it intrigues people and officials. One of the first and probably only official papers that have been conducted about the topic was a survey report, *Report on Crowdfunding Survey*, conducted by the Ministry of Finance of Finland (Ministry of Finance, 2014). The survey received 37 answers from the leading finance people in Finland (including officials from public institutions and also private finance institutions) and gathered a comprehensive overview about the current state of crowdfunding in Finland. The survey not only provided information about the current state of crowdfunding in Finland by numerical measures, but also gave good insight on how the crowdfunding activities are seen from the investor point of view and in relation to rest of the finance field. According to the common belief in the study, crowdfunding can be also seen as a boosting element in the economy. It is seen that it can create jobs and activate “lazy” capital that people have laying in their bank accounts.

The main problems that the report brings up deal with regulations and consumer protection. At the moment there are no tailored laws for the crowdfunding activities. According to the survey the need for common regulations exists. Since crowdfunding can involve international activities (foreign people investing in Finland for instance) it would be very beneficial if the regulations were done on pan-European basis. At the moment the legislation is different in each country. Many officials and experts have been giving views and information that are contradictory. The development of the crowdfunding industry was considered to suffer because of the inconsistent regulations and actions. Common and tailored rules are seen also beneficial for the improvement of crowdfunding itself; its arising commonness and usability. According to the survey

the focus of the regulations should be on protecting and the rights of the investor who commonly is a non-professional investor.

Based on the survey the Finnish Ministry of Finance and the Ministry of Employment and the Economy came up with 5 possible follow-ups at the moment;

- 1) Assessment of existing legislation, to be amended where necessary
- 2) A comprehensive assessment is performed on need to require registration or authorization
- 3) Preparation of national legislation should not occur before possible legislative project by the EU
- 4) The Financial Supervisory Authority will prepare instructions on crowdfunding
- 5) The sector will produce self-regulation for its activities

From this survey we can definitely make the acknowledgement that at the moment all the forms of crowdfunding, including equity-based crowdfunding are gaining a seriously taken foothold in the finance sector. Since the phenomenon is new there is a great need for better understanding of the subject and its impact on the economic & social environment.

The aim of this literature was to give the reader an idea about where equity-based crowdfunding is currently standing from the academic research point of view. In the following sections the theory of equity-based crowdfunding is studied from more specific points; *relation to other forms of funding, regulatory views with share rights and valuation perspective.*

4.4. Comparing Equity-Based Crowdfunding With Other Investment Forms

Traditionally when private companies have been looking for funding in the equity form, the options that they have had for the source of financing have been *angel Investors, venture capital firms, private equity firms, institutional investors & corporate investors* (Berk & DeMarzo 2011: 771). In order to place equity-based crowdfunding in the larger context of already existing investment forms, we will make comparison of how these more traditional forms of investing are seen next to equity-based crowdfunding activities.

4.4.1. Venture Capital Firms

Venture capital firms are limited partnerships that specialize in raising money to invest in young firms (Berk & DeMarzo 2011: 772). The venture capitalists who run the business take care of the main investment decisions. They normally like to have a firm grip of control over the business. This can be seen for example in the great amount of voting rights that the venture capitalist may have in the starting businesses. When compared with equity-based crowdfunding the number one similarity is the fact that both forms are focused on smaller startups that have big potential for growth. The difference comes when we look at the size of the investor; venture capitalists are big compared to crowdfunders, where the general idea is to gain the capital from a larger crowd. Naturally there are exemptions to this rule as well but the main idea behind public crowdfunding is that many investors take part. The limited partners of the venture capital firms might get some benefits from investing directly in the start-ups by themselves, but the venture capitalists usually seek to somehow benefit financially from this as well (Berk & DeMarzo: 2011). In equity-based crowdfunding the investor is solely responsible for the investment without middlemen.

4.4.2. Private Equity Firms

Private equity firms are very much like venture capital firms in their actions and organization; they purchase shares of companies and they get their funding from limited partners. In addition to this they charge fees from the limited members and the volumes of capital that private equity firms tend to play with, are usually considered to be larger. But unlike venture capital firms, instead of being focused on the start-up type of companies, the private equity investors seek for more mature, larger corporations that have possibly been already publicly listed. Equity-crowdfunding activities do not always occur at the initial phase of the company neither, but the focus of equity-based crowdfunding is clearly not on the matured companies that are being bought-out. Hence we can say that the private equity firms are further from the crowdfunding activities than capital venture firms (Berk & DeMarzo 2011: 773).

4.4.3. Institutional Investors

Institutional investors consist of large pool of different organizations that have funds to invest in different assets. Examples of institutional investors are banks, pension funds or insurance companies. Institutional investors can be active by investing directly in the target business or they may become limited partners in private equity firms or venture capital firms (Berk & DeMarzo 2011: 773). When put in comparison with the other types of investors and crowdfunding, institutional investors are close to venture capital firms and private equity firms. They are all larger institutions interested in investing in smaller or bigger endeavors in order to get profit from the investment. Equity-based crowdfunding is again an endeavor for more individual investors.

4.4.4. Corporate Investors

Corporate investors are corporations that invest in younger private companies by buying them or buying portions of their ownership (Berk & DeMarzo 2011: 774). Unlike the previously mentioned types of investors, corporate investors may not be only interested in the monetary return when joining the business. An investor is called a corporate investor when they are also strategically interested in the target company. This means that they can strategically benefit from the purchase. For instance if the target company is operating in the same industry and performs excellently, it can be very beneficial to own a piece of it. From this perspective corporate investors differ from the previously mentioned ones. They are sometimes called strategic investors, or strategic partners. Crowdfunding can be seen to be similar in the sense that people who are involved in crowdfunding activities may also have a strategic agenda. Naturally it is impossible to generalize this notion, but usually people who are generally interested in the industry may also be strongly interested in contributing to the development of the endeavor. This deals with the issues we that previously discussed with the concept crowdsourcing and wisdom of the crowds.

When looking at all this in relation with crowdfunding we can make one major notion. Even though there might be many similarities with the more traditional forms of financing (for instance venture capital firms are strongly oriented towards startups just like crowdsourcing) there is one main difference; the people involved in crowdfunding investing are individuals in principle. *Venture capital firms, private equity firms institutional investors and corporate investors* are again considered to be larger institutions who normally also play with larger amounts of capital. This greatly affects

also the way how the companies who are looking for funding market themselves to the potential investors.

4.4.5. Angel Investors

The fifth and closest form of the more traditional sources of funding are the *angel investors* (Berk & DeMarzo 2011). Angel investors are individuals who purchase equity in private startups. This definition is practically identical with the one of equity-based crowdfunding; individual people inserting money in prosperous small companies that are about to take off in the market. But again the fundamental difference comes in the volume of capital that these individuals are inserting in the company. Angel investors tend to be wealthy individuals with insight to the industry, they are scarce and they can be hard to find. Good personal contacts help here a lot. Once a company has found one, they still have to be able to sell their business idea to the investor so that he or she is willing to take part. When purchasing equity, one also gets a hold on a relative size of the decision making power in the company. Angel investors who have expertise in the proper field of business may become extremely important help for the decision making in the company.

When comparing angel investors and crowdfunders we see differences in two volumes; the amount of investors and the volume that the investors put in the endeavor. The whole name of angel investor comes from the idea that “an angel of light” comes down to the small startup and gives it a change. In crowdfunding there is not just one angel but a crowd of smaller angels who contribute with smaller amounts of capital. The power of the crowd (Howe, 2008) is a thriving force here. In addition it is important to understand that not only angel investors may have decision making power in the company, also crowdfunders who have relevant experience in the specific industry can become part of the management decisions as well. After all they are shareholders who are interested in the development of the company and the potential return. Naturally each case is different and every company decides how they want to arrange the ownership and the possible voting rights. For instance Kansalaisrahoitus (a Finnish equity-crowdfunding platform) announces that the shares that are being issued in the investment rounds are practically always voteless. Angel investors are still more likely to be able to affect the business because of the relatively large portion of ownership that they have in relation to equity crowdfunders.

4.4.6. Initial Public Offerings

Initial public offerings (IPOs) can be considered to be the sixth form of fundraising (Berk & DeMarzo, 776). To clarify, the following issues explained originate from the Finnish model & legislation. In this context IPO means the situation when a company gets listed in the public stock market and becomes a public limited company. A company that is not listed in the stock exchange but has equity in the form of shares, is called here a limited company. Theoretically speaking IPOs are very close to equity-based crowdfunding; in both cases the company makes an offering of its shares (Laki24.fi, 2014). The difference between these two actions is that crowdfunding activities consist of private equity whereas when a large company makes an IPO, we are normally talking about public common shares. The common shares are freely exchanged in the stock exchange whereas the private equity is not so liquid. From the legal point of view the Finnish legislation says that a limited company has to have 2500€ of equity and for a publicly traded company this amount is 80 000€ (Finlex, 21.7.2006/624). The volume of capital that has to be involved in IPOs vs. crowdfunding is significantly greater. Therefore IPOs are not a form of venture capitalism and it can be argued that private crowdfunding activities are more desirable solution for smaller startup companies. It is easier because it requires less resources and the ownership of the company stay in the hands of a narrower group of people, in the critical startup phase.

4.4.7. Crowdfunding as Challenger for Traditional Venture Capitalism?

If we want to gather all the above mentioned types of financing under one term we can say that we are talking about venture capitalism or venture capital (excluding the IPOs). Douglas Cumming uses a known idea when explaining venture capital (Cumming, 2010). He states that venture capital is the “money of innovation”. Put simply normally when talking about venture capital we mean money that is invested in starting businesses with high risk, return and potential. As it was explained, venture capital can come from different sources and in different forms. Cumming states that angel investors, limited partnerships (private equity firms), corporate funds and government funds as well, are sources of capital (2010). Similarly equity-based crowdfunding, in its simplest form, is a source of capital for the companies. Fundamentally speaking the activity is the same in both cases. But when the new source of capital (equity-based crowdfunding) is compared with the other forms, we can say that many dissimilarities exist as well. Crowdfunding has emerged very quickly to the financing field, and with its

slightly different characteristics it can offer a good alternative for many companies.

Like venture capitalism, also crowdfunding activities are mainly focused on the innovative endeavors that need the starting capital. The main difference between these two forms is the same that came up previously; angel investors or private equity firms tend to gain decision-making power in the company, whereas in crowdfunding, the same amount of governance power is usually not conveyed to the investor. This aspect is explained more in the next part “Issued shares and voting rights”.

Manchanda & Muralidharan compared the relationship between venture capitalism and crowdfunding in a recent article/study (2014) *Crowdfunding, a New Paradigm in Start-Up Financing*. The basic question that they tried to answer was if crowdfunding will become a direct competition for the more traditional venture capital industry. As we have made the acknowledgement that there are some differences and some similarities, the study was somewhat in alignment with this thinking by arguing that most likely these two forms of investing will complement each other. They mention that crowdfunding can benefit venture capitalists by identifying the most promising start-ups. After a good business idea has been “approved” by the equity-based crowdfunders, the more professional venture capitalists can join in. Another descriptive term for this is “rising in the investment escalator”. This means that companies can start off with crowdfunding and once they have properly initiated themselves, they enter the next level by involving other forms of venture capitalism in their endeavor. In relation to this thinking Manchanda & Muralidharan also make the notion that in the USA many venture capitalist players have gotten also involved in the crowdfunding business. They have been purchasing and creating crowdfunding platforms where equity is being sold to smaller investors. By controlling these actions the platforms/venture capitalists can themselves offer support and create networks for the starting businesses. This makes it easier also for themselves to lean on the most prosperous opportunities.

It is a good to make here the side notion that the equity-based crowdfunding platforms are also involved in the business. These platforms are the market places for equity seekers and they will be explained later in this paper. Basically they provide the “facilities” for the companies and potential crowdfunders to meet by organizing the investment rounds where the equity is sought. The platforms can ask for a provision from the successful investment round, or they can require ownership in the company

that sought funding via their service. This is for instance what Kansalaisrahoitus does in Finland (Kansalaisrahoitus, 2013a), part of their fee comes in share options. This kind of development can be seen possibly turning the equity-based crowdfunding platforms themselves into a more fund or venture capital firm type of an entity. The difference here is that unlike with private equity firms, the crowdfunders would still have the final decision in choosing where their money is eventually being invested. The platform again would make its own profit and growth by taking its own fair share of the equity in the form of a provision fee.

4.5. Issued Shares and Voting Rights in Equity-Based Crowdfunding

When comparing the issued shares and the voting rights related to them, it is important to keep in mind that whenever shares are issued, publicly or privately, the rights that each shareholder has are unique and dependent upon the rules and contracts that have been created for the company and its shares. It can be that the equity shares being provided to crowdfunders do not contain voting rights at all. The Finnish Limited Liability Companies Act (Finlex, 624/2006) states that it is possible for a company to issue voteless shares. Normally it is considered that one share equals one vote. This is the fundamental thinking behind share ownership and it is also stated in the Finnish Limited Liability Act. But for instance Kansalaisrahoitus has applied the voteless share approach when doing crowdfunding for its customer companies (Kansalaisrahoitus, 2013b). Another case example of this kind of behavior is Hawina Productions (Invesdor 2014a). Hawina Productions is a company that looked for equity funding via the Finnish crowdfunding platform Invesdor. The shares that they issued via crowdfunding were so called class-B shares without voting rights. It was argued that the company needs clear and effective decision making-structure in order to stay well-functioning. They stated that "To keep the company eligible for private equity investment, it should not have a large number of voting shareholders who potentially disagree on issues." To make this arrangement seem more appealing to the investors, there was no control over trading the class-B shares.

This technique is understandable when we think about the nature of crowdfunding. Since the company looks for investors on a very broad-based approach, basically anybody can be an investor, the outcome of the investment round is usually that the equity is also gathered from a broad variety of people. People with different

background and interest in the business. Also some of the investors may be willing to purchase larger quantities of the business than others, giving them substantially large portion of power in the decision making if the voting right is not denied. To avoid a situation where outside capital starts to affect the crucial decision-making it is understandable that the original founders and owners want to somehow protect this. In these cases the benefit that the investor gets from the investment is the possible dividend or the profit that they can get from possibly selling the ownership further, or if the entire company gets sold in the exit-phase. To sell the shares further individually can be difficult because at the moment there does not exist any common aftermarket platform for the crowdfunded shares. In the later sections of this paper this matter will be discussed more deeply.

4.6. Valuation of a Startup and Targeted Investors

After a company has made the decision to try equity-based crowdfunding, they need to find the value for the business in order to decide about the amount of equity they are targeting. This is an important question that is strongly related to the section "Issued Shares and Voting Rights in Crowdfunding". When issuing shares, the company broadens its ownership to a wider base. This can have an effect on the decision making structures as well. It can also be said that this valuation provides the frameworks for the final company structure. In the valuation process the whole business, with all its related variables, are segmented into separate pieces which are then scrutinized in order to give a proper idea of the entire situation of the company. Since in equity-based crowdfunding the targeted investors are mostly considered to be non-professional, it is important to make the valuation understandable for them as well. This is also part of the marketing of the business opportunity.

The value of the company does not equal to the amount of money that is looked for in the investment rounds. One of the major questions that any company faces when they start to look for funding is to decide how much capital they are targeting; how much equity they need in relation to debt. Because the topic here is equity-based crowdfunding we will have a look at the issue only based on the equity side, not debt. This is an important and difficult question because here we are talking about the value of the entire business, how much is the company worth of? Over or underestimating the value in this phase may lead to the situation where the potential investors do not

find the whole endeavor appealing at all. Also consumer protection issues are a question in crowdfunding; many of the investors are not professionals and therefore treated as consumers. The high riskiness that is normally involved in the startup scheme should be addressed clearly in the marketing and valuation process of the company.

With equity-based crowdfunding this means that the fund-seeking company carefully examines how much equity they are looking for. While making this decision the company also decides how big part of the ownership they expose for the public to purchase. Pinto, Jerald E. Henry, Elaine Robinson, Thomas R. define valuation as “*the estimation of an asset’s value based on variables perceived to be related to future investment returns, on comparison with similar assets, or, when relevant, on estimates of immediate liquidation proceeds*” (2010: 1). From this statement it is difficult to say anything concrete. The stance is definitely on the future approach with focus on the possible and estimated returns that the endeavor might have. Anyhow we are always talking about estimations and that is what makes the valuation difficult. For a startup the riskiness is even more present factor.

Pinto et al (2010: 7-8) divide the valuation process into 5 separate steps:

1. *Understanding the business.* This step involves analysis of the industry and market and all the factors that create the base for the company performance.
2. *Forecasting company performance.* Making a realistic & proper but also convincing forecast about the core accounting activity; the cash flows.
3. *Selecting the appropriate valuation model.* Here the company can choose from a variety of different tools for the valuation. One of the most common tools is the *weighted average cost of capital (WACC) or discounted cash flow (DCF)* model.
4. *Converting forecasts to a valuation.* Judging the trustfulness of the forecast.
5. *Applying the valuation conclusions.* Creating the final value for the equity.

All the above mentioned steps should be made in connection with the crowdfunding market. The valuation process can be seen as part of the marketing of the endeavor as well and in crowdfunding the focus is on the big public crowd.

Since the disclosure obligations (FSA, 2013a) that listed companies have, do not include the private limited companies, the investor's position in the crowdfunding scheme may not always be on solid ground. This is one of the fundamental issues that deals with equity-based crowdfunding; the non-professional investor may not get access to enough information about the endeavor. The lack of proper company information to the investors can start already in the initial investment phase. The benefit of this "freedom to conceal information" for the company is that the organization structure is less rigid with less bureaucracy and all the information does not have to be revealed. On the other hand there is the issue of possibly misinformed investor. Drover & Zacharakis (2013) make an interesting notion about the "typical crowdfunder" in their article *Crowdfunding's Impact on the Entrepreneurial Equity Food Chain*. They suggest that since the people who take part in investing via crowdfunding may not be professionals they are more likely to take the company's valuation of their business as a fair deal. This gives more power to the company when deciding about the value of the company for the investment round. If compared with a situation with more professional investors, the information requirements by the crowdfunders are possibly not that demanding. Naturally the value created this way is an illusion and ethically suspicious. When a company may run their second investment round after the falsely created initial value, people who are more aware of the current business and industry may spot the overvaluation of the company. This leads to the situation where the falsely created value comes down and the original crowdfunders lose the value of their investment (Drover & Zacharis 2013). The Finnish consumer protection act can take this into consideration when assessing the accuracy of the valuation of the startup (Finlex, 20.1.1978/38). In the following section the main legislative framework that is related to equity-based crowdfunding in Finland is explained.

4.7. Legislation Dealing with Equity-Based Crowdfunding

Equity-based crowdfunding deals with great juridical responsibilities and therefore in order to understand the concept thoroughly it is important address the main legislative issues as well.

At the moment crowdfunding activities in Finland do not have their own legislation. This is because of the fact that crowdfunding is relatively new phenomenon and therefore there is no tailored legislation for it. The same applies generally on the European level

as well. Since the market and industry is just developing itself, officials and administrative bodies are following the development and waiting if they need to take action and direct the development to some direction. Because of this, the already existing legislation has to be separately applied to all the crowdfunding activities (Marjomaa 2013: 21).

The legislation that is involved in the equity-based crowdfunding includes the Limited Liability Companies Act (Osakeyhtiölaki), Securities Markets Act (Arvopaperimarkkinalaki) and Act on Investment Services (Sijoituspalvelulaki) (ECN, 2013). Because the nature of crowdfunding can be considered to be more public than private (the investment possibilities are online, and publicly offered to basically anybody, and not for only professional investors) some of the investors can be considered to be normal consumers and therefore consumer protection laws have to be applied as well (Marjomaa 38). The Consumer Protection Law (Finlex 20.1.1978/38) focuses on keeping the selling and marketing of the shares fair. The investor is seen as a consumer and any relevant information regarding the company that is looking for investments, should not be concealed from them (ECN 2013a). This issue was also discussed in the previous section “Valuation of a Startup and Targeted Investors”.

At the moment the Finnish platforms providing equity-based crowdfunding services do not fulfil the *Markets in Financial Instruments Directive* (MiFID) definition of investment services requiring a license (ECN 2013a). The acts are interpreted so that the crowdfunding platforms are not currently providing banking or investment services according to the law. In practice this means that all the transactions and issuing of shares that occur in the sphere of crowdfunding, are done primarily between the investor and the company. The platform offers information and assistance but does not practically get involved in the service of the financial instruments. Important question is to look at whether there occurs money remittance under the Finnish Payment Institutions Act (Finlex 30.4.2010/297). When the transactions occur via customer's deposit account it is not considered as money remittance by the crowdfunding service provider. The main legal relationship remains between the investor and the investing party. This is of course always unique for each case and platform. Depending on what kind of service the platform is giving, it could be possible they were interpreted to be acting under the MiFID but so far the Finnish equity-based crowdfunding platforms have been working without licenses (ECN 2013a). The fact that there is no official regulation or supervision covering solely crowdfunding, can be seen to have positively

contributed to the fast development of the industry.

Regarding the size of the investment there is not one single rule on the European-level and the legislation varies depending on the country that we are looking at (ECN 2012). The Prospectus Directive (2003/71/EC, amended by 2010/73/EC) has been the guideline that has had an effect on the ways how equity-based crowdfunding can be applied in the EU-countries. The problematic issue here has been whether or not the company has to make an official prospectus of the offering of the shares. In Finland this limit is 1 500 000 €; in other words the company is not obliged to publish the prospectus when *“the total value of securities offered within a 12-month period is less than EUR 1,500,000”* (FSA 2013b). It has been stated that the current type of equity-based crowdfunding type would not be possible or feasible if the legislation would require prospectus for a financing round with value under 1 500 000 € (Kauppalehti 26.2.2014).

5. Equity-Based Crowdfunding in Practice in Finland

The previous sections provided a solid picture of the main theoretical issues about equity-based crowdfunding, both globally and locally in Finland. In this section a more practical approach is taken in order to give an insight to the current situation in Finland. The industry and its players with their actions are explained in a descriptive way that gives the reader a better understanding of the concept in practice. This understanding will be deepened even more in the last section “Analysis & Discussion” where the most relevant current topics are discussed in relation to possible future developments.

But how does equity-based crowdfunding occur in practice in Finland? As mentioned before, the wide use of internet has made crowdfunding activities possible and feasible. The companies that are looking for the funding run an investment round where they promote their endeavor and ask people to join. Here the crowdfunding platforms are in the center of attention and they are main players in the development of the crowdfunding industry. The platforms create a market place where loose capital finds its way to promising investments. According to Kauppalehti (26.2.2014) in the spring 2014 there existed four major platforms or services for equity-based crowdfunding in Finland. These are *Kansalaisrahoitus*, *Invesdor*, *Venture Bonsai* & *FundedByMe*. *FundedByMe* is a Swedish-based service but they are active in Finland and therefore included here.

5.1. The Industry in Finland with Examples of Crowdfunding Platforms.

At the moment there exists 3-4 four main platforms for equity-based crowdfunding in Finland. Other platforms that are more focused on the other forms of crowdfunding exist as well, but they are not really relevant for this perspective when we try to understand the concept of equity-based crowdfunding. These platforms are services that create investment rounds for companies that are looking for funding. In addition to organizing the actual round, they can also be very active in the promotion side of the campaign. Many platforms offer side services that help companies prepare their sales pitch. A big part of this promotion is also the site itself; on the platform each investment round is detailed with all the correct information about the venture. At the moment the

estimation about the size of the industry vary a lot since there is no official database about the crowdfunding actions. However, it is estimated that a couple of dozen companies have found funding via these platforms and the total value of the investments is around 20 million euros (YLE 21.1.2014). Any official figures for this do not exist yet. This is simply because of the fact that crowdfunding is such a new phenomenon in Finland.

Following are described the main platforms that are active in Finland. This section includes only those 4 platforms that have already managed to arrange a few successful investment rounds. This descriptive part of the paper is twofold; simultaneously while the platforms are being described, the focus of the text is also on the practical explanation of how equity-based crowdfunding functions in Finland. This method gives a good overview of both the industry and its common practices and size.

Kansalaisrahoitus is a Finnish platform for equity-based crowdfunding and it was started in 2012 (Kansalaisrahoitus 2013a). They state that they are helping companies to find funding for their business idea and at the same time they are offering opportunities for the investors to get rich. Like basically all of the equity-based crowdfunding platforms, also Kansalaisrahoitus focuses its actions to SME and start-up companies with the highest possible prospects for growth. Since their start they have successfully managed to gather funding between 15 and 17 million euros. (Kauppalehti 26.2.). This fact makes Kansalaisrahoitus the largest service in Finland when it comes to the received funding.

A big part of Kansalaisrahoitus's marketing strategy are face-to-face meetings where the actual pitching and the final investing decision takes place (Talouselämä 10.2.2013). This can be seen differing from the general approach that is usually related with crowdfunding; the internet-based approach. Naturally their website works as a good source of information but the actual pitching for the possible investors happens at the in-person meetings. Because of this fact it can be considered that Kansalaisrahoitus is separate from the other equity-based crowdfunding platforms that use internet as the main venue for pitching. After this acknowledgement it can be said that there is not only one way of doing crowdfunding and it has to be kept on mind that in principle crowdfunding is merely a marketing tool. What makes it different from the other forms of finding equity, is the fact that it is aimed more at the unknown "normal" people; big public crowds of potential investors. The internet offers great opportunities

for this.

Just like any equity crowdfunding company, Kansalaisrahoitus organizes investment rounds for companies that they think have potential. The normal volume of one investment round is between 500 000 € and 1 499 999 € (Kansalaisrahoitus 2013c) and it lasts 2-3 months. When compared with the other major crowdfunding platforms in Finland it is relevant to notice that Kansalaisrahoitus deals with larger amounts of capital than the others. The minimum amount for any investment is 3000 € (Kauppalehti 26.2.2014). For the investment the investor is entitled a corresponding amount of voteless shares (Kansalaisrahoitus 2013b).

Invesdor is an equity-based crowdfunding platform from Finland that operates in the Northern Europe. The company was also founded in 2012. Invesdor focuses on smaller scale investments than Kansalaisrahoitus since their scale for investment rounds starts from 20 000€. In theory they arrange rounds all the way till 5 000 000 €, but considering the nature of crowdfunding and the prospectus requirements, it can be argued that these volumes of capital have not been sought so far (Invesdor 2014b). When equity-based crowdfunding platforms choose the companies that finally get to pitch their business to the crowd, there is certain criteria that all platforms require from the companies. The business has to have clear professional stance and proof of (possible) success. This is important for the image of the platforms as well; in order to keep the business and industry appealing for investors only the most promising endeavors are accepted to take part.

The average volume for Invesdor's investment round is 100 000 €. The minimum amount for individual investment is 20€ and the recommended amount is 200-500€ (Kauppalehti 26.2.2014). In this light it is even clearer that Invesdor is targeting investors who are not necessarily looking for larger investment opportunities like Kansalaisrahoitus or Venture Bonsai for instance.

Like many other crowdfunding endeavors, also Invesdor applies the idea of a minimum amount that the round has to achieve before the capital can be accepted in the business venture (Invesdor, 2014c). If the pre-set minimum amount of capital is not achieved all the money that the investors possibly had inserted in the endeavor, will be returned. After the minimum amount is achieved the company can decide whether they want to proceed towards the maximum amount. After the round is closed and all the

equity from the investors is received, the company has to inform the Finnish Patent and Registration Office about the new issued shares (PRH, 2013). Here the relationship between the company and the investor gets highlighted; the platform itself does not offer any financial service, it only brings together the company and the investor who then alone make the mutual contracts.

Venture Bonsai, founded in 2010, is one of the first Finnish-based equity crowdfunding platforms. Venture Bonsai operates on the European level so they offer investment rounds for all European companies (Venture Bonsai, 2014). Similarly like Kansalaisrahoitus, also Venture Bonsai is looking for bigger investments than Invesdor. The typical volume for one investment round is 100 000 - 500 000 € and the minimum recommendation amount for one individual investment is 1000€ (Kauppalehti 26.2.2014). Whenever we perceive these recommendation volumes for investments it is important to keep in mind that each investment round is a unique situation, where the company itself decides how much and what kind of capital & investors they are looking for. From this perspective it is fair to say that crowdfunding platforms should be seen as a way for companies to market themselves for the desired targeted investors.

The fourth platform that operates in Finland is called **FundedByME**. This platform is a Swedish-based service that was founded in 2011. The marketing and activities are strongly based on the internet aspect and its actions are close to Invesdor.

This part of the paper provided a practical picture of the current provision of equity-based crowdfunding services in Finland. The reader should now have a good picture about the concept and its place in the field of financing. In the following section “Analysis and Discussion” comes the interpretative study part of this paper where the future developments are discussed in relation to the most relevant current topics in equity-based crowdfunding business.

6. Analysis and Discussion

Based on the descriptions of the industry and the literature that have been discussed in this study, it is possible to make a fair estimation about the future developments of equity-based crowdfunding in Finland. The approach that is taken in this future prediction is based on the main public discussions and a couple of topics that are present and relevant at the moment in the world of equity-based crowdfunding. Even though we limit the scope of the study to Finland we have to understand that we are talking about a globally acknowledged concept. Equity-based crowdfunding is a mean to find shareholders for an endeavor and this can be considered to be a universal idea. More precisely it is a universal idea in the Western part of the world where modern market economy is the present economic system. The legislation and regulations that deal with equity-based crowdfunding (the Companies Acts for instance) are different in each nation, and therefore too specific generalization is not relevant. The main idea is the same all over, also in this study, but the more descriptive and detailed information is strictly bound to the case of Finland.

6.1. The Future of Equity-Based Crowdfunding

To predict the future of anything is extremely difficult if not even impossible. When predicting the future it is commonly understood that the only actual way to form a solid view about the future events is to have a look at history and the recent developments of the perceived matter. In the case of equity-based crowdfunding good indicators of the possible future developments are the recent growth rates of the industry, any numerical facts from the public administrative statements and the general discussion about the topic. This part of the study starts off with a look at the European situation. Finland is part of this economic area and therefore it is important to understand the wider picture; the fast developing industry takes influences all around the business area and Finland is also legislatively bound to this sphere. After the part "European Developments" a more precise discussion about the situation in Finland is conducted. The approach is descriptive but in this section the focus is more on the specific questions about the future developments. The field study interviews also play a role in the interpretation.

The prediction of the possible future developments in Finland is done in relation to 4 topics that are current in the equity-based crowdfunding scheme. These topics provide insight to the most relevant discussion that is going on at the moment in the field.

In the part “Situation in Finland & Field Study Findings” each studied topic is also discussed in relation to the field study findings that were received from the interviews that were conducted for this paper. The interviews provide an interesting addition to the perspective that is gathered from the public discussion and articles. The answers are from 3 anonymous managerial professionals from the Finnish equity-based crowdfunding platforms. Therefore the *field study findings* can be considered to give more subjective than objective perspective. Since at the moment the crowdfunding industry is strongly leaning towards a self-regulative approach in its development (Ministry of Finance 2014), it is fair to say that these people can provide an interesting insight view to this development. Since the self-regulative approach considers that the “best practices” are being developed currently in the field, these people are in the core of the development and therefore the experts for these questions. The questions that were used for the interviews can be found in the appendices.

The future developments of equity-based crowdfunding will be approached with 2 main topics and 4 sub-topics

- European Developments
- Situation in Finland & Field Study Findings
 - Development of The Market in Finland
 - Division With Other Forms of Crowdfunding
 - Regulatory View
 - Aftersales Marketplace for Equity-Based Crowdfunding Shares

6.1.1. European Developments

Statistical information from the European Investment Bank in 2013 (ECN, 2013b), estimates that the 23 million European SMEs are in the core when discussing about the economic recovery of Europe. They account for 67% of all jobs and 80% of all the new jobs being created. From these companies 30% use bank loans and 40% rely on short term or overdraft services when funding their business. Access to capital can be seen as a general problem for these companies. The possibilities that these millions of companies can have in crowdfunding activities cannot be neglected when thinking about the future of the economy in Europe.

Finland is part of the European Union and economically very closely knit to it; the area shares common currency and market area, free movement of goods and services are in the core of this policy (European Commission 2014a). Considering this fact it is relevant to say that when scrutinizing the situation in Finland it is wise to have a broader look at the developments in the entire common market area. After all especially influences that deal with the fundamental ideas of equity-based crowdfunding are more or less the same in each of the Member States. Legislative intricacies are a minor issue in the big picture, but important when we go into more depths with the case of Finland.

The European Commission has provided the public a press release where they identify crowdfunding and its current state in the EU (European Commission 2014b). The communication given via the report strongly imply that crowdfunding activities are getting more and more popular and wide spread in the EU. According to a study (Massolution 2013) that was mentioned in the Commission report, crowdfunding raised 735€ million in the year 2012 which was 65% more than in the previous year. The study forecasted that in the year 2013 this figure would reach 1€ billion. The growth can be considered to be significant. Comparison with angel investors reveals that crowdfunding activities outperformed them in the volume of capital that was inserted in different businesses and projects. In this comparison we have to acknowledge that the Commission report did not solely focus on the occurrence of equity-based crowdfunding, but on crowdfunding in general; equity-based crowdfunding is therefore only a portion of the entire 735€ million. This does not take away the relevance of the report for equity-based crowdfunding because equity-based crowdfunding actions were also included in the growth and the trend. Put simplified, smaller investors

(crowdfunders) are gradually getting more and more involved in inserting their own capital to endeavors that they find meaningful, and this fact promises growth for the crowdfunding industry.

The same report emphasized the possibilities that crowdfunding provides for businesses that find it difficult get in touch with other forms of capital. Like the general opinion, also here crowdfunding was seen practical especially for smaller businesses. At the same time with the press release the European Commission issued an official communication about the current state of crowdfunding in the EU, *Unleashing the potential of Crowdfunding in the European Union* (European Commission, 2014c). This is one the first larger official documents that the EU has published about crowdfunding. The report focuses on defining crowdfunding and explaining its current state in the EU. This can be considered to be the agenda that any current paper about crowdfunding tries to do; explain the phenomenon. As mentioned many times before, this is all because the concept is so new and there seems to always be a clear need for carefully defining what we are talking about when we are talking about crowdfunding. An issue that can be seen to derive from this general explaining of the concept to the readers, is that the majority of the papers talk about all the forms of crowdfunding. To get more detailed reports about only equity-based crowdfunding is still rare. The distinction between the different forms of crowdfunding is normally made in the papers but more specific discussion about the different forms of crowdfunding is still rare. The general lack of awareness about crowdfunding is mentioned also in the report (European Commission 2014c). The paper highlighted strongly the potential that crowdfunding has as a complementary tool for the more traditional sources of funding. The concept was seen as a very optimistic addition to the “funding escalator”; crowdfunding was characterized as a startup tool for startups who are then afterwards possibly seeking other forms of funding, i.e. rising the finance escalator. The problems that SMEs in Europe face today in finding funding, were clearly identified in the report and crowdfunding was as a possibility to improve this situation. The European Commission stated that crowdfunding is as a part of the work plan for channeling more “*funding towards the long term investment to ensure economic growth*” (European Commission 2014c). It righteous therefore to argue that the European Commission partly leans on equity-based crowdfunding when pursuing general economic growth. This fact itself is a positive sign for the development of the industry; a higher authority takes seriously this new field of business that has still scattered practices.

The Commission's statements were also acknowledged in the European Crowdfunding Network (ECN) and they were seen as a big step for the industry (ECN 2014a). ECN is a not-for-profit organization that consists of professionals and associate persons of the crowdfunding industry (ECN 2014b). It is an interest group that was founded in 2011 and it can be considered to be the number one individual contributor to the development of crowdfunding in Europe. The network has published several white papers regarding the prevalence of crowdfunding in Europe, its regulations and other issues. ECN can be considered to be the number one advocate for crowdfunding in Europe. The objectivity in their studies has to be carefully measured because the network openly promotes the crowdfunding activities and the business itself. They are biased in this sense. On the other hand the network represents the current European state of art knowledge in crowdfunding. The organization tries to openly improve the state of crowdfunding on the European level by creating networks between people and affecting the public discussion by consistent approaches. Self-regulation in the development of crowdfunding activities is also seen in the core of the business by ECN (ECN 2014b).

One of the first documents that ECN published was *A Framework for European Crowdfunding 2012* (ECN, 2012) and it provided a solid picture of the entire phenomenon. This publication was also already referred to in this paper in the section "Crowdfunding in General". This paper can be considered as the base for all the following developments to crowdfunding in the EU.

The newness of the concept and the rapid growth with big interest faced towards it does not put the policy makers in an easy situation. A problematic area deals with the regulations since every country applies their own laws and regulations in crowdfunding. A good comparative study that builds a nice insight to the differences within the European framework was also carried out by the ECN (ECN, 2013). The report highlighted the scattered legislative practices with crowdfunding and especially equity-based crowdfunding in the EU. For instance a good example of the differences in the legislation between member states is to think through whether crowdfunding platforms are considered to be providing financial services; in Germany yes but in Spain no. The discussion and lobbying that this interest group (ECN) is having with the European Union can be considered to be in the core of the development of the market. At the moment we are still in the phase where the potential & risks of the concept are being studied (European Commission, 2014c). A proof of the ongoing studying is the recent

study *Unleashing the potential of Crowdfunding in the European Union* 2014.

Considering the proofed growth rates of the industry and the general buzz, we can argue that crowdfunding will increase its importance and awareness around the topic will grow. The future of the legislative part is still very unclear because of the differing regulations in each country. For equity-based crowdfunding, international dealing within the EU was seen problematic because of these regulative differences (European Commission 2014c). Whether more all-encompassing regulation should be initiated is still questionable now that market is only developing itself. The potential is acknowledged but instead of actions the focus is on closely paying attention to the global and European developments and then reacting to those. Since the focus is on self-regulatory means and the EU fosters the idea of free movement of capital, we can expect to see more international involvement in equity-based crowdfunding activities. For instance FundedByMe or Invesdor are platforms that already operate internationally. The easiness of internationally getting involved in the crowdfunding scheme in countries like Finland for instance, makes the growth of the industry even more potential.

6.1.2. Development of the Market in Finland

All the above mentioned facts can also be applied to the situation in Finland since the country is part of the European business area. Here of course the national legislation is the unique factor as mentioned above, but the interest that is paid to the concept of equity-based crowdfunding, can be seen to follow the same principles. In this section we take a closer look at the situation and possible developments in Finland. This discussion is divided into different segments that are the most relevant current topics in the studied area. Even though we speak on the Finnish level it is inevitable to make connections with the global developments because the topic is extremely current; influences & ideas around crowdfunding are strongly in the evolving state due to the newness of the concept. Different crowdfunding applications are being tested all over the world, always within a specific legal framework. A good example of this is the aftermarket places for shares initiated via equity-based crowdfunding. At the moment one of the first platforms for these instruments in the world is being tested in Finland.

Equity-based crowdfunding is definitely a growing phenomenon in Finland, there is no doubt of this when we take a look at the current buzz that the new form of funding has gained around itself. This fast development is in strong alignment with the

developments other parts of Europe as well. The number of equity-based crowdfunding platforms has risen significantly. At the moment there are 4-5 main platforms that offer equity in Finland (Kauppalehti 26.2.2014) when only a few years ago there were none. It can be said that the general interest towards crowdfunding strongly in the increasing. This can be noticed in the amount of recent news articles in the general media. Equity based crowdfunding have already been acknowledged on the ministry level as well, which implies that we are talking about a serious phenomenon.

A few relevant examples of the media interest in crowdfunding:

Startup-yritysten joukkorahoitus tekee tuloaan myös Suomeen, YLE 21.2.2014

Ministeri Vapaavuori povaa joukkorahoituksen kasvua, Helsingin Sanomat 13.3.2014

Mistä rahat bisnekseen? Joukkorahoitus ja Twitter auttavat uutta yrittäjää. YLE 20.2.2014

Joukkorahoitukselta puuttuu selkeät pelisäännöt, Turun Sanomat 7.4.2014

Links to the articles can be found in the appendices.

This is naturally only a small segment of the great spectrum of opinions in the field but they provide a good idea about how the concept is becoming more and more recognized; the main discussion at the moment is related to explaining the phenomenon and how it should be approached in regulative terms. According to this discussion the development of the industry is very rapid and it can offer a good opportunity for SMEs to find funding in the future. Since the financial crisis in 2008 the financing possibilities that starting companies have had, have become more scarce. Banks are less willing to offer credit because of the weakened economic situation (Ministry of Finance 2014).

Since there is no official supervision tailored only to equity-based crowdfunding activities in the Finnish environment, there is also no official information gathered about the industry developments. At the moment the official situation can be considered to be in a "natural state" where the players are just finding best practices. The following information tries to answer the question what kind of Finnish companies are looking for equity-based crowdfunding. The information was gathered from three different equity-based crowdfunding platforms that operate in Finland and the sample consists of companies that have successfully organized an investment round. All the information

was public and the division into the different business segments was done by the author of this paper.

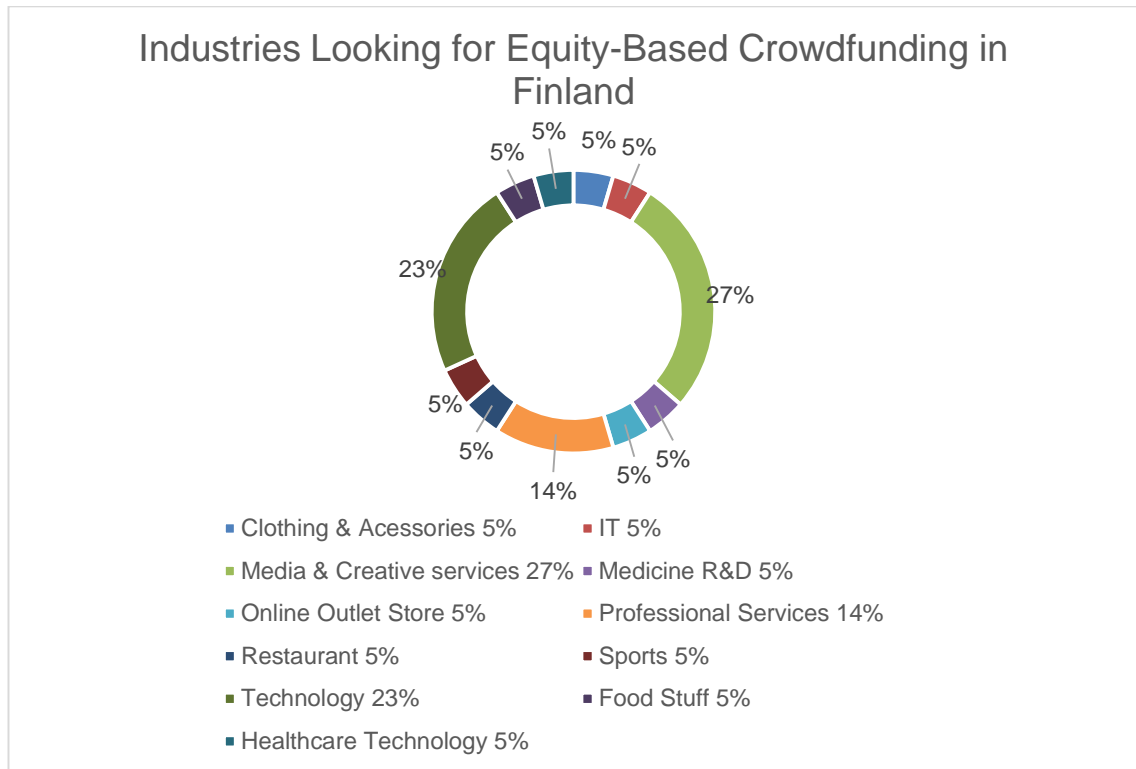


Figure 1: Industries Looking for Equity-Based Crowdfunding in Finland

From the graph we can say that equity-based crowdfunding is a measure not limited to any specific industry. The variety is great, from restaurant services to healthcare technology. Technology and media & creative services seem to stand out from the chart. The general fact these companies is that they are all startups with an innovative idea in their own industry. Technology and media services are often products of this kind of development and this might explain their relatively large weight in the graph.

The same crowdfunding platforms that were used for the figure, were also used to create an average figure for the volumes of capital that are gathered via the system. In the study only publicly shared information was included from 12 companies that had successfully been funded via crowdfunding and whose main marketing happened via the internet platforms. The finding was that the average amount of equity for these companies was 140 000 €. These figures does not match with the Kauppalehti article (26.2.2014) that was used in describing the Finnish platforms in the previous section of this paper. This is most likely because Kansalaisrahoitus does not publicly announce

the size of their investment rounds and therefore they were not included in the figure gathered for this particular paper. As it was mentioned before Kansalaisrahoitus seems to be targeting larger investments. If they had been included in the figure, the average amount would have probably been greatly higher. The differences between the

The average ownership that was offered to people via crowdfunding was 11,4%. This indicates that the companies do not seem to be putting any majority blocks of ownership open to the market. They have interest in keeping the majority of the ownership in their own hands and crowdfunding is therefore considered to be a supplementary form of equity.

These figures give a good idea of the volumes that are involved in the business. Since all equity-based platforms do not openly share information about their actions these figures are limited to only those platforms that market equity strictly only online. Each case and platform is always unique in their actions and volumes. The Kauppalehti-article (26.2.2014) suggests that the volumes of the investment rounds are ranged between 100 000 € and 1 000 000 €. In practice, because of the prospectus requirements, the Finnish scheme encourages to look for crowdfunding up to 1 500 000 €. These figures alone do not tell much about the possible future developments, but they are an evidence that the industry really does exist and it is growing. Following the international and European developments it is reasonable to expect that more and more startups see the possibilities in this new form of financing and are interested to try it out. It is easy and riskless way for the smaller companies to find equity. But in order to gain the required capital the business idea has to be properly addressed and sold to the crowdfunder. For this issue crowdfunding does not offer any ease, it is important to keep in mind that crowdfunding is merely a business marketing tool that gives access to target large volumes of people. Once the recognition of the concept grows, it is very likely that more and more startups try this form funding.

Next the comments from the interviews are discussed in relation to the development of the industry in Finland.

Feld Study Findings

The future of the equity-based crowdfunding industry was seen positive in the field study interviews. This was not a surprise because of the rapid growth of the crowdfunding market. It was mentioned that several successful investment rounds have already been conducted and the general awareness of the investment form is rising. Finland was seen as very promising country for crowdfunding since the potential and knowhow in the Finnish startups was seen extremely high. This is true especially in technology driven industries; Finland has a great amount of engineers who are open to new opportunities. This can be acknowledged also in the Figure 1. A mentioned example of this was the case of Nokia; when the company started to lose its position in the market and financial value, the knowhow in the people who had been working for company did not disappear anywhere. The problem that these motivated people have is the absence of initial capital for their business idea. The startups that are rising from this heritage are seen very suitable for crowdfunding. Crowdfunding was seen also a possibility for companies that are looking for second or third round investments.

The threats for the development of the industry that were acknowledged in the interviews dealt with the possible misinformation and prejudices that people may have about crowdfunding. Since the concept is very new and it is still finding its place in people's minds, it is important that great public mistakes are avoided in the marketing and pitching processes. Otherwise there is the risk that first stage marketing mistakes give a negative image to the entire industry. This is again partly because of the lack of relevant information about the concept. Since the concept has not been established permanently there is the threat that bad decision or performance today might drive the whole industry to a narrow margin. Too restrictive changes in the regulations were also seen as a threat to the industry. At the moment the regulations are not heavily guiding the industry, but the players in the field are afraid that changes that make operating in the field heavier might occur. If these threats are avoided there is a great possibility that equity-based crowdfunding becomes a central source of funding for SMEs. The increasing amount of "success stories" that have been initiated via crowdfunding were seen important for the development.

6.1.3. Division with Other Forms of Crowdfunding

One aspect that can be seen important for the development of crowdfunding is to make people more aware of it. As it has come up already, there exists 4 different types of crowdfunding; *equity, donation, lending and reward based crowdfunding*. All of these types differ from each other when it comes to the purpose and meaning that each type represents. The connecting factor is that all of them look for funds that are gathered from a broad basis that exceeds the sphere of professional investors or funders. The more traditional type of investors can of course be also involved in crowdfunding activities, but the standing point from the fundraising side is different; to tap the crowds.

Since the forms between the different forms of crowdfunding differ in nature, it is important to make a clear division between these forms. An example could be as follows; there is a clear difference when a person buys a share from a promising startup versus when he funds an album project that a musician has initiated. Buying a share is clearly a long-term investment, the shareowner receives the rights stated in the articles of association of the limited company. Financial benefit can be considered to be in the core here; the shareowner may receive dividends and the value of his share in the company can increase. In the case of funding a musical album, the crowdfunder receives the final product or some other material reward for the involvement in the business, after the project is done. Here we perceive a clear difference in the nature of the action; financial gains via investing vs. material reward in the form of pre-sales of a product. Also the volumes of capital that people put in crowdfunding differ according to the type. In Finland a single equity-based crowdfunding investment can easily be a couple of thousand euros, whereas in reward-based models this usually figure stays under 100 € (Kauppalehti 26.2.2014).

Because of these different characteristics also the widespread use of the term crowdfunding can be considered to be problematic. This is especially present issue now when the general knowledge of crowdfunding is still very minimal. People tend to speak only about crowdfunding when it would be more enlightening to refer to the particular form of crowdfunding. A future development that could ease the misunderstanding that can derive from speaking only about crowdfunding would be to make a clear division between the different forms. A good example of more detailed definitions can be seen in the European Commission report *Unleashing the potential of Crowdfunding in the European Union* (European Commission 2014b). The report

provides a distinction into three different crowd activities; *crowd investing*, *crowd lending* and *crowd sponsoring*. These terms describe more specifically what the actual motive behind the crowdfunding action is. Equity-based crowdfunding is seen as crowd investing, crowd lending again refers to lending-based crowdfunding and donation & reward based crowdfunding activities are considered to be crowd sponsoring. Naturally this is just a terminology issue but in order to better understand the phenomenon, we need to have better tools to describe the perceived matters. To talk about crowdfunding by meaning all the activities under the umbrella term is not appropriate. To speak about crowd investing or crowd lending can be seen more accurate to describe the action behind the term. In the future a clearer distinction between the different forms of crowdfunding is likely to happen because of the increasing knowledge about the topic.

Field Study Findings

The comments that were gathered from the field study also suggest the same thinking. The importance of making a clear division between the different forms of crowdfunding is significant for the development of the industry. In the interviews it was strongly implied that equity-based crowdfunding is clearly a form of investing, and it involves large volumes of capital that are regulated differently from the capital that is gathered in the reward-based models for instance. Division in terminology makes it easier also for the consumers to understand where they get involved in.

The different forms of crowdfunding differ also juristically. It is important for the consumer to understand in what kind legally binding contract they agree to. In order to make people more aware of the differences, it would be very important to use different, more precise terminology as well.

It was also mentioned that clear rules for crowdfunding would make this division more understandable. Generally this issue has to do with the common understanding about crowdfunding; making people more aware of the different types is easier when they are referred to more precisely. In the future it is very likely that there will be a clearer division between the different types of crowdfunding due to the differences in nature that they have.

6.1.4. Regulatory View

As it has come up already the regulations & legislation that are connected with equity-based crowdfunding are scattered around the field and there is no single framework for crowdfunding activities. The Finnish Financial Supervisory Authority (FSA) does not consider that the crowdfunding platforms are involved in the provision of financial services and therefore they are operating without financial institutions license, and outside the prospectus requirements. The platforms are seen as marketing tools for the companies and they are only engaged in contract or investment broking, not offering the investments (ECN 2013a). At the moment FSA has only given an overall presentation about crowdfunding on the general level (FSA 2013). Here FSA focuses on the consumer protection aspect by enlightening the concept of crowdfunding and what issues investors should take into consideration when they get involved with it. At the moment when the industry is still strongly in the developing phase, the officials are also in the state of following the movements in the market and trying to understand the development without too much interference. A sign of the rising interest towards crowdfunding are the investigations related to crowdfunding that are conducted. For instance *Report on Crowdfunding Survey* was conducted by the Ministry of Employment and the Economy, and the Ministry of Interior is currently making an investigation whether the Money Collection Act should be revised (Ministry of Interior, 2014). The Money Collection Act is only related to donation and reward based modes of crowdfunding, but we can say that the general interest towards crowdfunding is in the center of attention here. Also by fine-tuning the legislation for the other forms of crowdfunding, the distinction between equity-based becomes clearer.

So far the regulation has involved mainly the following of the developments in the field. Self-regulatory views are a present element in this approach. Since there is no single regulative act that would cover the crowdfunding activities, the national administrative bodies agree that the players in the field should have the power to create the best practices that would benefit everybody. The Finnish Ministry of Employment and the Economy see crowdfunding as a potential provider of sufficient capital to startups. According to the Ministry of Finance there is a great possibility that the industry is able to create its own code of conduct based on best practice principles. This could be followed by creating certificates that are required from the players in the crowdfunding industry, the equity providing platforms for instance (Ministry of Finance 2014).

The outcome of the survey conducted by the ministry was that the regulations on crowdfunding should be kept light but at the same any possible misconduct has to be taken seriously. The self-regulation was seen important for the future development of the industry. FSA should be providing guidance and some frameworks for possible registration requirements. Following the European developments and possible requirements in the regulations was seen important. One of the main points was that more assessment is still needed to fully understand the impact that crowdfunding can have from the legislative perspective.

Extra attention should be given to the Act on Alternative Investment Fund Managers (FSA 2014). AIFM is a new act that regulates the actions that an alternative investment fund manager does. This does not straightly concern equity-based crowdfunding because the final investment decisions are made by the investors alone. However, the role that the crowdfunding platform takes, defines whether the action is considered to be under the act (ECN 2013). For instance if a platform decides to start to provide a service where they on behalf of the investor make the final investment decision, it is likely that the action falls under the act. At the moment there is not any such actions in sight, but for instance the platform Kansalaisrahoitus receives some of their commission in the form of share options from the crowdfunded company (Kansalaisrahoitus 2013). This kind of conduct, where the financial instruments are starting to accumulate to the platform, can possibly move its nature closer to an alternative investment fund. The main question is still whether the final investment decision stays with the investor.

Field study findings

The interview with equity-based crowdfunding professionals revealed that in the market, possible tightened regulative changes can turn out to be harmful for the industry. The fear in the industry is that rigid procedures and heavy administration of the crowdfunding activities can make it less appealing to people. An interpretation to this can be that since there is no existing legislation that clearly covers only crowdfunding, the possible changes in the existing legislation are seen as a possible threat to the development of the industry; the framework that would solely take crowdfunding into consideration and protect it, does not exist.

So far the regulation free sphere around equity-based crowdfunding can be considered to be the reason behind its rapid development and growth. The industry has been able to create its own ways of conduct without too much interference from the state. The fact that the Financial Supervisory Authority is not controlling the actions of the crowdfunding platforms tells about the free nature of the business. Even though the freedom is greatly appreciated in the field, at the same time some regulation or “soft law” was also desired. Clear rules were seen important in order to avoid the possible misconducts and frauds in the market. As an example of a fraud that was mentioned in the interviews was a company that actually did not even have the product they were marketing. The professionals in the industry think that it is beneficial for the image of the entire industry that possible misconducts can be cleared away. This is in alignment with the findings from the ministry report; self-regulative approach with guidance from the FSA is expected.

The future of the legislation in crowdfunding business is in open. At the moment when the industry is still evolving, the administrative authorities are in a state where they closely follow the movements of the industry and possibly react to them. It can be expected that the self-regulative approach still remains dominant but as the phenomenon becomes more known, some more official statements and guidelines will be applied. The European level developments are also in the center of these actions and like the Finnish officials, also the EU is closely following the development and possibly taking action when they see it is required.

6.1.5. Aftermarket for Crowdfunded Shares

A prominent future development that is happening in the area of equity-based crowdfunding is the emergence of aftermarket places for the shares that have been initiated via crowdfunding. One issue that have been considered to restrict the attractiveness of equity-based crowdfunding is the absence of a functional after-sales market. Once the investors make the initial investment and become a shareowner in the company, it may not be that easy to sell the shares further. Since these are shares that are not listed in the official stock exchange the liquidity of the instruments is not good. For each transaction the seller has to individually find a buyer. Also the conditions stated in the Articles of Association of the company may restrict the sales of the ownership. If the articles of association include a redemption clause there is no

guarantee for the new buyer of the shares that he will be able keep those shares. The redemption clause is a very common part of any articles of association. In the Companies Act it is stated that “*a shareholder, the company or another person has the right to redeem shares due to be transferred to a third party by a shareholder other than the company*” (Finlex 21.7.2006/624). In the end it is always up to the company to decide if they want to keep the clause in their own Articles of Association. For this paper 10 articles of associations were randomly chosen from companies that were looking for equity-based crowdfunding on the Finnish platform Invesdor (Invesdor 2014d). It turned out that in all of the randomly chosen articles of association there existed some form of redemption clause. In most of the cases the clause was taken straight from word to word from the companies act. This can be interpreted so that it is a common practice in the Finnish limited liability scheme to include to the clause. In order to create a functioning aftermarket for the shares, there ought to be a change in this general approach, because with this clause selling the shares further does seem appealing or feasible. This can be seen as a restrictive issue in the development of the aftermarket places.

Are the smaller private companies willing to give up the clause and reduce the amount of control that the company on its ownership arrangements? For startups it can be seen important to keep enough control measures within the company in order to be able to make decisions according to the changing conditions. From a corporate governance perspective this is an interesting issue. It has been acknowledged that there can be conflicting interests between the funders (managers) of the company and the investors (Kauppalehti 26.2.2014). If the investors are able to create big blocks of ownership in the company, this definitely has an effect on the decision making as well. Some managers might therefore be slightly cautious when issuing new shares, and especially if these shares were meant for larger audiences as. One common possibility to retain the decision making is to issue dual class shares (Berk & Demarzo: 935). As an example, a company can create A & B shares, where class-A shares are entitled to only 1 vote in the decision making whereas class B shares give 10 votes per share. In this kind of arrangement the class-A shares would be aimed at crowdfunding activities and class-B shares were retained for the funders of the company. The class-A shares would therefore be more suitable for after sales markets as well. The simplest way to retain all the management power in the hands of the company is to issue non-voting shares. This can of course have an effect on the attractiveness of the investment for the investor; no primary possibilities to affect the decision making in the company.

While this paper is being written Finland is in the frontier of the aftermarket development. The equity-based crowdfunding platform Invesdor and a banking company Privanet have been developing a market place for the sales of unlisted private shares (Taloussanomat 30.1.2014). It is stated that this is among the first platforms in the world where unlisted, originally crowdfunded, shares can be sold further (Privanet 2014). From the legal point of view the aftermarket platform differs from the crowdfunding platforms where the shares are initially marketed. The aftermarket is considered to be a type of financial service provider and therefore they are under the control of the FSA. In other words we are talking about the “stock exchange of the smaller players”, and this does not have anything to do with the initial issuing of the shares. The idea behind the concept is to give more liquidity to these otherwise very rigid instruments; private shares.

At the moment we are living very interesting times in the crowdfunding industry because of the possibilities that aftermarkets could offer to the investors. On the other side companies' willingness to get involved in the market can be questioned because of the possible loss of governance. Besides this fact, there exists a great interest to try out this possibility. Also the crowdfunding survey, conducted by the Employment and the Economy, advocates the idea by arguing that a well-functioning aftermarket platform would improve the investor's protection (Ministry of Finance, 2014).

Field study findings

The effect that a well-functioning aftermarket platform could have on the crowdfunding industry was seen significant in the interviews. It turned out that the professionals in the market believe that this kind of service would definitely make it easier for the investors to get involved in the business. At the moment the expenses that come from operating in the aftermarket place can be high, but technology can improve the functioning of the market place in the future. Since private shares are not traditionally considered to be instruments that are part of the “trading scheme”, it can be rigid in the beginning to make supply and demand meet. Transactions can be slow and costly in the beginning. Openness and internationality were also seen important aspects of the possible market place. This would create more options for investors to choose from, since the Finnish market is considered to be relatively small. The same applies vice versa when thinking about how foreign investors can boost the markets in Finland.

In the interviews it was also mentioned that there is the possibility that some companies would not be interested in this new market place because of losing control over the ownership of the shares and possibly decision making. This fact was also discussed in the analysis above. Despite this problem it was considered that the aftermarket should be initiated with those companies agreeing to the terms and current conditions. In the end it is always up to the company itself, how they decide to arrange the issued shares and their rights. "Listing" does not suite every company's agenda. In the end the companies make their own decision to join the aftermarket based on whether they find more advantages than disadvantages in "listing". For instance this can involve studying the ratio between time and money; how much extra work is there involved in the aftermarket actions versus the gained capital or some other benefit. Considering these facts it can be argued that the advantages that come with aftermarkets are more on the investor side; more liquidity makes it easier to join the endeavors. This is again beneficial for the growth of the crowdfunding industry. For the companies that get involved in the aftermarket scheme there can be clear disadvantages; loss of control over the shares plus managing he ownership structure become more difficult. The positive side is that it can be easier to find the initial capital.

The future prediction is that the aftersales markets will be initiated, and this has already happened by Invesdor. The successfulness of it depends on how many companies are willing to get involved. Possible success stories can create more trust in these actions. The internationality of these markets is also a great possibility for the future. Making the market place appealing for foreign capital can be a big boost for the industry and this possibility was acknowledged in the field study interviews as well.

7. Conclusion

This paper was a descriptive study of the current state of equity-based crowdfunding in Finland. The purpose was to give an idea about how this new form of financing fits into the big picture of funding business and the more traditional forms of investing. The study was done by defining equity-based crowdfunding's characteristics and fundamentals, and by addressing the most recent relevant public discussion about the concept. At the same time the purpose was to give a prediction about the possible future developments that are facing the equity-based crowdfunding industry. This can be considered to have been the research gap in the paper.

The methods that were used involved extensive studying of the concept of equity-based crowdfunding in general and at the same time creating a picture of the current market and its main present actions. In addition to this framework, subjective insight information was gathered with interview-method by contacting a couple of crowdfunding professionals.

To conclude this discussion we can state that crowdfunding is a rising form of funding, that is likely to complement the more traditional forms of financing once it gets properly recognized. Equity-based crowdfunding differs from the more traditional forms of venture capitalism in the size and volume of investors; there are more investors with smaller individual investments. A main characteristic of the investors in crowdfunding is that they are usually considered to be non-professional. Eventually the concept of internet 2.0 has made crowdfunding possible by creating networking opportunities between fund seekers and these non-professional investors. Naturally professional investors can be involved as well, but the premises do not expect this. The concept offers a good opportunity for SMEs to find funding from a broad spectrum of investors when other sources of equity capital are scarce. At the moment the industry in Finland is being created. Currently there are a couple of dozen companies that have successfully gathered funding via the 3-4 main online equity-based crowdfunding platforms. The regulation in the field is not heavy and a lot of importance is given in developing self-regulatory practices.

The current developing state of the equity-based crowdfunding puts it in a very interesting situation; what will the future market conditions be like, and how the possibly changing regulative issues can affect it. The results were arranged according to four relevant issues/questions that are present in the field at the moment. The issues were: *development of the market, division between the different forms of crowdfunding, legislative approach and possible aftermarket place for the shares initiated via crowdfunding.*

The results were that the market in Finland is strongly developing and getting bigger, this development will most likely continue in the future. The boost for this development can be seen as a result from clearer division between the different types of crowdfunding which makes people more aware of the possibilities that equity-based crowdfunding can offer. Legislation is seen as both threat and opportunity; the likeable situation is that self-regulative approach in crowdfunding activities remain and the industry can evolve according to the best practices. On the other hand it is possible that some tightening in legislation can make it more difficult for the industry to evolve. The act on alternative investment fund managers can be a possible restriction for the development of some of the services that equity-based crowdfunding platforms provide. At the moment the developments in the market are being observed and the possible actions to the changing situation are seen in the future. Consumer protection can be seen in the core of the regulatory actions. In relation to the legislative development we can see the rising of aftermarket places of the shares initiated by equity-based crowdfunding. The development of these marketplaces are seen as having a positive impact on the attractiveness of the industry for the investors. The amount of companies willing to join these aftermarkets is still an open question.

The contribution that this paper had on the existing literature and discussion of the topic, is of exploratory and information combining nature. The paper addressed the main issues that are involved in the development of equity-based crowdfunding and created a still image of the current state of equity-based crowdfunding in Finland. The problems that were encountered during the research process dealt with the lack of information and existing literature of the topic, especially in the Finnish context. The open information about the subject is still very limited due to the newness of the concept.

Further study of the topic is definitely needed. A more precise study requires better access to data about the industry in Finland. As time passes and understanding about the concept develops with the industry, it is possible to make to detailed studies about some specific part of the concept. The issue with share ownership via crowdfunding in relation to actual decision making power should definitely be studied further; what are the motives that both the investor and the fund seeking party have, when they decide to get involved in crowdfunding activities. Crowdfunding is also a perfect object for legal studies; the application of the current legislation to the concept, and the possible changes that might be required when knowledge about the industry increases.

8. References:

Bibliography:

Berk & DeMarzo, 2011, *Corporate Finance Second Edition*, Pearson, USA

Clayman, Michelle R. Fridson, Martin S. Troughton, 2012 George H. *Corporate Finance : A Practical Approach (2nd Edition)*, Wiley, Hoboken, NJ, USA

Cumming Douglas, 2010, *Venture Capital: Investment Strategies, Structures, and Policies*, Wiley: Hoboken, NJ, USA

Cumming Douglas, 2012, *The Oxford Handbook of Entrepreneurial Finance*, Oxford University Press, New York, USA

Jeff Howe, *Crowdsourcing*, 2008, Crown Business, USA

Jerald E. Pinto, Elaine Henry, Thomas R. Robinson, John D. Stowe, Abby Cohen, 2010, *Equity Asset Valuation, 2nd Edition*, John Wiley & Sons inc. USA

Marjomaa 2013, *Oikeudellinen lähestymistapa joukkorahoitukseen*, Bachelor's Thesis, Oulun seudun ammattikorkeakoulu

Newspaper:

Kauppalehti, 26.2.2014, Päivikki Pietarila, *Yrittäjä hakee rahaa joukoilta* p. 14-15

Online sources:

Ahlers, Cumming, Gunther, Schweizer, 2013. *Equity Crowdfunding*. Available at:<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2362340> [16.4.2014]

BBC, 2013. *The Statue of Liberty and America's crowdfunding pioneer* Available at:<<http://www.bbc.com/news/magazine-21932675>> [16.4.2014]

Drover, Will & Zacharakis, Andrew, 2013, *Crowdfundings Impact On The Entrepreneurial Equity Food Chain*, Ivey Business Journal Online (Jul/Aug 2013), Available at: <http://iveybusinessjournal.com/topics/strategy/crowdfundings-impact-on-the-entrepreneurial-equity-food-chain-2#.U07t4vl_uYE> [18.4.2014]

European Commission, 30.1.2014a *General Policy Framework* Available at: http://ec.europa.eu/internal_market/top_layer/index_en.htm [17.4.2014]

European Commission, 27.3.2014b: *Communication on crowdfunding in the European Union - Frequently Asked Questions*, Available at: <http://europa.eu/rapid/press-release_MEMO-14-240_en.htm> [17.4.2014]

European Commission, 27.3.2014c: *Unleashing the potential of Crowdfunding in the European Union*
http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf [17.4.2014]

European Commission, 2014d, *Crowdfunding*, Available at:
<http://ec.europa.eu/internal_market/finances/crowdfunding/index_en.htm> [18.4.2014]

European Crowdfunding Network, 2014a, Available at:
<<http://www.europecrowdfunding.org/2014/03/european-commission-helps-crowdfunding/>> [18.4.2014]

European Crowdfunding Network, 2014b, *About us*, Available at:
<<http://www.europecrowdfunding.org/about-us/>> [18.4.2014]

European Crowdfunding Network, 2012, *Framework European Crowdfunding* available at:
<http://www.europecrowdfunding.org/files/2013/06/Framework_EU_Crowdfunding.pdf> [17.4.2014]

European Crowdfunding Network, 2013a, *Review of Crowdfunding Regulation*, Available at: <<http://www.europecrowdfunding.org/wp-content/blogs.dir/12/files/2013/12/ECN-Review-of-Crowdfunding-Regulation-2013.pdf>> [17.4.2014]

European Crowdfunding Network, 2013b, *Regulation of Crowdfunding* Available at:
<http://www.europecrowdfunding.org/files/2013/06/20130610_Regulation_of_Crowdfunding_EC_N_OC.pdf> [17.4.2014]

Financial Supervisory Authority FSA, 2013a, *Disclosure obligation*. Available at:
<http://www.finanssivalvonta.fi/en/Listed_companies/Disclosure_obligation/Pages/Default.aspx#.U07rIPi_uYE> [18.4.2014]

Financial Supervisory Authority FSA 2013b, *Prospectuses* Available at:
<http://www.finanssivalvonta.fi/en/Listed_companies/Prospectuses/Pages/Default.aspx#.Ux9YuYWt-VI> [18.4.2014]

Financial Supervisory Authority FSA 2014, *Vaihtoehtoisten rahastojen sääntely – AIFMD* Available at:
<<http://www.finanssivalvonta.fi/FI/SAANTELY/SAANTELYHANKKEET/AIFMD/Pages/Default.aspx>> [28.4.2014]

Finlex, 2012, *Arvopaperimarkkinalaki 746/2012* Available at:
<<http://www.finlex.fi/fi/laki/ajantasa/2012/20120746#L3>> [18.4.2014]

Finlex 21.7.2006/624, *Companies Act - Osakeyhtiölaki*, Available at:
<<https://www.finlex.fi/fi/laki/ajantasa/2006/20060624>> [18.4.2014]

Finlex 30.4.2010/297 *Finnish Payments Institutions Act* Available at:
<<https://www.finlex.fi/fi/laki/ajantasa/2010/20100297>> [18.4.2014]

- Finlex 20.1.1978/38 *Consumer Protection Act* Available at:
<<http://www.finlex.fi/fi/laki/ajantasa/1978/19780038>> [16.4.2014]
- Forbes, Brummer & Gorfine, 2013. *The JOBS Act Isn't All 'Crowdfunding'* Available at:
<<http://www.forbes.com/sites/realspin/2013/10/08/the-jobs-act-isnt-all-crowdfunding/>> [16.4.2014]
- FSA, 2013 *Joukkorahoitus: Mitä sijoittajan on hyvä tietää?* Available at:
http://www.finanssivalvonta.fi/fi/Tiedotteet/Esitelmat/Documents/Ajankohtaista_sijoittaja_nsuojasta_151113.pdf [17.4.2014]
- Invesdor, 2014a, *Learn English with Interactive Speaking Games (Sales Pitch)* Available at: <<https://www.invesdor.com/en/pitches/176>> [16.4.2014]
- Invesdor, 2014b, *Target Company Criteria*, Available at:
<<https://www.invesdor.com/en/how-it-works#target-company-criteria>> [17.4.2014]
- Invesdor, 2014c, *Kierroksen jälkeen* Available at: <<https://www.invesdor.com/fi/how-it-works#after-the-round>> [17.4.2014]
- Invesdor 2014d, *Pitches*, Available at: <<https://www.invesdor.com/fi/pitches>> [17.4.2014]
- Kansalaisrahoitus 2013a, Available at: <<http://www.vauraus.fi/kansalaisrahoitus/>> [16.4.2014]
- Kansalaisrahoitus 2013b, *Sijoittajalle*, Available at:
<<http://www.vauraus.fi/kansalaisrahoitus/sijoittajalle/>> [16.4.2014]
- Kansalaisrahoitus 2013c, *Rahoituksen hakijalle*, Available at:
<<http://www.vauraus.fi/kansalaisrahoitus/rahoituksen-hakijalle/>> [17.4.2014]
- Laki24.fi 2014, *Osakeyhtiö: Osakeyhtiön osakepääoma* Available at:
<<http://www.laki24.fi/yrit-osakeyhtio-osakepaaoma.html>> [16.4.2014]
- Manchanda, Karish; Muralidharan, Pushkala, 2014: *Crowdfunding: A New Paradigm in Start-Up Financing*, Global Conference on Business & Finance Proceedings 9.1: 369-374. Hilo: Institute for Business & Finance Research.
- Massolution, 2013, *2013CF Crowdfunding Industry Reports* Available at:
<http://research.crowdsourcing.org/2013cf-crowdfunding-industry-report> (not the actual study, only a link to the commercial study)
- Ministry of Finance 13.3.2014, *Raportti joukkorahoitus kyselystä*, Available at:
<http://www.vm.fi/vm/fi/04_julkaisut_ja_asiakirjat/01_julkaisut/07_rahoytusmarkkinat/20140313Raport/name.jsp> [18.4.2014]
- Ministry of Finance, 2014. *Report on Crowdfunding Survey* Available at:
<https://www.vm.fi/vm/fi/04_julkaisut_ja_asiakirjat/01_julkaisut/07_rahoytusmarkkinat/20140313Raport/name.jsp> [17.4.2014]

Ministry of Interior 2014, *Sisäministeriö käynnistää rahankeräyslainsäädännön muutostarpeiden jatkoselvityksen* Available at:
<http://www.intermin.fi/fi/ajankohtaista/uutiset/1/1/sisaministerio_kaynnistaa_rahankerayslainsaadannon_muutostarpeiden_jatkoselvityksen_50791> [17.4.2014]

Tim O'Reilly, 2005, *What is Web 2.0*
Available at
<<http://www.learnos.com/vbaxi/What%20Is%20Web%20%20point%200.pdf>>
[18.4.2014]

PRH, Patent and Registration Office 2013, *Osakeanti*, Available at:
<<http://www.prh.fi/fi/kaupparekisteri/osakeyhtio/muutokset/osakeanti.html>> [18.4.2014]

Privanet, 2014, *Invesdor ja Privanet luovat yhteisen kauppapaikan* Available at:
<<http://www.privanet.fi/fi/uutiset/invesdor-ja-privanet-luovat-yhteisen-kauppapaikan>>
[17.4.2014]

Schwiebacher A. & Larralde B. 2010. *Crowdfunding of Small Entrepreneurial Ventures* Available at:
< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1699183> [16.4.2014].

Talouselämä, 10.2.2013: *Puhelinmyyjät houkuttelevat taviksia bisnesenkeleiksi*
Available at:
<<http://www.talouselama.fi/uutiset/puhelinmyyjat+houkuttelevat+taviksia+bisnesenkeleiksi/a2168453>> [17.4.2014]

Taloussanomat, 2014, *Joukkorahoittaja voi pian käydä kauppaa osakkeillaan* Available at:
<<http://www.taloussanomat.fi/porssi/2014/01/30/joukkorahoittaja-voi-pian-kayda-kauppaa-osakkeillaan/20141476/170?pos=related>> [17.4.2014]

Venture Bonsai, 2014 *About Us* Available at:
<<https://www.venturebonsai.com/pages/about>> [17.4.2014]

Venture Bonsai, *About*, Available at : < <https://www.venturebonsai.com/pages/about>>
[18.4.2014]

Yle 21.1.2014, *Yritysten joukkorahoitus tekee tuloaan myös Suomeen*
<http://yle.fi/uutiset/startup-yritysten_joukkorahoitus_teeke_tuloaan_myos_suomeen/7024941> [18.4.2014]

Main interview questions in the field study

1. How do you see the future development of equity-based crowdfunding in Finland?
2. What things can be in the way of the development?
3. How important is it to make a clear distinction between equity-based crowdfunding and the other forms of crowdfunding, and why?
4. How important is the possible aftermarket place for the shares issued by equity-based crowdfunding? What are the possible limitations for the growth of this kind of platform, for instance the importance of redemption clauses for the companies?

Links to the Articles in 7.1.2.

Startup-yritysten joukkorahoitus tekee tuloaan myös Suomeen, YLE 21.2.2014

<http://yle.fi/uutiset/startup-yritysten_joukkorahoitus_tekee_tuloaan_myos_suomeen/7024941>

Ministeri Vapaavuori povaa joukkorahoituksen kasvua, Helsingin Sanomat 13.3.2014

<<http://www.hs.fi/talous/a1394680365566>>

Mistä rahat bisnekseen? Joukkorahoitus ja Twitter auttavat uutta yrittäjää. YLE 20.2.2014

<http://yle.fi/uutiset/mista_rahat_bisnekseen_joukkorahoitus_ja_twitter_auttavat_uutta_yrittajaa/7096768>

Joukkorahoitukselta puuttuu selkeät pelisäännöt, Turun Sanomat 7.4.2014

<<http://www.ts.fi/uutiset/talous/615744/Joukkorahoitukselta+puuttuu+selkeat+pelisaannot>>