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Ca' Foscari  
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30123 Venezia

# THE CROWDFUNDING IN THE ITALIAN MARKET

Opportunities, advantages and risks of  
collective financing

## **Supervisor**

Ch. Prof. Giovanni Vaia

## **Undergraduate**

Nicolò Stefani

Registration Number: 850710

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# INTRODUCTION

The global economic context has deeply changed in recent years. The classic conception of economy as we know it, with all its define roles where suppliers are suppliers, customers are customers and everyone has a specific task, does not exist anymore. In the modern conception of economy, all the roles are mixed, and everyone can contribute in more than a single way in the economic process. The modern economy provide the involvement of the total productivity chain to produce something that has possibility to have success in the market.

All the actors (suppliers, customers etc.) have merged in a great process that contemplate their involvement more times and with different roles. For example, the modern conception of marketing starts from the idea that customers are also the best providers, since they are the final users of the product/service, and nobody can give best advices and suggest better improvements than them (in fact, economists utilise more and more the term *prosumers*).

One of the roles they developed in recent years was that of *lenders*; in fact, the economic world has realized that they represent also a nearly infinite source of money and assets for the companies. They can realize that clients might be not only the final users of a product/service, but also the first promoters and above all, the first financers, bypassing the traditional funding instruments, too often blind in front of innovative projects.

In fact, the traditional financial institutes as banks or financial companies often refuse to grant economic support to SMEs or innovative start-ups, since they focus on short-period profits and a reliable economic return, that these companies cannot guarantee.

This lack of financial resources has often inhibited the full development of these innovative businesses, also due to their higher risk rate.

Although these rules of conduct represent the best way for the credit institute to survive and avoid giving money to everyone, (remember Lehmann Brothers?), this situation is an impediment for the development of many innovative businesses. These innovative enterprises have underlined their importance above all in latest years, presenting themselves as an alternative way of doing business in the recent period of economic

crisis. However, despite their importance is widely recognized, they still meet serious difficulties in accessing capitals and funding to promote and realize their project.

This fact brought to the search of an alternative way for fundraising, bypassing the traditional instruments, and turned the attention on a group of funders with low resources, but with minimal claims: *the crowd*. Everyday people, common people that may have few money, but do not look for personal gains (most of times) and just want to give their support for the will to be active part in a project or for personal interest. The great discover was to understand that pushing on people's interests and their will to be protagonist, even with a little part, can unlock a huge potential of financial sources. This innovative way of fundraising, is called *crowdfunding*. It works through online platforms, to reach as many people as possible.

It represented in last periods an effective fundraising way, not only for businesses, but also for non-profit projects and money lending. People act to support a project that reflect a passion (sport, cinema or others) or trying to enter in an active business (start-ups) and they don't have all the bureaucracy and requirements of banks and other institutes.

Crowdfunding is considered as a perfect integration of other funding instruments (it is not so developed to be considered an *alternative*) and is a reality present in many developed countries.

The goal of this thesis is to present a complete research about this discipline, understanding the differences between the different types of crowdfunding platforms, presenting the advantages, the risks and try to comprehend the full potential of this discipline in the Italian market.

The Italian context of crowdfunding is the central argument of this thesis, since it aims to offer a complete explanation of the rules governing the crowdfunding world, the state of art about projects and the general perception Italians have about crowdfunding, with a research made on a small group of people.

The first chapter of this elaborate is about the origins of crowdfunding and its story, giving an explanation about where and when it started, an above all, the motivations behind its success. Crowdfunding might appear as a modern discipline, however its origins are more ancient than anyone can imagine. The comprehension of the motivations behind the funding can reveal itself as a focus key to understand not only the successes obtained, but to concentrate even on possible limits that still inhibit the

full development. The focus will be also on the economic context that brought to this situation, with a comparison also between crowdfunding and the traditional moneylenders for SMEs and start-ups (angel investors and venture capital providers).

The second chapter analyses the differences between the different types of crowdfunding and studies the advantages and risks a proponent might encounter in promoting a project on an online platform. Furthermore, it explains how to make a successful crowdfunding campaign, with all the detailed steps to follow in order to meet success.

The third chapter offers a complete excursus on the main regulations among the EU and its member states, with a central focus on the biggest ones (above all Germany and France). The main defy is trying to understand the motivations that block the issue of common norms in terms of crowdfunding, and to analyse the differences between the most developed member states and Italy. In analysing the different legislations, readers might be surprised in understanding that Italian norms are at the forefront respect to those of other states (even USA), and that is the only country to have a complete legislation about equity crowdfunding (one of the main types.)

The fourth chapter focus on the central argument of this thesis: the crowdfunding in the Italian market. In the first part, it provides a complete explanation on the state of art of the different crowdfunding types, and on how they contribute to the development and success of this discipline.

The second part is all about the legislation surrounding this innovative discipline, starting with the laws from which the actual norms took inspiration.

There is also a final part about the two Decree of Growth emanated by the Italian government in 2012 and 2015, concerning the regulation of equity crowdfunding in the economic market. These decrees are important because they regulate two new economic figures of the Italian legislation, the innovative start-up and the innovative SME. The last chapter focuses about a detailed analysis on the entire market of crowdfunding in Italy. The goal is to analyse the finished projects, for every category, in order to understand the categories that meet the highest appreciation from the users.

The conclusions focuses about the ways to unlock the potential of crowdfunding in Italy, where many steps have been made, but many others remain to be done. In particular, there will be a lot of attention in the conclusions, to what still hampers the full development of the crowdfunding market, and the ways to overcome these obstacles.



## CHAPTER ONE

# 1.THE CAPITAL RAISING THROUGH “CROWDFUNDING”

In recent years, the economic world has been characterised by the growing affirmation of crowdfunding as a truly effective way for small enterprises, start-ups, makers and non-profit organization to raise capital overpassing the traditional loan and funding models.

Although the literature and the researches on this argument are still sporadic and not so complete as in most economy fields (at least in Italy), the intention of this first chapter is to offer a first look at how this phenomenon started and evolved through years, correlating it at the traditional capital raising models and the modern economy background.

## 1.1 History and definition

Crowdfunding is still an emergent field of study for academies, so is not possible to give a complete and approved definition, since there are still debates on which policies should be included in “crowdfunding” and which not, or what features a campaign must have to be defined as a “crowdfunding campaign”.

Since it is an emergent field of study for economy scholars, a complete and formal definition could be arbitrarily limiting. We can use the words of Schwiembacher and Larralde to define crowdfunding as *“an open call, essentially through the Internet, for the provision of financial resources, either in form of donation or in exchange for some form of reward and/or voting rights in order to support initiatives for specific purposes”*.<sup>1</sup>

The inventor of the word “crowdfunding” was Michael Sullivan, who coined this word in 2006, with the launch of his platform Fundavlog.

Fundavlog was an online platform that, in the intentions of the author, should has been

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<sup>1</sup> Schwiembacher and Larralde, *Crowdfunding of small entrepreneurial ventures*, Oxford University press 2010 , p.4

use as a collection point for for videoblog-related projects and events, with a fundraising functionality. The dream of Sullivan was to build a platform that could be entirely financed with donations, leveraging on common interest sharing and the connectivity of the web.

Sullivan himself described it as a "*project based on reciprocity, transparency, shared interests and, above all, funding from the crowd*,"<sup>2</sup>

The project failed, but the word "crowdfunding" and its meaning remained, and some years later, the launch of *Kickstarter* and other similar platform, contributes to their definitive consolidation.

Although this term seems to us to be of recent use, probably due to the fact that is a new term and to its straight connection with social media, the first real project ever recognize of being realized by "collective financing" dates back more than a hundred years ago.

We are talking about the creation of the Statue of Liberty, made in 1884, when terms like "collective financing" and "crowdfunding" were still totally unknown.

In fact, when the Statue arrived in New York in 1885, the American Committee allocated only a part of the funds necessary to build the pedestal, and works could not start.

The American Committee started to raise funds asking for public donations to the American people, but the money raised was still not sufficient. The situation drastically changed when Joseph Pulitzer, the famous journalist, started a public initiative in his newspaper (the *World*): he published an announcement where he declared his intention to raise \$ 100,000 with a public collection, and that he would have personally thanked every donor writing the name on his newspaper.

After only 5 months, the collection raised the incredible amount of \$ 102,000, given by 120,000 different donors, which had, for the most part, donates less than a dollar.

What Pulitzer did was to spur the citizens, leveraging on their sense of belonging to the community and on the moral value of the donations for a great purpose.

In effect, if there had been the *Web*, the phenomenon would have been classified as "*crowdfunding*".

A recent example of a successful crowdfunding policy has been the 2008 elections for the White House where president Obama raised \$ 600 million thanks to crowdfunding; in fact, while his opponent McCain totally counted only on the funds of his party, Obama started a collective campaign made of small donations by many people.

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<sup>2</sup> Enzo Villani, *Crowdfunding, the new buzzword in capital formation*, Cornell University 2013, p. 3

In this way, he was able to collect the record amount of \$ 600 million, and the most part came from sub - \$ 1,000 donations (the average amount was 86 dollars).

The Obama campaign leveraged on the message of Hope and Change that the senator of Illinois represented. Economic crisis had just started, and the vision of an innovative, first Afro-American president was seen as a potential new beginning.

In addition, in this case, promoters relied on the sense of belonging to a common political view, and to the moral value of donations, even without rewards.

This recent method of collective financing then, presents distinctive features that differentiate it from the most common methods of capital raising:

- The utilization (for the majority of cases) of online platform.
- The absence, in most cases, of intermediaries, except for the platform itself.
- The capital raising through many different investors and small amounts of money.
- The absence, in many cases, of a financial return.

Crowdfunding is a method that operates overcoming the traditional intermediators of banks and lenders, where capital passes directly from the hands of investors to those of entrepreneurs. This method actually obtains a great consensus precisely for these characteristics; it is a period where banks almost completely close the concessions of credit, and there is a growing sense of distrust towards financial institutions, considered responsible for the economic crisis. Even venture capitalist and angel investors, who usually supported the initiatives of start-ups, started to restrain their funding, and asked for increasingly severer requirements and warranties.

The result of this situation is the insertion of crowdfunding as a new funding discipline, perceived as good, simple and honest because you can rapport with real people, in contrast with the cold and artificial world of finance.

The paradox is that people became more disposed to renounce to granted, professional and yielding safe investments, to embrace a new policy made of trust, absence of material rewards and investments to high-risk start-ups without the warranty of a return. However, the rise of crowdfunding is clear and undeniable; from 2008/2009,

which can be considered as its starting period, to 2013 as example, the online fundraising campaigns passed from an amount of \$500 million per year, to an amount of \$ 6.1 billion per year. Its grand total has increased tenfold in only five years, and it continues to growth. In 2014 capital raising through crowdfunding reached \$ 16 billion, with more than 1000 new platforms formed, and recent analysis say that in 2015 it touched the incredible amount of 34.4 billion dollars. The strong growth in 2014 was due in part to the rise of Asia as a great crowdfunding region. Asian crowdfunding volumes grew by 320 percent, until the \$3.4 billion raised. This data puts the Asian region ahead of Europe (\$3.26 billion) in the raising of collective financing. North America continued to lead the world of crowdfunding, growing by 145 percent and raising a total of \$9.46 billion in 2014. Business categories remained as the most popular crowdfunding collectors, raising 6.7 Billion in 2014, which represents 41.3 percent of total crowdfunding volume.

Despite these data represent clearly an amount not comparable to those raised by traditional financial instruments, the growth is stunning.

Looking at the Italian market, despite it might seems unusual, Italy has made innovative policies for crowdfunding. It was the first country to issue a specific regulation for equity crowdfunding, and this discipline, in our country seems very lively, notwithstanding the difficulties in providing financial resources. The European Commission itself has never hidden its interest for this form of funding that was defined as “fundamental”. The E.C. goal is to promote a harmonisation of European legislations, to overpass the limits encountered by platforms that want to operate abroad. The reasons are that is helpful not only in crisis periods, but also to create an “*alternative banking system*”, overcoming the limits of traditional banking processes.<sup>3</sup>

Crowdfunding is useful not only because it provides alternative funding and nearly complete transparency, but also because ideas are seen with the “consumers “eye”, which might better understand their potential. So, can we suppose that this instrument is going to supersede the traditional loan models? It is still too early to say it safely, but this trend is visible to everyone, and we can affirm without doubts that traditional fundraising instruments are going to lose a huge portion of market in next years.

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<sup>3</sup> Piattelli U. ‘*Il crowdfunding in italia: una regolamentazione all’avanguardia o un’occasione mancata?*’, p.8, Giappichelli, 2013.



## 1.2 The economic context

As explained before, the origin of crowdfunding as we know it started in 2008/2009, concurrently with the beginning of the economic crisis.

Observing the growth of this lending instrument, we can affirm that there were three main factors that contributed to the creation of a prosperous environment for crowdfunding.

- Economic crisis and lack of funding
- The growing importance of start-ups and SMEs for the economy
- Affirmation of theories regarding the “*wisdom of crowd*” and “*the long tale*”

### 1.2.1 Economic crisis and lack of funding

The bankruptcy of Lehmann Brothers in 2008 is traditionally considered like the spark that switch on the fire of the actual economic crisis. Lehmann Brothers was one of the bigger and safer investment banks in USA. Between 1994 and 2007 the net revenues of the bank grew by \$ 2.7 billion to 19 billion and staff from about 8,500 units to 28,000 units. In the following year, 2008 began the decline for the bank. In the second quarter, he recorded, for the first time since 1994, a loss of \$ 2.8 billion<sup>4</sup>.

This loss and the lack of liquidity were due mainly to its exposition to subprime loans, which remains for great parts, unpaid. Lehmann was obliged to sell parts of its assets to obtain liquidity, and registered strong losses. Prestigious banks like Barclays and Bank of America moved trying to save Lehmann, but they relinquished due to lack of warranties from American Government. Fear began to spread in the financial markets, and on 15 September 2008, the bank’s shares collapsed by 80% of their value, and the Dow Jones index that day sank of 500 points, the greatest fall after the 09/11/2011. This moment is universally recognised as the start of the economic crisis. Banks and credit

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<sup>4</sup> Details at <http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp>

institutions closed their funding and started to ask more and more warranties after moving on the market. The economic crisis was a terrible blow for young entrepreneurs, start-ups and SMEs, (today the main crowdfunding users) which were hardly affected. The small enterprises in fact are the most vulnerable to crisis and recession periods, because :

- They are almost unable to diversify their activities.
- They possess a weaker financial structure.
- They depend for great part on external credit, having few financial options.

Since they were small and with low financial power, they faced growing delays in obtaining earnings; this, together with the slump in goods demand was the reason that brought to a lack of liquidity. In Italy for example, in 2008, 25% of SMEs and start-ups experimented insolvency due to these factors.<sup>5</sup> Tom Vanacker, in his book *“Effect of crisis on start-ups”*, said that in EU, the start-ups funded in the years of crisis faced a downturn of about 27% in bank funding<sup>6</sup>. This stagnation was also due to the inability of banks to access capital, due to the general sense of fear that pervaded the economic markets. States implemented several policies to re-vitalise banks and to strengthen their balance sheets, in order to provide credit for small and innovative enterprises. They also extended guarantees and tried to facilitate the capital access. However, these measures did not serve almost for anything, and credit access remained difficult for most of these companies. Small enterprises and start-ups started to look around for alternative source of finance (self-financing, acquisition, utilization of reserves), since the economic crisis affected also the two major alternatives to bank financing: venture capitals and angel investors. Venture capital are specialized private equity investors that provide resources for innovative firms in the early stage of life. Angel investors are former or active business owners, managers or independent professionals who want to acquire a risky company that operates in a business that is often innovative, but with high-expected return.

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<sup>5</sup> Zecchini S. *“The impact of global crisis on SMEs and Entrepreneurship financing and policy response”*, p.8, OECD 2009.

<sup>6</sup> Vanacker T, *“Effect of crisis on start-ups”*, p. 12, Paper, 2013

## **1.2.2 The growing importance of Start-ups and SMEs for the economy**

We are realizing, every day more, that economy is not only based on big companies and great brands and names. Of course, the big enterprises attract jobs, make investments, and bring prestige to the place where they are located. Nevertheless, they are not the economy's backbone. Looking at the worldwide economy, we observe that SMEs represent about 95% of all companies. Considering the OECD data, SMEs represent about 95% of all companies, and employ about 70% of the workforce. On average, always following the OECD data, there are about 31 SME's every 1000 people.

The Italian economy has always been characterized by the predominance of small businesses. Nearly 40 percent of the workforce in the private sector is employed in companies that generate annual revenues less than 2.5 million euro. For the other EU-countries, this rate hovers between 12 and 17 percent.

The other factor is the growing birth of start-ups the world faced during the past years. New and innovative firms started to raise not only in Silicon Valley, but also in other USA cities (Austin, New York and others), and in different countries across the world.

In particular, Germany, Israel and South Korea have implemented a strong and affirmed start-up market, and even Italy is moving to help this business, with tax breaks, incentives and funding.

Last year, EU started the "SME Instrument", a new system of 2.8 billion euro financing from the European Commission, managed by the Executive Agency for Small and Medium Enterprises (EASME) which aims to support economic growth, providing enterprises support, mentorship and up to 3 million euro to finance new businesses.

Even Italy is facing a growing trend for start-ups, despite the continuing difficulties in obtaining credit. In 2013 there was an overall investment of € 52 million in seed capital for start-ups with 66 operations: + 16% compared to 2012 (57 transactions) and + 53% compared to 2011 (43 operations). In 2014 there were 2716 innovative registered start-ups (in expansion respect to the 1227 in 2013).

Looking at the sectors, the ICT monopolizes the interest of investors in venture capital with about 50% of investments in last 3 years , followed by the industrial products (8%) and foodstuffs (5%). Although the start-ups faced also a decline in average investments, and many of them remain small and unable to grow as they could, there is a cautious

optimism among scholars, considering that only few years ago Italy didn't have a its own start-ups market.

The two factors explained above contributed to the development of a favourable environment for crowdfunding. The lack of funding by traditional investors, and the importance of SMEs and start-ups for economy, brought to the creation of alternative way of fundraising, driven not only by the mere prospective of profit.

### **1.2.3 The affirmation of theories like the “wisdom of crowd” and “the long tale”**

In the first year of this century, the essayist Chris Anderson developed a new economic model, based on the potential of what he called “the long tail” of the products.

His deduction was relatively simple: if we draw a graphic of a company's sales, we observe that the first part of the graphic is occupied by a limited quantity of “best-sellers” articles, while the second part is a long decreasing line of niche products, unknown to the major part of the public and reserved only to few lovers. This line seems to have no end, and the number of niche products is extremely higher than that of “best-sellers” product.

The long tail has implications designed to influence the culture and politics. Where the costs of warehousing and distribution are high, retailers sold only the most popular products; where on the contrary, the long tail works, tastes of minorities are satisfied and individuals have more choice<sup>7</sup>. In situations where the popularity is determined by the lowest common denominator, a long-tail model can generate an improvement in the cultural level of society. In *Graphic 1.1* can observe an example of the “long tail” applied to the DVD industry.

The blue part of the graphic regards the newest and most popular film, the “blockbusters” which have the biggest popularity.

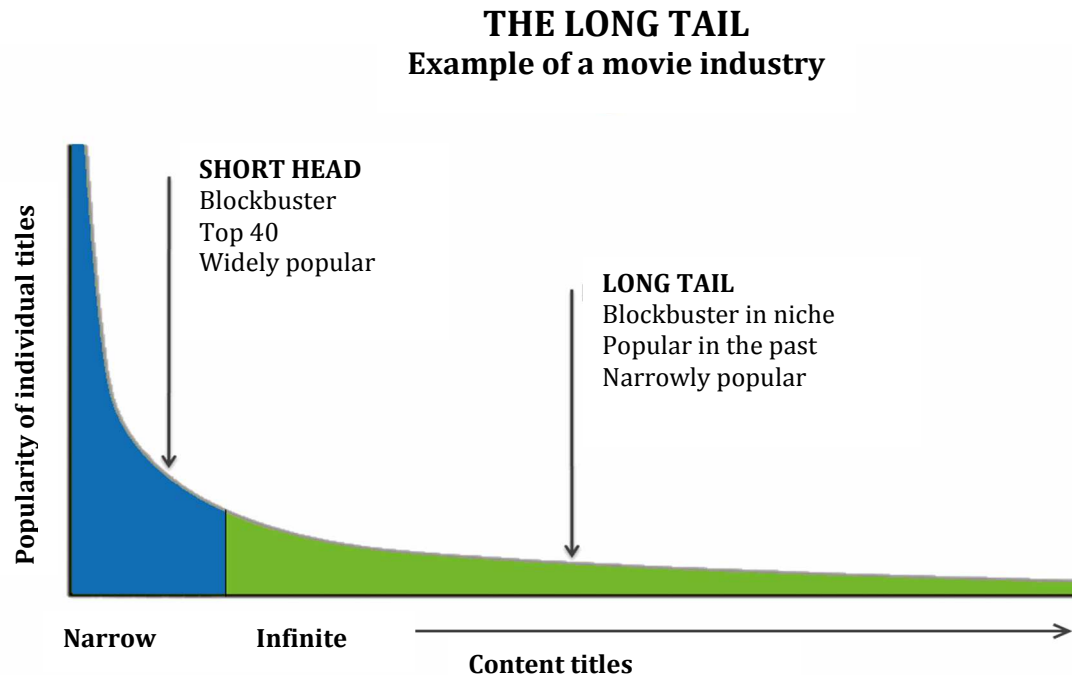
This part, that contributes for the greatest part of the sales is, however, relatively short. The green part regards all the niche or old movies, which have a narrow circle of fan or

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<sup>7</sup> For further details, read the full Chris Anderson's article at <http://www.thelongtail.com/about.html>

that were popular in the past; as we can see, the green part is constantly decreasing, but it seems to have no end, because it refers to the vast majority of the products

**Graphic 1.1**



*Source: Anderson, C. "The Long Tail: Why the Future of Business is Selling Less of More". (2006), New York. Hyperion.*

Of course, in the past, companies faced fixed location costs and had a limited space, so they obviously concentrated on the "best-sellers" products.

In the past the golden rule was "80-20", that is the 20% of products contributes to the 80% of returns, and of course niche products were present in shops in limited quantity. Amazon was between the first companies to observe that, without the costs of a physical place, and with the limitless space of web, the choice of books could have been nearly infinity. It could have included also the books (but also movies and more) absent in a classic library, because of their few sales.

The surprise they have was amazing: the market of the long tail, made on web, generates practically the same amount of returns of the best-sellers market.

This happens because, even if a product has few supporters, there are many products. The sum of all this niche products generates sales comparable with the best-sellers ones.

The knowledge has changed too; as we saw, people can easily gain information so they are able to know immediately the goodness of an unknown product, or when something almost unfamiliar is available to purchase.

Television represents an excellent example of long tail. TV stations have limited space, so the cost of acquisition of each space is high; stations therefore choose programs that provide maximum listening. However, with the growth in the number of TV stations and with the distribution of programs on digital channels, the choice of TV programs increases and with it the cultural diversification.

Another theory that is the basic of crowdfunding is the “*wisdom of crowd*”. In 2005 James Surowiecki, an American journalist wrote a book called “The Wisdom of the Crowds”, in which he renewed and validated this old economic theory. In this book, he explained that groups are always better in decision-making respect to a single person; as we say, “*unity is strength*”.

The first person to think about this topic was Francis Galton, an English naturalist, who observed this phenomenon in a game at a country fair. The game was to guess the exactly weight of an ox. When the contest ended, he asked for all the tickets with the weights written by the participants. Surprisingly, studying them, he discovered that the average weight of the “crowd” was 1198 pounds, and the real one 1207. The “crowd” almost guess the real weight, doing much better than every single person did. James Surowiecki wrote this experiment in his book, and arranged four rules that, for him, everyone should respect for the effectiveness of this theory<sup>8</sup>:

- ***Diversity of opinion***: each person must have a different opinion.
- ***Independence***: others must not influence the views of the people.
- ***Decentralization***: no one should be able to drive decisions from above.
- ***Aggregation***: the opinions must be able to be aggregated in order to obtain a final result.

The characteristics are of course obvious to give a sense to this theory. There is no reason to address the crowd if everyone has the same opinion. Conversely, is the diversity of opinion that gives value to the entire story.

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<sup>8</sup> Data from James Surowiecki, *The Wisdom of the Crowds*, Anchor Books 2005

Independence is related with the first feature; no one might be influenced by any other. This is not always possible, as demonstrated by the existence of the so-called “opinion leaders” (bloggers, icons and others), which have a strong power in influencing the crowd’s thought. To better explain it, we might say that every person *must have the possibility* to think alone and have his own opinion.

The third feature, decentralisation, is again related with the second one, and the discussion made above is valid for it. Decentralisation is decisive because everyone could have his thought without influences. Like explained above, influences don’t signify that the choice is driven and obliged, but simply the advices a person collect are more favourable to a direction respect another. Decentralisation, explained better, means that nobody has to say “you have to do like me” and the power to force the choice; it’s a theory valid in the real world, because are people who choose to follow opinion leader, without forcing. Aggregation of course is the natural conclusion for every collection of ideas. This theory perfectly applies to crowdfunding, where the contribution of the “crowd” is essential for the success of the projects. People might help the creators not only by providing them financial assistance, but also giving advices in management, design, building and others. Projects, to have success, have to be built by the crowd. It is unthinkable to make a project only by themselves, counting on others only for funding.

The “wisdom of the crowds” theory is universally recognized as valid in the economic world. The four circumstances described above contributed in a decisive way to the development of a favourable economic environment for the growth of crowdfunding.

Surowiecki himself, however, acknowledges in his essay that there are cases in which the theory of the wisdom of the crowd fails and the crowd gives a wrong judgment. This happens when people influence each other and begin to think in a similar manner instead of developing their own opinions independently.

Probably, without these four situations crowdfunding would have never been born.

Without the economic crisis, investors probably would have continued to lend money, and SMEs and start-ups maybe would not face the difficulties they find nowadays to have capital.

Who knows if, without the diffusion of long tail and wisdom of crowd theory, and they discover by market operators, crowdfunding will have growth so fast; maybe, if there has been a general mistrust of the crowd’s opinions, or long tail had been ignored, market would be full of stand-alone operators, which couldn’t hope in anybody help.

## 1.3 The social context and the psychology

### 1.3.1 The Web 2.0 and social cooperation

Of course, the affirmation through years of Web 2.0 has given a key input for the development of crowdfunding.

Web 2.0 is a term referred to the next evolution of Web that allows uses to interact with other people, to communicate in every part of the world and to share contents like photos, videos and much more.

Web 2.0 is based on the people's will of being protagonists and receive other's appreciation. The increasing desire to communicate, to inform others and know what they think has drastically increased the easiness wherewith we find information on every argument we are looking for.

A climate of collaboration has been always growing since the invention of interest-sharing platforms (Facebook, Tumblr, Pinterest, but also blogs and forums); we can just think about marketing campaigns like Coca-Cola "Share Happiness" or the "Ice Bucket Challenge". Did we obtain monetary gains in participating through these campaigns? The answer is not: we made them just to obtain friends' appreciation, or to be protagonists of something that was "trendy". We made them to contribute to their diffusion, to collaborate (unawares) with others to their success.

The same philosophy, we can say, might apply to crowdfunding: we want to participate not just to earn a monetary return, but maybe only because we have the same passions of the creators. We might finance them just because they want to realize what their childhood-dream was, or because we share the values of their projects.

We are passing from the phase DIY (Do It Yourself) to the phase of DYT (Do It Together). We can share our ideas, our projects and obtain not only funds, but also advices, moral support, indications, in a word *collaboration*. Times when we built a project by our own have passed; now to success we have to use all the competences and help we can obtain, and these competences and helps are spread worldwide, in every person.

These ideas find their ideal collocation in an era where we can share and acquire information with extreme facility. We are able to show all the details of our projects at nearly zero costs, and we can easily measure the return in interests observing the visits to the site, the "likes" on Facebook, the comments and shares.



Web 2.0 and social media (beware, not just *social networks*) are fundamental for the growth of crowdfunding, and probably without them it would not even ever have existed.

### 1.3.2 Communal reinforcement and social proof

Other social movements that are essential for Crowdfunding are the communal reinforcement and the social proof. The *communal reinforcement* is a social mechanism that transform an assertion in a strong and shared belief, even if there are not strong evidences to prove it. This explains why some convictions sediment in societies even if they are, originally, just rumours.

Chris E. Stout reports an example in the book, "*The Psychology of Terrorism: Theoretical Understanding and perspectives*"<sup>9</sup>: the author writes that there are no strong reasons that push an individual to take a sacrifice individually, but the attitude changes dramatically when he's placed in a group where such thoughts are shared. The conviction is that a theory, a project, or an idea is correct simply because there are many people that believes in it. The everyman is pushed to believe in it simply because his group sustain the theory.

The communal reinforcement is a strong mechanism of persuasion, useful to pass ideas into a crowd, taking some people as "leaders" who influence the others. This fact can be find also in crowdfunding projects. A man who wants to give money to a campaign is more inclined to help the one with more followers or positive comments.

Maybe he is not the campaign he would have chosen alone, but he trusts the feedback of the "crowd".

A similar mechanism is the *social proof*; while communal reinforcement regards beliefs or ideas, social proof is about behaviours.

The idea is that, when we see that a behaviour is dominant and considered as correct by our group, we soon adapt and perform that conduct. An effective example come from the Bandura's research on fears:<sup>10</sup> children who are scared by dark are able to win their dreads when they see other children enter in a dark room. Another example of that

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<sup>9</sup> Stout E.C, "*The Psychology of Terrorism:Theoretical Understanding and perspectives*", p. 22, O.T.B Company, 2002

<sup>10</sup> Bandura A. e Menlove, F. L. (1968), "Factors determining vicarious extinction of avoidance behavior through symbolic modeling", *Journal of Personality and Social Psychology*, Vol 8(2, Pt.1)

research, always about children is that, if dogs scare them, they surpass this fear if they see other children playing with dogs. Why does it happen? Because they, as member of a “group” are influenced by the dominant behaviour, and win their frights to be accepted. Children are, of course, the easiest creatures to influence, but also adults are prone to follow the crowd’s behaviour. An example come from the research of Latané and Darley<sup>11</sup>.

They showed that, in case of call for help by a man, the more there are, the fewest are the probabilities that someone help him. Why? Because if the dominant conduct is not to help him, most of the persons adapt to it, probably because they think that someone else already called for help.

This mechanism can influence also crowdfunding campaigns. For example, if a creator, who’s reluctant to crowdfunding, discovers that many others acquaintances have chosen that way, he will probably do the same.

In the same way, if a lender, reluctant to crowdfunding, finds that several colleagues used that, probably he will follow that way.

The strength of social proof also varies across different cultures. For instance, studies have shown that subjects in collectivist cultures conform to others' social proof more than those in individualist cultures.<sup>12</sup>

These social mechanisms are an important base for crowdfunding projects that, without a global acceptance by the crowd, probably will never start.

Those two social norms are important because they provide safety on people, give an instrument to be accepted and considered as part of a group. Maybe, after reading this thesis, you might explore some crowdfunding platforms, and become confidential with this discipline; this because it explains you that crowdfunding is a world-accepted instrument.

This might start a communal reinforcement process, adapting your behaviour in a favourable way to a subject you had never watched.

In the next paragraph, this thesis analyses those that can be defined as the “ancestor” of crowdfunding: microfinance, microcredit and crowdsourcing, with a brief analysis of them and their evolution until the birth of online collective fundraising.

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<sup>11</sup> Latané e Darley J. (1970), “The unresponsive bystander: Why doesn't he help?”, Appleton-Century Crofts

<sup>12</sup> Bandura A. e Menlove, F. L. (1968), “Factors determining vicarious extinction of avoidance behavior through symbolic modeling”, *Journal of Personality and Social Psychology*, Vol 8(2, Pt.2)

## 1.4 The “fathers” of Crowdfunding

In this paragraph, this thesis analyses three disciplines that can be considered the “ancestors” of crowdfunding. We can easily say that it took inspiration from them, and probably without their affirmation, it would never be born.

The three disciplines are:

- Crowdsourcing
- Microfinance and microcredit

Microfinance and microcredit are obviously related each other, since they are both destined to microenterprises; crowdsourcing is similar to crowdfunding, because crowdfunding is also defined as a “crowdsourcing of financing”.

Although the first two can be considered as similar, there are some differences that is opportune to analyse. In particular, this analysis focus on their features and their similitudes with crowdfunding.

### 1.4.1 Crowdsourcing

Crowdsourcing is a business model in which a company or institution relies on the design, construction or development of a project, subject or an indeterminate idea to external people, not previously organized<sup>13</sup>. This process is encouraged by the tools that provides the web, because operators usually work in an online community specifically created for the project. Usually the mechanism of the open call is made available through the portals on the network Internet, above all through a company site or its pages on the social media.

Hearing this definition, a person could think that crowdsourcing is nothing but outsourcing, maybe involving specific projects instead of entire activities; however,

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<sup>13</sup> David Bratvold, definition and articles at <http://dailycrowdsource.com/training/crowdsourcing/what-is-crowdsourcing>

despite they can appear as similar, there are some differences we have to take into consideration to better understand this process and not confuse it with outsourcing:

- Crowdsourcing is global, not confined on specific offices, made above all through the Web, using a virtual and not physical space.
- Workers are admirers of the company, or simple amateurs who want to participate to an innovative project, rather than firm's employees.
- Workforce is flexible (someone can work to the project in Japan in a moment, while someone else can continue the work from USA in another moment), and base on "crowd" rather than on specialists.
- There are no fixed or facility costs.

The term "Crowdsourcing" was coined by the American journalist Jeff Howe in 2006, in an article in which he defined the new-born discipline as "*a business model in which a company or an institution requires the development of a project, a service or a product to a distributed set of people not already organized in a team*"<sup>14</sup>.

Despite the term is very recent, examples of crowdsourcing can be found exploring history.

For example, in the Fifties, just to mention an Italian example, Enrico Mattei created a context to find the symbol of his company. The "dog with six legs", which became the symbol of ENI, won the competition.

This can be considered as one of the first example of Italian crowdsourcing, in fact Mattei asked to non-professionals people, outsourcing the creativity he wasn't able to find alone.

Crowdfunding can be seen as an extension of the intelligence and abilities of the company, which involves also its stakeholders and other amateurs in collaborating for a project.

A modern example of crowdsourcing, kept on a collective platform, is Wikipedia; the authors simply crowdsourced the knowledge.

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<sup>14</sup> Jeff Howe, *The rise of crowdsourcing*, Wired 2006

Jeff Howe, in his book, described the crowdsourcing as an application of the Open Source Software to other sectors; as we know, in the OSS everyone can give his contribution to improve them. This is a similar concept, applied in other fields, where all people can help to the success of a project, putting their skills available.

Crowdsourcing, just like crowdfunding is a relatively new-born discipline, so a perfect definition is still not available.

Since now, scholars have analysed the phenomenon focusing on the type of community (*Kozinets, 2008*), or on the governance structures (*Feller 2009*), but nearly nobody has explored it in its complete potential.

Given the difficulties of definition and categorization, we face the need to identify the key dimensions to present a framework of the phenomenon, to identify those activities that can be classified as *Crowdsourcing*.

Identifying and studying some analysis of crowdsourcing made by the leading scholars of the field (Howe, Bucheler, Leimester and Kleeman) there are some key points that emerge in every testing, and can be used to draw a framework of characteristics of a real crowdsourcing campaign:

- ***A well-defined crowd***, with specific and particular features, who are useful for the projects.
- ***An incentive to encourage the crowd***, that could be both monetary or abstracted, like a monetary prize, the opportunity to develop creative skills, the simple fun, altruism, share of knowledge.
- ***The crowdsourcers***, which are the people who promote and follow the campaign in name of the company.
- ***The creation of a participative process***, in which people are pushed to work together, to give an advantage compared to the companies that “don’t know how to use crowdsourcing” (*Malone et al., 2010*).
- ***An open call on a platform***, to spread the knowledge of the project and the existence of a specific online platform to develop it.

In Italy, although it is also a niche process, crowdsourcing starts to take hold. Successful platforms like Starbytes (to create a website), or Usefarm (to create spot and web series) are the proof that it is starting to raise also in our country.

Crowdfunding is usually considered as a derivative of crowdsourcing and many analyses describe it as a model of crowdsourcing based on the externalisation of fundraising; in fact, crowdfunding has all the features to be considered like a true crowdsourcing campaign, which is simply based on fundraising instead of creative knowledge.

The other fields we are going to analyse are *microcredit* and *microfinance*, which share with crowdfunding the no-profit goal (in many cases) and the fact they are directed to help new businesses, above all in the Third World.

#### **1.4.2 Microfinance and Microcredit**

These two disciplines have an important thing in common with Crowdfunding: they are both disposed for borrowers who are not able to receive funding from traditional institutions because they do not have the necessary warranties.

In fact, these institutions lend money without having a real assurance of return, because their borrowers present a high financial risk.

With the term “*Microfinance*” we refer to a set of financial services (like Micro-assurance, Micro-leasing and naturally, Microcredit) offered by specialized moneylenders to people that are recognized as “insolvent”.

For the fact that they are provided to insolvent people, these financial services could have a very high interest rate (the world average tax is 37%). These high rates are unavoidable to cover the high financial risk; in fact, they run a great risk, and often they are not even able to confirm the identity of the borrowers.

However, a large part of microfinance providers started as non-profit organizations and operated with state funds or private financing.

In every case, we do not have to forget that Microfinance is usually adopted to help starting new businesses in the Third World countries, where there is a high instability from both the economical and the political point of view.

Although it started to raise in recent years, Microfinance is a very old matter. One of its first fathers was Jonathan Swift, the author of “*The Gulliver’s travels*”. In 1730, when

Ireland was wounded by famine and poverty, he lent money from his own to many compatriots who were considered unreliable.

His great surprise was to discover that, despite their being classified as insolvent, they repaid with extreme punctuality the loans.

The reason was that they were so plenty of gratitude that the first thought was to repay the debt.

While Microfinance refers to all an ensemble of financial services, Microcredit specifically refers to *“small amount of credit aimed to the start-ups of a business or to meet emergency expenses, towards vulnerable people in social and economic terms, which are generally excluded from the formal financial sector”<sup>15</sup>*.

Microcredit is then, the branch of microfinance that specifically refers to loans.

Until 1976, official year of birth for Microcredit, the world population could be divided into two broad categories: the “bankable” and the “non-bankable”, which are the most.

Only recently, a new strategy was implemented, to meet their need. Since it focuses on very small loans, it was called *“Microcredit”*.

One of the main principles of Microcredit is to give a preferential access to women, which are considered more reliable than men, especially in underdeveloped countries.

In Italy these two disciplines are present and used, although their utilization is nowadays too much fragmented, and a lot can be made to improve it.

Microcredit is regulated by the National Committee for Microcredit, established in 2006. Microfinance and microcredit, with the rise of economic crisis start to be seen as valuable alternatives to the traditional way of funding (just like Crowdfunding), and their development, according to many scholars, is only at the beginning..

In Italy microcredit and microfinance are truly used, and also biggest companies are starting to utilize them for promotion to low-income customers<sup>16</sup>.

An example is the initiative started in 2014 by Poste Italiane, called “Poste Italiane Loans for Students”.

With that, families can ask for small loans to pay the studies of their sons, and repay them in three years with a low interest rate. Another important campaign, that underlines the importance of microfinance for women is the one launched in 2013, called “Restart from you. Beautiful deed to be woman”.

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<sup>15</sup> Renee Loth, *Women entrepreneurs*, Boston Globe 2002

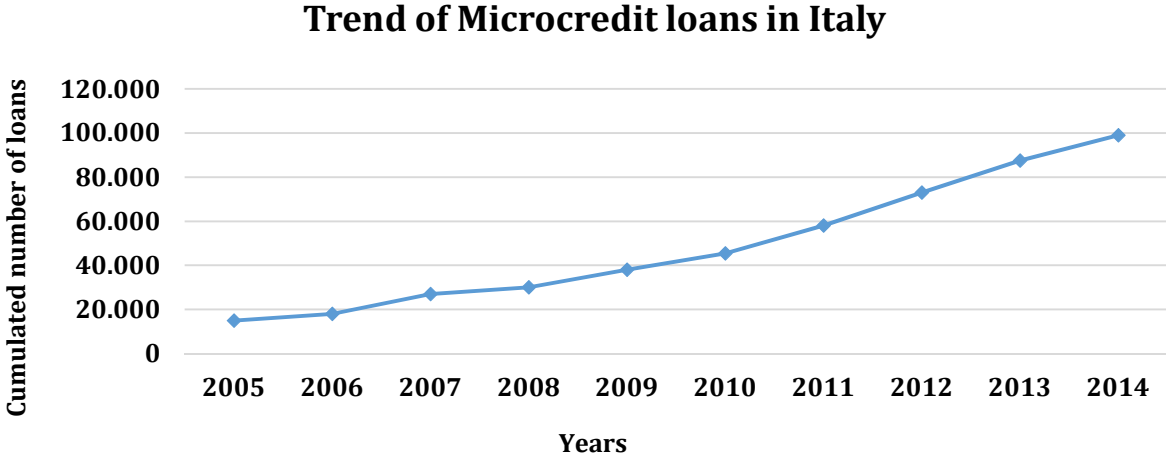
<sup>16</sup> Borgomeo C. *“Microcredito sociale ed imprenditoriale”*, p. 10, Paper, 2014

The project, made with the support of the Labour Minister, provides facilitated loans for women that want to start their own business.

Microcredit is also an instrument used to give funding to South Italy, with more than 100 new information desks giving directives for self-employment.

In the *Graphic 1.2* is possible to see, just to have an idea, the growing trend of Italian microcredit loans.

**Graphic 1.2**



*Source: C.Borgomeo & co."9<sup>th</sup> report on Microcredit in Italy", 2009*

It is easy to observe that during the 2010-2013 period the number of beneficiaries of microcredit in Italy almost doubled. It is interesting to notice that microcredit (and microfinance) market seemed to be not affected by the economic crisis of 2008, but continued to grow.

The Italian Labour Minister estimates that from 2007 to 2014 the market grew up from less than 10 million (2007) to more than 100 million (2014).<sup>17</sup> This growth is a good signal in an environment that depends a lot on banks and where half of the country nearly has the economy of a developing country.

Microcredit can be an effective policy for Italian enterprises that want to start businesses in countries like Africa or Latin America.

<sup>17</sup> Borgomeo C. "Microcredito sociale ed imprenditoriale", p. 59, Paper, 2014



## 1.5 The traditional moneylenders for start-ups

This chapter analyses the other fundraising models that are traditionally used by start-ups to raise capital and funds. Since these methods still consist in the major part of fundraised capital by SMEs and start-ups, crowdfunding is growing much faster than they are. Whereas there was a brief explanation of U.S market above, this one will focus, as promised, on the Italian market

### 1.5.1 Private equity and Venture capital

The European Private Equity & Venture Capital Association (E.V.C.A) gives the following definition of Venture Capital : *"Venture capital is instead defined as "a type of private equity focused on start-up, which supports entrepreneurs with innovative ideas relating to products or services that need investment and technician support in developing their own business"*.

By this definition, we easily understand two things: Venture Capital is a branch of private equity, and it is focused on innovative start-ups.

Just to understand what private equity is, we can use another definition of the E.V.C.A, that defines it as : *"A form of investment in the risk capital of unlisted companies, which allows the creation of better business by strengthening expertise and management"*.

We use the adjective "private" to underline that these operations are made through companies not registered in the Stock Exchange, bearing a high risk of default.

Venture capital are specialised investors who bet on the growth and potential of a company, usually cut off the traditional credit system, helping them in hope to have a growing financial return. Their operations are usually classified according to the life stage of the company they help. The operations in the early stage of life are called *early stage financing*, and they are:

- ***Seed financing***, the very first time, where the real goal is the development of the idea.
- ***Start up financing***, focused on product implementation and marketing.

- **First stage financing**, where the business is developed at a trade level

The first financing stages are characterised by a high risk on every one of these phases, so the investor's approach is essential, in terms of both funding than in terms of managerial and expertise support. In almost all cases, in fact, the borrowers have innovative idea and a brilliant mind, but have zero knowledge in management.

The operations made to support an already started enterprise are *called expansion-financing operations*, and can be of many types. The main ones are the expansion of the market share, expansion of product capacity and finally, the internationalization of the company. In this phase, competencies of the Venture Capitalists are very important, because, once the business has reached a determined amount, an autonomous direction of the founder is impossible. Private equity investor also invest on:

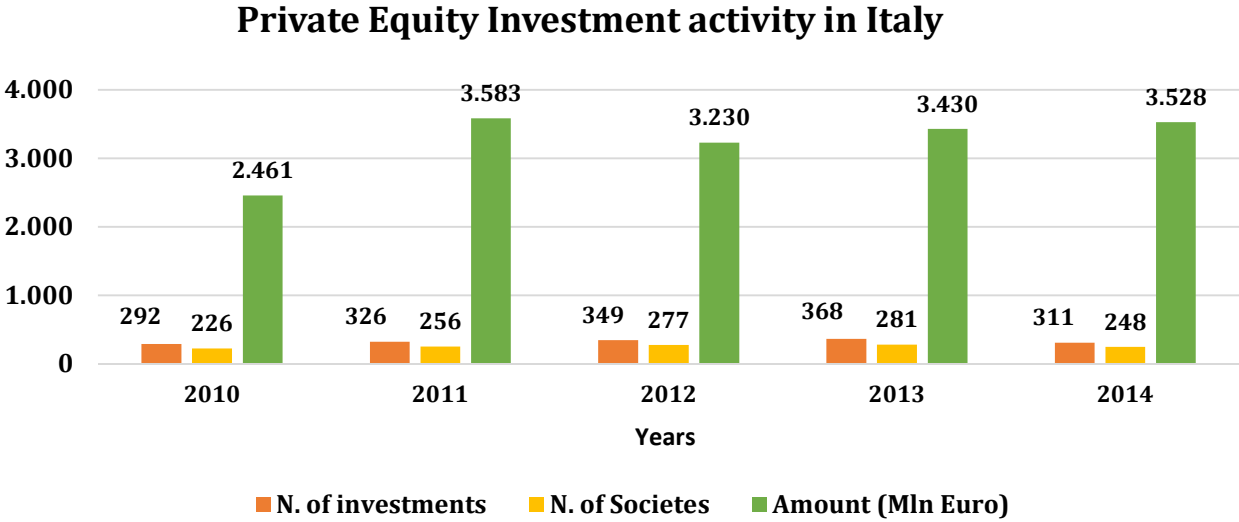
- **Turnaround** operations, building a restructuring plan of company that are in a financial crisis.
- **Replacement** operations, to modify the shareholder base.
- **Buyout** actions, where the management takes on the role of entrepreneur, noting together with a private equity fund company.

In Italy, Private equity and Venture capital are regulated by the AIFI, an Italian association born in 1986 to regulate and coordinate the operators of this market.

Private equity and VC in Italy are regulated by the *Unique text of Finance (1998)* and follow the norms of the *Regulation for the European long-term investment funds (2015)*.

We can have an idea on how this market is going in Italy watching Graphic 1.3, the same reported in the *"2014 Analysis of Italian Private Equity Market"*, which stats the investment activity progresses in Private Equity operations analysing a sample of 188 operators, both members and not members of AIFI. We can easily observe that the amount of investments is nearly stagnant from 2011 to 2014, after a good expansion from 2010 to 2011. The number of societies and project realized from 2011 to 2014 have almost completely stopped, and in the last two years is possible to see a decreasing trend in number of societies and investments.

**Graphic 1.3**



Source: "2014 Analysis of Italian Private Equity Market", AIFI 2014.

This confirms the affirmation we gave at the beginning, where we sustained that VC and P.E market is standing, and its evolution has been braked from the beginning of the financial crisis.

A further confirmation arrives observing the previous graphics of U.S market, which reflects an identical situation.

**1.5.2 Angel Investors**

They are informal investor that gave capital and financial resources to start-ups in exchange of ownership equities and convertible bonds.

This category finds its historical collocation already in the end of XIX century, where risk-taker individuals financed some shows in Broadway. This practice then grew up, until it covered many other entrepreneurial activities, and already in 1933 angel investors were classified as *accredited investors* in U.S.

They usually are former business owners, active and retired managers that have the desire to invest in high-potential firms that are not able to access credit.

These businesspersons had good financial possessions (they invest their own money) and a high knowledge and experience in business, that they make available to young entrepreneurs.

The motivations pushing them are not only profit and gain, but also above all interests in a technology, sense of challenge, or simply the will to act as masters for young executives.

Angel Investor usually are more likely to provide seed funding respect to Venture Capitalist, and usually act in a more “informal” way compared to VC, which are real and organized investment societies. Many investors, above all in USA, follow the “*20 minutes rule*”, that is they finance only entrepreneurs that are located at maximum twenty minutes of car.

This just because they want to have an active participation, and not be mere money providers.

A great difference between them and the V.C, is the greater speed and informality in the various processes (due diligence, business analysis and others) informal investors have respect to V.C, who have to follow all the “formal” procedures of a professional institute. In Italy business investor invest a lot on the manufacturing enterprises, probably for the high reputation of “Made in Italy” and for the lack of hi-tech start-ups in our country.

The Angel investors usually group themselves in online network called B.A.N (Business Angel Network), to help each other in project proposition and partner acquisition. The most developed Italian network for business angels is “I.B.A.N”, the Italian Business Angel Network, that help business angels to meet entrepreneurs that are seeking for funding and competencies, and promote the creation of a more favourable environment for informal institutions

Despite the Italian market is still too much tied to traditional investments, with banks at the first place, encouraging signals are coming from the world of informal investors, above all considering that only a few years ago it was an almost unknown market.

Next chapters aim to introduce the different typologies of crowdfunding that the market offers, with a specific focus on the differences between platforms and the norms that rules this discipline in the different European countries, with a focus on Italian market.

The purpose is to understand the current legislation and the potential of Italian crowdfunding.

## CHAPTER TWO

# 2. HOW TO USE CROWDFUNDING: MODELS, PLATFORMS AND CAMPAIGNS

### 2.1 The reasons to use collective financing

Crowdfunding is without doubts a revolutionary way for entrepreneurs and creatives to gain access to financial capitals. However, like on every subject, it presents advantages and disadvantages that is correct to analyse. A fundraising discipline, based totally on the Internet, without even knowing who is on the other part, of course creates doubts and perplexities, above all to those who not have great confidence with Web instruments. A deep analysis of pro and cons helps to clarify the ideas on why someone should start a crowdfunding campaign and what it can gain, or vice versa, why he should not start one.

#### 2.1.1 Benefits of crowdfunding

The main advantage as already been explained in the previous chapter, and it is the access to capital for small borrowers; entrepreneurs and creatives that usually find the door closed by banks, here are able to have the financial resources they need. The other main advantages for creators are the creation of a customer base and a network of relationships, the non-invasiveness of funders. From the point of view of moneylender, crowdfunding offers the advantages of *risk minimization on a wide variety of choice*.

However, here there is a complete explanation of pro and cons of crowdfunding:

- ***Creation of a customer base and a network of relationships***

First, a creator can use the platform to build a small customer base, if he is projecting goods or services. The platform can be used as a “presentation point” of the product and

began to raise consensus between the crowds.

People than finance it, or simply leave a comment or visit the page can be interested in having the product once it has finished. An example is Phree, a particular pen that write on every surface, transferring the notes on your smartphone: during the crowdfunding campaign, the creators proposed many presentations of Phree, and, once they have finished, there were tons of people asking for it.

Moreover, the project can be used to establish an useful set of relationships that could be useful for a future campaign.

- ***The non-invasiveness of funders***

When venture capitals or angel investors finance a project, usually they pretend to be an active part of the plan.

This situation is truly helpful in most situations; however, it can create diseases if the lenders start to be too much “invasive”. In crowdfunding, this does not happen: the funders are almost unknown, and they limit to follow the campaign or to give some advices, without having a participation in first person; in doing so, the borrower is free to follow his ideas and convictions, without external influences. Crowdfunding allows also creating a network of relationship that might continue across time, being useful for other future ideas.

- ***Minimization of lenders’ risk***

Watching from the lender’s point of view, crowdfunding is useful because it minimizes risk and allows him to invest a minimum amount in many different projects; doing so, the lender can easily diversify the risk.

A crowdfunding platform also allows a financier to have a lot of projects choice, everyone in the same web page. Simply opening a website, he can easily choose between a wide variety of ideas, having a lot of specialized information with the minimal effort.

- ***Lower cost of capital/higher return***

Crowdfunding allows entrepreneurs to have debt capital at a lower cost respect to other form of investment. At the same time, for investors, there is the possibility of higher return of capital, if compared with other types of financing.

## 2.1.2 Risks of crowdfunding

Advantages are, without doubt, a lot, but as the sages say, is not gold everything that glitters. Crowdfunding have also some disadvantages that is necessary to analyse:

- ***Information asymmetry between the parts***

Entrepreneurs, of course, know everything about their projects, while crowdfunders have limited access to information. They have to trust what the borrower says, or collect some information they find online (the potential of the market, the technology used, the identity of the borrower, etc...).

- ***Absence of warranties and risk of fraud***

There is no assurance that the money will return back, or will be used for the established goals. With the aim of overpass this mistrust, some platform rely on a bank as financial partner that acts as guarantor. To show that money is used to the established objectives, borrowers must post photos, videos and evidences that the project is going on.

One solution is to give a loan divided in more instalments; doing so, the lender is able to value the behaviour of the borrower, the goal he reached, and decide step by step the opportunity to continue or to interrupt. With this method, in case of moral hazard or dishonest conduct, the financier lost only the initial part of the investment.

- ***Risk of platform closure***

Despite almost all the crowdfunding platforms, show a positive turnover, the risk for a platform to be closed or shut down is concrete and exist. If the platform close, the investor's risks and funds are lost and unable to be repaid, for the disappearance of the intermediary. An example of platform shutdown is Quackle that closed abruptly one night in 2011, leaving no explanation and resulting in a 100% investment loss.

- ***Risk of default***

The risk of default from the borrowers worth a consideration, because it is a possible risk. Due to several reasons (creator's inexperience, underestimation of project difficulties, unforeseen circumstances, etc...) the entrepreneur might become insolvent and unable to repay the debt. A famous case is Prosper, now one of the biggest platforms,

but in 2006 just one of the main emerging brokers. Prosper lost control of the solvency of its loans, accepting projects from borrowers with a very low credit score, starting a policy of what we could call 'subprime loans'<sup>18</sup>. This policy conducted to a high default rates (about 30%), which obliged the platform to close for six months, to reorder its accounts and regulation.

- ***Liquidity risk***

The liquidity risk is present because, for most platforms there is no secondary market. Investors cannot replace shares by contracting each other, and if they are inexpert could not really understand the risk of investing in illiquid stock.

- ***Lack of professional investors***

The great force of crowdfunding can also be one of its weaknesses. The lack of professional investors (and then of proved reliability and confidentiality) might make the entrepreneurs to become risk-adverse in sharing information. Without knowing who is on the other part, the creator could be reluctant in giving detailed explanations or telling his "secrets". For this reason, most of the makers register their inventions and make patents before starting a crowdfunding campaign.

Of course, the use of a crowdfunding campaign depends if an entrepreneur or an investor is more risk-adverse or risk-seeker. Due to the online nature of crowdfunding, there are more potential risks for the funder than for the borrower, of course because he is the one that provides money. However, some risks are not as frightful as one might imagine. The World Bank report of 2013 showed a substantial absence of fraud attempts on a total market of about \$ 5 billion, including "lighter" (and thus more permeable) crowdfunding models such donation and reward.

The greatest platforms, as Kickstarter or Indiegogo are able to monitor and detect fraudulent projects, and before the acceptance, the proposer have to pass many preliminary steps, to prove its reliability and integrity. In Italy, for example, platforms accept offers of financial instruments only if a professional investor subscribes 5% of them, and there is the right of revocation for investors, in cases of significant changes.

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<sup>18</sup> Lieber, R (2011) 'The Gamble of Lending Peer to Peer', *The New York Times*, [Online] Available at:



## 2.2 Typologies of crowdfunding platform

Online platforms are the true engine of crowdfunding, the means that allow its own existence.

Despite the existence of several types of platforms, everyone with its own rules, fees and projects, there are three common characteristics identifying them as “*crowdfunding portals*”<sup>19</sup>

- The creators have the possibility to present their projects to the crowd, surpassing every geographical limit (but early stage entrepreneurial financing tend to be local).
- The platforms consent small financial transactions, allowing people to participate as a “crowd” with low risk.
- They provide information about crowdfunders and creators, and the tools to communicate directly with each other.

There are mainly three ways to differentiate crowdfunding platforms, depending if the classification considers the variety of projects accepted, the fundraising method, or the return for the borrower.

According to the variety of projects accepted, there are two categories of portals:

- ***Generic platforms***

These platforms accept every kind of project, or at least a great variety of initiatives.

- ***Specific platforms***

They are platforms that accept only the projects that belongs to a specific area (music, charity, art or other).

Two famous generic platforms are Indiegogo, one of the largest portals, which accepts

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<sup>19</sup> Agrawal, A., Catalini, C. and Goldfarb, A. “ The Geography of Crowdfunding ”, p. 9 Working Paper 16820, February 2011, National Bureau of Economic Research.

project of music, health, politics, religion and many other and RocketHub, another American portal, which projects varies from art to science and social. In Italy the main generic platforms are Eppela, with projects of technology, music and movies, and Kapipal, one of the oldest one, that allow also fundraising for personal projects (wedding, birthday and other).

Specific platforms are of course the favourite for the supporters of a particular discipline or art. Creators know that they can find passionate people that are more stimulated to understand and finance a project.

In addition, borrowers and lenders here are more prone to exchange opinions, thanks to their common interests and competencies.

Some very famous specific platforms are Kiva, a website for zero-interest microloan for social causes, and Sellaband, that allows emerging music bands to raise money for disks and tours. Depending on the fundraising and financing method, platforms divide themselves in two main types:

- ***All or nothing***

In this model, the money collected is given to the applicant only if all the amount is raised; otherwise no projects are funded, and the money is given back to the lenders.

- ***Keep it all***

With this model, the borrower keeps all the money collected, even if the project does not reach the entire amount.

The two most famous crowdfunding platforms (Kickstarter and Indiegogo) follow these two models. In particular, Kickstarter used the *all or nothing* typology, applying a 5% fee if the amount is collected, and no fees in case of failure.<sup>20</sup>

Indiegogo instead uses both models, even if the majority of projects is financed using the *keep it all* method.

The platform, on the *keep it all* projects, puts a 4% fee in case of success, and a 9% fee if the total amount is not reached. This policy, according to the funders, help people to start credible projects, to ask for reasonable and not exaggerated amounts, and to better

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<sup>20</sup> FAQ on Kickstarter site, available at <https://www.kickstarter.com/help/faq/kickstarter%20basics>

follow and advertise their campaign.<sup>21</sup>

In general, *keep it all* platforms (also called *flexible funding platforms*) apply higher fees on the projects, just because the borrower can keep the money in any case.

The platform receives a fee (is a percentage of funds raised that can range from 2% to 25%) in case of a positive outcome of the crowdfunding campaign and, sometimes, even in the event of failure.

In addition to the commissions some sites may charge a flat fee, albeit small (on average, approximately \$ 15), just to publish a project on the platform.

Returning on platform classification, the most important one is made according to the return for the investors and to the type of transactions originated (donations, loans etc...).

In effect, although we spoke about crowdfunding mainly as an alternative to traditional loans, this is not its unique and primary purpose.

There are several types of crowdfunding platform, and, as we are going to see, lending model is just one of them. This model is not even the most used or important for crowdfunding, and in some states is still forbidden or regulated by strictly norms.

There are five main models of crowdfunding, each one with a different purpose, different investors and a diverse feedback.

These five models are:

- *Donation-based crowdfunding*
- *Reward-based crowdfunding*
- *Equity- based crowdfunding*
- *Lending- based crowdfunding (or social lending)*
- *Royalty- based crowdfunding*

Of course, there are also hybrid models intersecting two or more of the main ones, but first is necessary to give a complete explanation about the primaries.

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<sup>21</sup> Rigelmann D. interview available at <http://www.girlgeeklife.com/2015/02/danae-ringelmann-indiegogo/>

### 2.2.1 Donation- based crowdfunding

This is probably the most used and developed crowdfunding model. This type of crowdfunding funds entirely on people's donations, and do not give back any economical return for its supporters.

This model is the most used by non-profit organizations and charities, which rely on patronage for their projects.

Donation-based crowdfunding is also called "*charity crowdfunding*" just because is founded entirely on charitable donations. Donors give help because they share the values of the campaign and they want to give some type of support to particular action or idea.

A recent example of donation campaign is the one made by Thom Feeney, a 29 years-old English manager who started a crowdfunding campaign on Indiegogo to save Greece. His intent was to raise \$ 1,6 billion avoid Greece's default and pay the debt towards the IMF.

Although his affirmation "*a donation of three euros from everyone in the Eurozone can save Greece*"<sup>22</sup>, he failed to reach that amount (he collect about 1,5 million dollars).

Another example of donation crowdfunding is the one explained in the first chapter about the Statue of Liberty.

In that case donors were thanked with a mention on a newspaper, and it's a way many charities use to push people to donate and to thank them: givers can be mentioned among the authors of the project, their name written on a newspaper or in a presentation video. This is useful to give the donors a real sense of participation and gratitude (and of course the demonstration that money has been correctly used).

Donation-based crowdfunding is divided in three main groups:

- ***Charity crowdfunding***

It refers about every donation based on "charity" to help other people and give them assistance. It involves all the campaigns that aimed to bring help to needy people, providing them food, water and medical assistance. An example can be a project that aims to help people after a natural disaster, giving them helps and first assistance. Of course the proponents have to understand that crowdfunding is not like a magic panacea

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<sup>22</sup> Interview available on <http://thinkprogress.org/world/2015/07/05/3676872/greece-indiegogo/>

for their ideas or projects, as may seem watching several platform and listening to advertisement; these sites are not a sort a magical cure, and most of projects fail without even reaching a small percentage of the total.

- ***Civic crowdfunding***

Civic crowdfunding is an interesting branch of donation-based model. It refers to all the crowdfunding projects started to provide something useful for the community. This method start to be used by municipalities and provinces where lack funds to realize a work of public interest. A recent example is the built of the “*Luchtsingel pedestrian bridge*” in Rotterdam, a wooden bridge financed through crowdfunding. This bridge connects the Hofplein area with the Northern districts of Rotterdam, allowing pedestrians to avoid the hectic traffic below; in fact, it passes above two very busy road. Donors were rewarded with their name written on a rod or entire block, based on the amount they donated.

*“Civic crowdfunding campaigns are usually of small amount, about \$5,000-10,000, but they are growing as a positive solution to help downgrade monuments or areas”<sup>23</sup>. It bets on people’s sense of community, on the desire to be part of a big project, as the campaign “I Make Rotterdam”, that allows to build the bridge.*

- ***Social crowdfunding***

Although it might seems similar to civic crowdfunding, social campaigns are made for something that is “immaterial”, linked to a social cause. In this case, there are no bridges but it rather involves the support to political causes, or organizing an event for the city. To give a better explanation, civic crowdfunding is more for “material things”, while social is more for causes and “immaterial things”. Of course, to fund themselves, most platform ask a fee on what people raise. Some platform apply a fix rate, while others a variable fee depending on the amount raised. In Italy, although is not the most used model, there are 7 active donation platforms<sup>24</sup>: Commoon, IoDono, Leevia, Letsdonation, PensiamociNoi, Retedeldono, Shinynote.

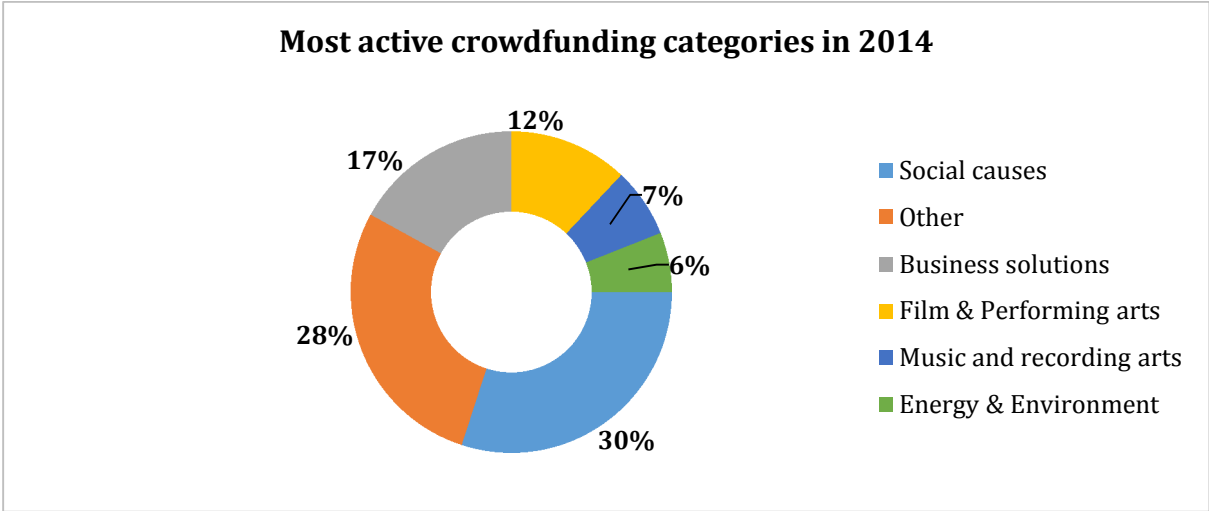
*Graphic 2.1* shows how social causes were the most active category (globally) in 2014 for number of projects.

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<sup>23</sup> Rodrigo Davies,, interview on <http://www.shareable.net/blog/civic-crowdfunding-and-the-public-good>

<sup>24</sup> Data from *Analysis of the Italian crowdfunding platform* page 5 , ICN May 2014

**Graphic 2.1**



Source: Massolution.com, 2014CF — “The Crowdfunding Industry Report” (global data)

**2.2.2 Reward- based crowdfunding**

Reward-based crowdfunding is probably the most popular and used model. Unlike donation-based, founded on donations, reward-based base on passive investments.<sup>25</sup>

Passive investments are funding where the lender cannot be actively involved in the project, but is a mere financier. They distinguish from active investments, used in other social lending and equity crowdfunding, where investors are actively involved in the process.

What is the difference between passive investments and donations? The first one provides rewards, although intangible.

Therefore, reward-based crowdfunding is a type of fundraising where donors give money in exchange for immaterial donations. The beneficiary decides the repayments, and they depend on the amount of the offers. For example, a filmmaker who want to raise money for a film can decide to give a mention in the film’s credit for a donation of \$ 100; for those who give \$ 500 he might decide to give a mention and a poster, and for

<sup>25</sup> Larralde B., Schwienbacher A. (2010). “Crowdfunding of small entrepreneurial ventures”. In: Cumming, D. (red.), 2012, The Oxford handbook of entrepreneurial finance, Oxford: Oxford University Press.

1,000 dollars to concede a personal meet or even give a small part in the movie.

The rewards can be of two types:

- ***Modal donations***

The most diffused and it provide a little immaterial or material reward for the donor (a mention, a gadget, a ticket for the movie, an autograph, etc...)

- ***Pre-order donations***

With pre-order donations, donors obtain special rights on the purchase of a good produced with the money raised. For example, the creator of an innovative product can give the right to purchase it first, or at a lower price.

It is the case for example of Phree, the special pen mentioned above; the funders that gave a determinate amount now have the right to purchase it first if they want.

One of the first example of modern crowdfunding is those of the Marillion. The British rock band entirely financed a tour using crowdfunding in 1997, raising the amount of \$ 60,000. Although the idea became from a fan, they later use crowdfunding to finance part of their albums, in exchange for an advanced purchase of their disks.<sup>26</sup>

The most famous reward-based crowdfunding platform is Kickstarter, to which is dedicated a focus paragraph at the end of the chapter.

Kickstarter, which name means *to make it start* was founded in 2009 in USA from Perry Chen, Yancey Strickle and Charles Adler, with the goal to finance creative projects.

In particular, the projects cover thirteen categories: food, art, dance, design, film and video, photography, comics, games, fashion, music, publishing, theatre and technology.

The side exclude the possibility to fund charities or non-creative projects like a travel or others. Another world-famous platform is Indiegogo, which unite the reward-based model with the donation-based model.

In Europe, one of the biggest portal is Pledgemusic, founded in London in 2009. It is a thematic platform, spanning all genres of music, in particular country, jazz, electronic, hip-hop / rap, pop, rock and classical music.

Artists may realize album in presale to generate revenues even during the recording of

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<sup>26</sup> BBC article, May 11, 2001". BBC News. May 11, 2001, article at

<http://news.bbc.co.uk/2/hi/entertainment/1325340.stm>

an album, selling fragments of songs in preview, make private concerts, give tickets, t-shirt, limited edition gadgets, etc. In Italy, this is the most popular type of crowdfunding, since the majority of platform is based on this method.

The most popular reward-based platform is Eppela, that allows the publication of creative projects. Other significant portals are Distribuzioni dal Basso<sup>27</sup>, dedicated to cinematography, and Crowdfunding Italia, which unite charities and creative projects.

The reward-based methodology is the most used for art, music and inventiveness projects, since it allows repaying funders with non-monetary awards, and permits a great choice of platforms and large visibility.

This crowdfunding model also it is the best to create a first circle of customers, since the reward can be to purchase the product before the others, and it perfectly works as a marketing instrument for the creators.

Is a tool to understand the customers 'perception of something, before its ultimate launch. The use of those platforms also as "marketing tests" is not rare among crowdfunders, especially those who develop very innovative products.

Actually, in the E.U area The European Commission is considering whether these platforms should be subject to VAT. The investigation launched by the Commission has to decide whether it is a financial service defined by the VAT Directive of the European Union. Otherwise, the brokerage services offered by crowdfunding platforms are likely to be subjected to VAT.

### **2.2.3 Equity-based crowdfunding**

The equity-based crowdfunding is the model that has grown the most in the last years.

This typology of crowdfunding struggled to affirm because legislators applied several constraints in the field of financial products offer.

In particular, this model is still strictly regulated in USA, where a first regulation was given in 2012 thanks to the JOBS Act signed by president Obama; every country has its own rules for equity crowdfunding, and most of them are based on existing norms about risk capital.

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<sup>27</sup> Leone A. "Crowdfunding, la rivoluzione del web per creare ricchezza" p. 30, 2014



With the law decree n.179 of 18<sup>th</sup> October 2012, called “Decreto Crescita bis”, officially converted in law in the same year, Italy became the first country to have a complete regulatory on this argument.

In July 2012 the Consob, following this law, officially published the “*Regulation on risk capital raising by innovative start-ups through online portals*”<sup>28</sup>, formalizing Italy’s primate on the regulation of equity crowdfunding.

Equity based crowdfunding consists in capital raising by an online platform, through the acquisition of a company’s shares.<sup>29</sup> The users of this model are those who wants to sustain projects giving resources to acquire a part of the capital stock.

The funders became stockholders of the society, so it is easy to understand how this is the model with the highest percentage of risk. Since it regards the issue of securities and it connects with risk capital, equity crowdfunding is still restricted in many countries, and between the main one, only U.K, Italy, France and USA are those with a specific and detailed regulation.

In the USA it is regulated by the JOBS Act of 2012, who was converted into law by president Obama in 2012. This regulatory first allows public advertising for equity fundraising only to accredited investors, leaving out of the group; however, by the end of 2015, a new regulation called A+ is going towards approbation, to extend equity crowdfunding also to non-accredited investors.

To protect the investors who are often inexperienced, Regulation A+ specifies that they are allowed to invest a maximum of 10% of their income every year.

In France equity crowdfunding is widespread and long used, although with some limitations on the minimum amount a person can invest. It’s, in a certain matter, the opposite of USA regulation, where norms make all the possible to protect the investor.

In France most platform have an average minimum amount of € 1,500 to invest, and is probably the country with the clearest regulation. In particular, the funding requested may not exceed one million euro for a period of 12 months, while in Italy the limit is 5 million euro. On the other side, though, there are openings and considerable simplifications. Any type of company can use the equity crowdfunding, for example, even those operating in real estate, and the intermediary is the platform itself. In Italy, to

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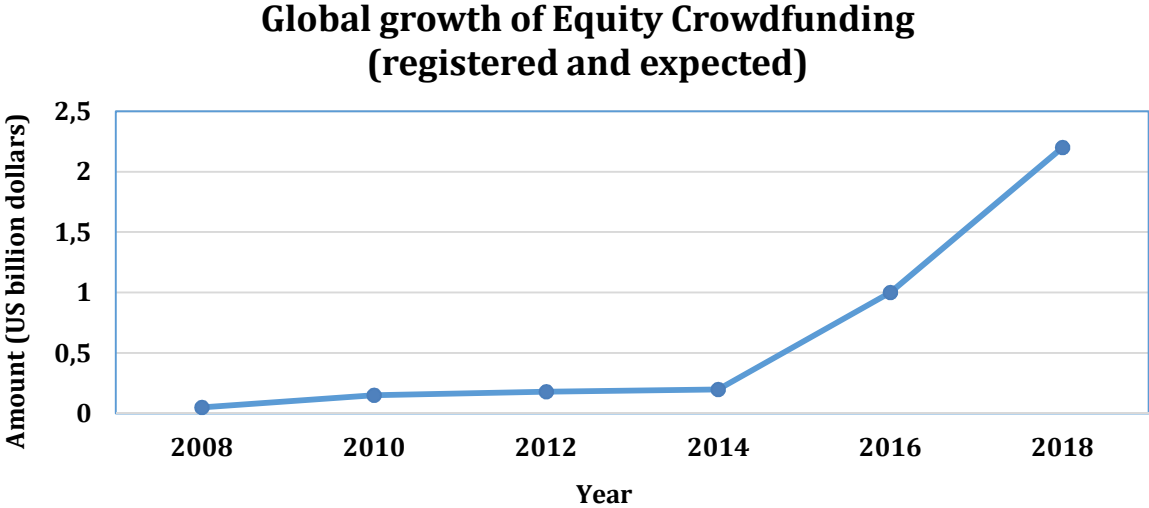
<sup>28</sup> Consob, Resolution n°18592, available at

<http://www.consob.it/main/documenti/bollettino2013/d18592.htm>

<sup>29</sup> Bradford S., *op. cit.*, pag. 31; Lerro M.A., *op. cit.*, pag. 33 s.s.; Piattelli U., *op. cit.*, pag. 14

make an example, equity crowdfunding extended only to startups and innovative SMEs, and 5% of capital has to be subscribed by a professional investor. Today the equity crowdfunding is experiencing a strong growth in France, so that the platforms have collected more than 25 million euro in the last year with a growth of + 146% over the previous year. In 2014, moreover, the average budget raised for a project was 376 733 euro<sup>30</sup>. According to Massolution report, equity crowdfunding in 2015 is going to surpass \$ 2 billion in equity transactions, based on the industry trends of the past years, where this method raised more than \$ 1 billion in 2014, increasing five times compared to 2013 (\$ 204 million). Graphic 2.2 shows the global expected trend for equity crowdfunding, according to Massolution “*Crowdfunding industry report 2014*”.

**Graphic 2.2**



*Source: Massolution, “Crowdfunding industry report” 2014*

**2.2.4 Lending-based crowdfunding**

Lending- based crowdfunding is the exchange of a certain amount of money given in the form of a loan, from a lender to a borrower using a crowdfunding platform.

This mature crowdfunding model already has exhaustive legislations in nearly all

<sup>30</sup> *Review of Crowdfunding Regulation 2014* p. 75, Lahua J, Luotio M, published by European Crowdfunding Network, 2014

countries.

The lender publishes the request on a platform, asking for a precise amount of money, and when they raise enough money, the platform originates the loan and paid it to the borrower. Usually (but not always) the petitioner pays an interest on the debt. The set interest rate is usually higher than the average saving rate a lender can have, and lower respect to that of a traditional loan, for the borrower.

Due to the rise of online platform as intermediaries, nowadays lending-based crowdfunding usually divides in three groups:

- ***Microloans***

The microloan provides financial services to clients with low incomes; the money is raised by a group of people and is managed by a local broker.

- ***Peer to peer lending***

It is the online lending to private people at affordable rates, without the intermediation of financial institutions.

- ***Peer to business lending***

It refers to a loan given by private people to SMEs or start-ups.<sup>31</sup>

Lending-based crowdfunding is also called “social lending”, to underline the “social” side of the discipline that departs from the traditional fundraising models. Although every country has its own regulation on social lending, there is a common way on how a platform works:

- ***Assignment of a rating point***

The platform assigns a rating point to every applicant, to understand his solvency, in a similar way on what banks do.

- ***Analysis of documentation and loan issue***

The loan starts after a careful examination of the documentation collected by the platform, and of the acts brought by the applicant.

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<sup>31</sup> Leone A. “Crowdfunding, la rivoluzione del web per creare ricchezza” p. 11, 2014

- ***Restitution of the money lent***

The borrower repays the loan with a monthly instalment. Usually the platform itself open an account in a bank or in authorised Payment Service Provider, where the money is collected, and then is the intermediary itself to distribute it to the creditors, according to the capital share and interests.

Because of the complexity of the operations, and the high risk of this investments, there is a lack of common classification for the platforms, and every jurisdiction has its own rules. There are five major regimes to regulate P2P lending, taking into consideration the three main aspects of the matter: the borrower's reliability, the investor's protection and the regulation of the online platform. These five regulations are<sup>32</sup>:

- ***Lack of regulations or definitions***

In countries like Brazil, South Korea or China there is no peer-to-peer lending market, or it is too small to give a definition or establish a regulation. Some countries (like UK) has classified social lending as "exempt market".

- ***Platforms regulated as intermediaries***

Some jurisdictions regulate P2P lending platforms as intermediaries or brokers. The platform usually has to register at the competent authority as "financial intermediary". The requirements and the obligations of course vary by country. The most important states using this regime are Australia and Argentina.

- ***Banking regulation***

In some countries, these platforms are classified as banks, due to their intermediary role in credit functions, and consequently regulated with the same rules.

In these countries, the market is very small, because platforms have to obtain all the licenses and requirements to be classified as "banks" (e.g. France, Germany and Italy), and this of course inhibit the development.

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<sup>32</sup> Kirby E., Worner S. "Crowdfunding, an infant industry growing fast" p. 32, IOSCO research department.

- ***The U.S model regulation***

This model is present only in United States. At a federal level every platform must register with the SEC, and every loan has to be registered in SEC. Platforms are treated as public companies, having to disclose their finances, documents and cash movements.

Below the federal level, there is state regulation; some states prohibits the use of social lending (Texas), while others limit the amount of money or the type of investors.

- ***Prohibited***

In some countries, like Japan or Israel, local jurisdiction prohibits social lending.

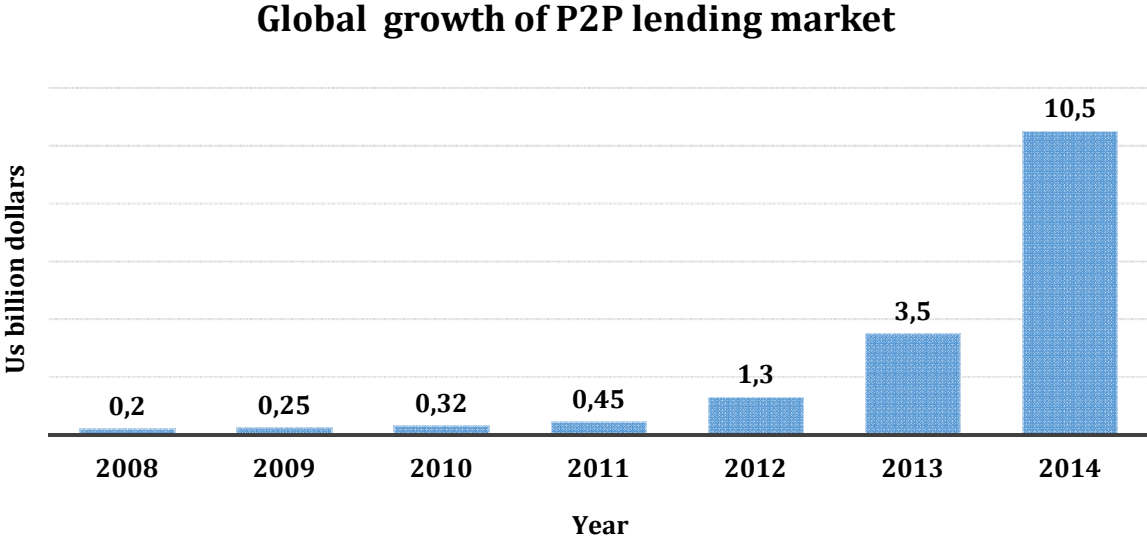
A common feature of every P2P lending platforms is they reluctance to operate out of the national borders; in fact there are only few platforms that operate in an international context (Funding Circle, Lendico, Ratesetter, Bondora). This fact is due mainly to the jurisdictional problems that arise once a platform overtakes the national borders: under what jurisdiction should the loan be regulated? The lender's one or the borrower's one? Could be the platform regulated in one way in a country and in another way on the other country?

The two major lending-based platform are both located in United States, and they are Prosper and Lending Club, both under U.S legislation and regulated by the SEC.

Since their foundation, they raised respectively 612 and 2.563 million dollars, making the US market the more developed in P2P lending. Despite it is considered as a good integration to traditional financial systems, social lending market is still small, in proportion to other crowdfunding markets.

However, thanks to the growing regulation of platforms, it faced a stunning growth in recent years. Last year, in USA, social lending market grew about 150% respect to 2013, with an amount of 6.6 billion dollars generated in loans. In E.U, P2P lending market grew up about 144% respect to 2013, reaching 3 billion euros of loans originated. This trend is present in many countries, with an average growth of about 89% for year, above all in young crowdfunding market (notable are the data of France and Estonia, which signs an increase of about 150% for France and 70% for Estonia). *Graphic 2.3* shows the stunning growth of social lending in the last years. Data leave no doubt that it will affirm more and more as an alternative way of funding. Forecasts say that it will reach \$ 64 billion in 2015 and touch \$ 1,000 billion in 2025, if it maintains this trend of growth.

**Graphic 2.3**



*Source 1: Kirby E., Worner S. "Crowdfunding, an infant industry growing fast", 2014*

*Source 2: Crowdfunding insider, "Report: European Crowdfunding Stakeholders Forum Meets"*

### 2.2.5 Royalty-based crowdfunding

This typology of crowdfunding is relatively new, and lack of a precise definition and identification.

It might be defined as a hybrid model between the reward-based and the equity-based, where investors are remunerated receiving a monetary return on gains and losses of a project.

The definition 'hybrid' is correct, because some scholars still debate if consider it as a part of reward based crowdfunding (because royalties are like monetary rewards) or include it in equity crowdfunding (lenders participate in the project's returns). Naturally, many scholars affirm that it must be considered as a stand-alone category, since reward-based is non-monetary and there is no issue of shares.

Therefore, in this particular model, creators maintain 100% ownership of the projects, having full control of them, without external influences in membership. Lenders are paid using a part of the project revenues. The value of this royalties depend on the platform and on the creator's decision; usually, to obtain this financial return, lenders must pay at

least a minimum amount (percentage of total or fixed amount), to have the right to “participate”.

Two popular platforms that use royalty-based crowdfunding (also called ‘*revenue-sharing*’) are Sellaband and Bolstr.

Sellaband is a thematic platform focused in music: artists can raise funding to produce their album or to finance their tours. Between the rewards it offers, there is also the possibility to participate to groups’ earnings (even though Sellaband advises against it, because most musicians are not millionaire<sup>33</sup>). Creators are free to decide how much investors can participate, and for how many time (if it is no specified, duration is five years long).

Bolstr is a platform that allows people to invest in manufacturing and retail businesses, permitting creators to define the amount to be repayed to the investors.

For example, if a borrower agree for a 3% return until every lender has earn 1.2x investment back, every month the 3% of revenues is withdraw, divided in rates for every investor (depending on how much they payed), and distributed until every funder receive 1.2x of his investment.

This is a method that is still niche, but it starts to grow, because it allows lenders to have a financial return with relatively low risks. It does not involves ownership of risk capital, and, in the worst of cases, investor loses only the amount payed. Royalties also works as an “attraction” to investors, often more effective than non-monetary rewards.

The royalties are an effective way for potential investors to start operating with equity crowdfunding and with the risk capital. What does it mean?

If there is someone that want to invest in an innovative business, but is still inexpert and does not want to lose the capital invested at the first attempt, he might begin with a royalty-based project.

These kind of projects allow the investor to enter in the world of business without risking too much, being paid with part of the profit and not being responsible in case of losses. This policy is helpful, because the lender can start making his experience as investor, with few risks, and maybe, after some successful campaigns, make the leap into the world of equity.

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<sup>33</sup> Sellaband Academy rules, available at [https://www.sellaband.com/en/pages/artist\\_academy\\_incentives](https://www.sellaband.com/en/pages/artist_academy_incentives)

## 2.3 How to make a successful crowdfunding campaign

Explanations on how platform works, what kind of return an investor should have, and everything we explained above, is, without doubts, essential. However, none of these points clears up how to make a successful crowdfunding campaign. There are tons of tricks and tactics a creator must take into consideration if he wants to succeed; like Cristiana Tumedei said *“A good idea and good intentions are not enough”*<sup>34</sup>.

This paragraph aims to give a clear explanation (and clear indications) on how to build a good campaign and illustrate a project. The process divides into three main phases:

- ***Pre-launch***

Consists in the generation of idea and in all the stages that come before the online publication (information gathering, target definition and others)

- ***Launch and fundraising***

The second part is about the publication on the platform and all the activities concerned (updates, public call to action, etc...)

- ***Project implementation and distribution of rewards***

The last stage, when the money is collected and the project realized. The very last phase includes the delivery of retributions and a public thank to the audit.

### 2.3.1 Pre-launch

The pre-launch starts, of course, with the generation of an innovative idea and the beginning of a project to realize it.

First, it is appropriate to explain how works the generation of an idea; usually it came because of two main things: something that is missing and someone's aspirations. An

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<sup>34</sup> Cristiana Tumedei, public relations and crowdfunding strategist, interview at <http://cristianatumedei.com/scrivere-un-progetto-di-crowdfunding-efficace/>



idea is the union of these two things, where a person's goals meet with the lack of a product or a service. This is correct not only for the economic world, but for every category.

For example, if I start a crowdfunding campaign to build a well for water somewhere in Africa, is because of two things; I want to help less fortunate people (my aspiration) and, of course, there is lack of water in that place (the missing thing).

Another example come with the innovative products, take for example Phree; Phree is a special digital pen that allows you to write on every surface, with a Bluetooth connection with your smartphone.<sup>35</sup> Notes are then transferred in form of words on its screen. So why Phree saw light? Because its inventors are brilliant people, which desired to invent something new (the aspiration), and they noticed that people often find difficult to write fast notes on their screens (the missing thing again).

Therefore, it is reasonable to affirm that the initial phase, what Claudio Calveri called "*the premise of the crowdfunding campaign, its creative process*"<sup>36</sup> is divided in three main phases:

- ***The intuition***

That is when someone realizes there is a not satisfied need, of a potentially desired product, not yet on the market; or simply that something already existing might work better, satisfying needs in a more efficient way.

- ***The idea***

It is the elaboration of a possible solution for the problem proposed by the intuition. Is when the creator start to work at the process of 'building', finishing with a practical solution for his intuition.

- ***The project***

It is the articulation of all the steps needed to achieve the solution, including methods, tools and processes.

After the completion of all this phases, the creator has clear in mind what he wants to do

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<sup>35</sup> Mc Lennan C, article for *Product Central*, 9th June 2015

<sup>36</sup> Calveri C, Esposito R. *Crowdfunding -World 2013 report, analysis and trends*, p. 92, 2013

and he indents what kind of benefits its project could bring to the society.

Once the project is ultimate, next step is about market. Crowdfunders are like companies that want to enter in some markets and make analysis to understand them.

The creator, in fact, must have a perfect knowledge of the environment in which he operates, avoiding rushing headlong in an unknown context. They must start to think like entrepreneurs, remembering that they are playing with their resources, time and their own reputation. Market's knowledge usually regards three "macro-areas":

- ***Knowledge of competitors and similar products***

This rules regards all the projects, doesn't matter if they concern an economic return, or simply a charity. Acquaintance of contenders (there is already someone planning a product/project like mine?) or analogue products (are there any products that already satisfy the needs I have noticed?). If the creators know the market they want to enter in, they might avoid to lose energies in ideas that are already been developed by someone else, or may not have encountered the audience's appreciation.

In the case of charities, this might allow benefactors to concentrate on helping someone else, with very new projects.

- ***Consciousness about the potential of the invention***

Creators must perfectly know how much their invention can be useful, and what kind of benefits it might bring. The most important thing is the inventors' own conviction. They must have total faith in what they are doing, and believe in it even if the first results are disheartening.

This belief reflects also on the campaign: an enthusiastic creator, who strongly believes in what is doing, is more inclined in doing a dynamic campaign. The funders must perceive its enthusiasm, also for a question of trust: money is in better hands, if the borrower is determined in achieving his goals.

- ***Knowledge of the potential audit and how to stimulate his interest***

When someone starts a crowdfunding campaign, it must be aware of his potential audit. The question to ask are these: who might be interested in my project? How can I catch his attention?

Creators have to know perfectly who their target is, and this not just to offer the right

thing to the right person, but also to correctly stimulate the interest.

For example, if the target are donors who often make charities, they can capture the interest posting videos on how effective my project can be; if the audit consists in potential product “innovation lovers”, inventor can post presentations and videos showing how innovative the product is.

For an effective crowdfunding campaign is important to take into consideration all the actors involved. This kind of operation is must be like a perfect engine, where every mechanism is complementary to each other.

Once the project is in mind, clearly defined and ready to the launch, the next step is, like Roberto Esposito said, *“to stop, take a breath and think which parts of my promotion are strong and which still have weaknesses”*<sup>37</sup>.

With this affirmation, he intends to say that a campaign is not just the proposal of a project, the funding and the realisation. Many activities and external factors might interfere, and is fundamental to be able to control them.

Before choosing the platform and propose the idea, with enthusiasm seeping from every pore, the proponent must answer to the following questions:

- ***Who is doing or might do something?***

This question provides a perfect awareness of all the actors involved and their role in the project. The primary risk is to focus on key activities (idea, promotion, fundraising), forgetting all the secondary factors (delivery of materials, effective abilities of the team members). The creator must have a complete reconsideration of the project, considering all the actors involved (also those not in the team, like suppliers of raw material) and verifying their affordability.

Never forget that, for every mistake, the responsibility falls on the authors of the project.

- ***What are the phases of the project?***

To have a complete idea, is useful to divide the plan in multiple “macro” phases, everyone concerning similar activities that can be verified together.

This division helps in following the effective progress of every step, identifying potential gaps.

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<sup>37</sup> Calveri C, Esposito R. *Crowdfunding -World 2013 report, analysis and trends*, p. 94, 2013

Macro phases might be the “platform campaign” (which involves posts, updates, answer the questions), or the delivery of rewards (which includes the choice of couriers, the production time of gadgets, etc...).

This division is important above all in the final phases (production and distribution), usually neglected by borrowers, and where most factors are external and difficult to control.

- ***What are the mechanisms?***

It regards all the skills and activities required so that we can proceed from a step to another within each phase. For example, to talk about a hypothetical stage of distribution / sale, it will be important to define the role of agreements with professional logistics (courier) or retail outlets.

- ***Can I correctly define costs and times?***

The knowledge of costs and times of every operation (or, at least, a precise prediction) is essential to avoid unforeseen and incidents. Of course, a perfect awareness of them is nearly impossible, but is important to give accurate predictions and to establish a range for every value.

A range definition give to the investors an idea of what they can expect, and avoid the embarrassment of having to communicate delays or costs bigger than expected.

It is opportune to say that a crowdfunding campaign requires the drafting of a real *business plan*. Creators must take into consideration that this process is not different from the launch of a product by a professional company. Both things have to be analysed well, and in every detail, before the next step is completed.

An useful method is to think like a real manager, and practice a *SWOT analysis* on the project, in order to identify strengths, weaknesses, opportunities and threats.

A good rule before starting a crowdfunding campaign is to observe the evolution of other similar, and try to understand why they succeed or fail.

Observe other ideas, notice what elements grab the attention and what make you look away and, above all, remember that is not a speed race.

Take as example the words of Bryan Fargo<sup>38</sup>, developer of *Wasteland 2*, (a post-apocalyptic play financed through Kickstarter in 2012) “*I spent three weeks preparing for our Kickstarter campaign. I stopped the company and that is all we focused on during this time. I also did a thorough analysis of our budgets and reward tiers.*”

Learn from the other’s mistakes in order to avoid them, is always a good rule. Another good rule is not directly start a campaign on a platform, but first, begin to spread the message on the site, on social networks and on every available communication channel. In fact, a good visibility is useful even before the real starting, and a real promotion began before the publication of the project.

The first communication starts with the decision about the message: if there is a team, all the members mobilize to assure the perfect connection between the posts, to avoid discrepancies and inconsistencies. Once the message is ready, the choice falls on media; usually the social network are an obvious decision, given their high visibility.

Presentations can be made using short videos explaining the idea, posts that invite people to fund the project, and in many other ways. In particular, video and images are a very powerful mean to give a clear idea, since they capture the attention most than words and allow a better interaction between inventors and funders. Is important to remember that pre-launch is a sort of *preview* of the campaign, like the trailer for a movie; its aim is not to describe everything in details, but to give an invitation, a stimulus to follow the project.

### **2.3.2 Launch and fundraising**

After all the pre-launch tasks are accomplished, next step is the choice of the platform. Next paragraph explains what factors must be taken into consideration during this decision.

When the creator solved all the doubts regarding his project, and he is reasonably sure about the shrewdness of the data he prepared, he can think about what platform could be right for the campaign. This decision is made taking into consideration some key

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<sup>38</sup> Steinberg S. *The crowdfunding bible* p.20, John Kimmich 2012

points<sup>39</sup>:

- **Target**

What are the platforms that my potential funders follow more, and why I can find them?

- **Visibility**

Can I have enough visibility on that platform? I want a thematic or a generic one?

- **Reliability**

Is the platform affordable? Might I have some surprises (a site crash, a sudden closure...)?

- **Fees**

What is my willingness to pay?

- **Return**

What kind of return I want to give to funders?

- **Type of crowdfunding**

I need all the money (all or nothing) or I can do something even with a part of it (keep it all)?

- **Duration**

How long should my campaign continue raising funds?

After the pre-launch, it comes the time to realize the real *launch*. The creator charges the project on the chosen platform, and it is visible to all the potential funders.

With the publication start a very delicate phase: the *interactive presence*.

Interactive presence means that the crowdfunder has always to be present, replying to questions, doubts, critiques, to load updates and all the indispensable activities to catch the funders' attention.

Lenders have to be captured by the message, and have to feel like an important part of the project, not only mere money providers.

However, their attention must continue through time; if they do not perceive attention, and think that the campaign is neglected even by its own starters, they will leave.

Crowdfunders do not have to forget that communication is the focal point of the entire campaign, and their only way to grab lenders' interest.

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<sup>39</sup> Steinberg S. *The crowdfunding bible* p. 24, John Kimmich, 2012

In order to catch the attention on their pages, they have to follow some simple rules that has always distinguished successful projects from failed ones:

- ***Adapt the communication to your target***

Of course, is not the same to make a speech in an equity-based platform and in a donation-based one. Kindness, professionalism and clarity are the golden rules for every platform, but the tone and attitude of course change.

In an equity or lending-based site, people invest to make gains, so there is also a high probability to find professional investors, or business angels.

The tone should be more serious, with a qualified attitude and few times for laughs and gags<sup>40</sup>. In the other platforms, the tone might be more confidential, with more space for a friendly pose, giving for granted the rules of clarity, kindness and professionalism.

- ***Keep the messages simple and clear***

This relates to what said above. The funders have to understand perfectly the idea, so is better to avoid using complicated words and many numerical data. The use of video and images is fundamental; in video attention must be grabbed in the first 10 seconds. Never forget that your project is only one of the many, so is easy for funders to pass from a project to another.

- ***Focus on value creation***

A good way to capture interest is to focus on the value that the project will create. Lenders might not immediately understand the consequences of a work, so a clear explanation of benefits help them to clear their ideas. A video or a text should start underling the problems an invention wants to resolve, and then explain why it is the solution. An example is the presentation videos of Phree, the pen that write on everything. One of the video starts with "*Smartphones are great, but they are not a perfect input device. To fully express ourselves we need better space, better precision...we need Phree*"<sup>41</sup>

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<sup>40</sup> Steinberg S. *The crowdfunding bible* p. 24, John Kimmich, 2012

<sup>41</sup> Lederer G. video presentation of Phree, 2015

- ***Involve people to participate***

Keep always in mind that crowdfunding is not only financing. It is not as if mom gave you a tip, you closed it in the moneybox and best regards. People *want to be an active part* of your campaign, they want to participate.

In videos and presentations, do not be afraid to ask more than money; show yourself glad to receive advice or warnings, and explain that their experience is precious for you. Remember that they are investing their money, so is natural if their desire to be active (but non-invasive) parts.

- ***Offer stimulant rewards***

Unless you are on a donation- based platform, people will expect some kind of return by your project. Maybe they like your idea, or they might share the same beliefs, but they are also stimulated by rewards.

It is the old rule “*nobody does anything for nothing*”, so keep in mind that returns are a key point for a crowdfunder.

It depends of course by the type of platform you are on. Investor might give importance to a good ROI, or to a preview of your concert, depending on who you are. Rewards are key point, so much than even in charities project funders receive a ‘return’ in form of a public thanksgiving.

These rules help the crowdfunders to grab the attention of the potential lenders, and everyone that wants a successful campaign should follow them. The crowdfunders, in addition to the attention, must grab also the funders’ trust, and follow some sort of “etiquette”<sup>42</sup> on the platform. This etiquette is for crowdfunding, the equivalent of netiquette for internet, and some rules of conduct that have to be respected by every borrower. In fact, these norms are called *crowdtiquette*:

- ***Availability***

Is the main principle. There are no stupid or inopportune question, every one of them needs attention. It is important to show a total transparency and availability to the audit’s questions.

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<sup>42</sup> Calveri C, Esposito R. *Crowdfunding -World 2013 report, analysis and trends*, p. 100, 2013



- ***Elasticity***

If someone asks you to re-explain something, not realizing the first explanation, it is important to change the way you expose, avoiding to repeat the same phrases; and of course, be patient. Do not forget they are investing their money.

- ***Timeliness***

Is another important rule. Never answer after a long time, but always make ready and quick answers.

- ***Inform, but not annoy***

It is useful to make some updates, to adjourn on the state of campaign, but it should not be stressful. Load irrelevant and unnecessary data just to give an impression of presence, is an index of insecurity and can bother the followers.

- ***Moderate***

If some debates or discussions arise, never be afraid of them. Instead of trying to stop them, encourage and act as a moderator. They are a good occasion to clarify ideas and make followers discuss to each other.

This may appear like simple rules, but they are never trivial. Tons of crowdfunding campaigns fail because inventors are not able to understand and correct their errors.

Sometimes is not even a matter of attract attention, but to maintain it. Campaign fail every day because creators are unwilling to give information or think that just a first explanation is enough. After the publication and the fundraising, start the next phase, the project implementation and the distribution of rewards. Next paragraph explains how a crowdfunder must behave during this stage, both in case of success and failure.

### **2.3.3 Project implementation and distribution of rewards.**

After the end of the campaign, both in case of success or failure, the crowdfunder must follow some behavioural rules useful to improve his web reputation.

If the project do not reach the required amount, is a good norm to thank the supporters and those who fund the campaign: even if this one failed, they might be the first promoter of a future campaign.

Give a thanksgiving and try to maintain the rapport is far from wrong. The followers might be the base from which to start a future project.

Both in the KIA and AON models ask the lenders if they want to be informed on any future developments, is a proven method to maintain relationship and keep the interest alive.

In the KIA model the creator maintain the money raised, so it means that now he's managing their resources. Is a natural consequence, for funder, to be adjourned on how their funds are being used.

Leave suddenly the platform, in case of failing, without writing something is the best way to ruin your future projects and appear like a mere money hunter.

In the AON model, try to maintain relationship in any case, as a base for web relations.

If the project reached the required amount, the matter is more complicated, and there are some precise rules the crowdfunder has to follow:

- ***Thanksgivings***

Is an obligation. Funders and followers supported you, with money or advices, and they deserve at least your gratitude. It is better to thank them personally, and not with a public announce, because it give a sensation of importance and acknowledgement.

- ***Give news about rewards or economic returns***

Of course, funders want to know when the rewards arrive. Give a date or an estimated period of time in which you are sure they will gain their returns.

Give constant updates on their development and do all the possible to avoid failings and delays.

- ***Give adjournments about project implementation***

Financers want to know about the status of the project. This is not only a matter of rewards, but also of ideas and beliefs. They might have financed it because they share the same goals, so not only just to have a reward; and realization became something

personal for them.

Of course, once the funding is ultimate, creators have to employ all their forces to realize the project; a failure, if the campaign was successful, is the best way to ruin the online reputation forever.

Although scholars describe crowdfunding as a new, alternative way for financing, is not a panacea, and creators must keep in mind that a great part of the project fails. Failures are, of course, normal in a world where there are tons of different choices, and not every project see the realization.

However, great part of them fail for crowdfunder's mistakes and defects. Some campaigns ask a budget that is too much high, convicted that internet is like a golden mine.

Some other creators are not able to overcome that barrier of scepticism created by something who is totally unknown; they are not able to give their product an *identity*.

These were the main guidelines to observe to implement a successful campaign. Of course, they vary according to the project, but there is enough to say that they are fundamental rules, without which crowdfunder is almost surely directed to failure.

There is also the possibility that the amount overcome the initial one; cases where crowdfunders raised 100 instead of 10, as they needed are not rare, and peculiar of projects that catch the attention.

This situation is, of course, a welcome surprise. Kickstarter data<sup>43</sup> shows that, between succeeding projects, only 1 in 9 raise 200% of the goal or more. It is a figure to be proud of, if we think that the same paper asserts that only 46% of crowdfunding project in Kickstarter succeed. There are data of the main platform, but this is the situation of most worldwide projects.

Usually if they fail, they fail by a large amount and if they succeed, is by a small amount. Precisely, between the unsuccessful campaigns, 50% of them is funded for 10%, and only 3% of them reach at least 50% of the goal. If they achieve the goal, only 50% of the campaigns is funded 10% more than the original amount, and less than 10% double the fixed capital

Like this data explain, a situation where the crowdfunders receive much more respect to what they though is very rare.

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<sup>43</sup> Bringmann S. "*Kickstarter Crowdfunding: How the Predictors of Success Vary by Project Category*" p.9, paper 2012

However, although it is rare, it might happen, like the Pebble Watch campaign demonstrated.

In these cases, the crowdfunder must not remain displaced, without knowing how to behave.

Maximize the effect of a triumphant campaign is very important to impression the funders and to make the best with that money. It is a natural consequence for lenders, once they see the result, to pretend more from the borrower.

Despite the appealing presentation or the making of a video or some pictures, the central focus of the campaign is the development project of the product. Every startup should be able to answer questions posed by their supporters, on how to invest the money obtained on the development and distribution of the product. Company loyalty bases on few clear principles: integrity first. Another golden rule is let others speak for you. In no place as a crowdfunding campaign a video is more effective. If there are industry experts, more or less known supporters or beneficiaries that can give their support with a short video statement, donors will understand that you are doing things right and that you are serious. The crowdfunder must prepare announcement where he explains the improvements he wants to do with the extra-budget, and propose some extra-rewards, to thank funders for their generosity.

He must not forget that there are greatest responsibilities if the campaign overreach the amount, and lenders' expectations are higher; in these cases, there cannot be failures in project implementation. Lenders must not forget that there is also their reputation exposed on the Internet, and not only a simple project. The failure in the realization, even when the campaign reach the total amount, is not possible. Too many creators do not consider the many unexpected events that can interfere in the realization of a project (bureaucratic, practical and other). They simply think that everything will be all right, and make promises on promises to convince investors to support them. These people will be the first one to fall down once the time of the implementation arrives. The rules explained above consist in a brief guide on how to succeed in crowdfunding. There is no rule more important than others are; all of them have are important. Next chapter focus about crowdfunding legislation and development in USA (very brief explanation), EU, and a first introduction on the Italian market. The third chapter works like an anteroom for the researches on the Italian situation of crowdfunding, and analyses the regulations for entrepreneurs and managers of portals.

## CHAPTER THREE

### 3. REGULATIONS AND NORMS FOR CROWDFUNDING IN GLOBAL MARKETS

This chapter is composed by three main parts: on the first one, it presents a brief analysis of crowdfunding regulation in USA market, which is considered the most developed one. The second one focuses on crowdfunding main markets and rules inside the European Union, to analyse some of the rules from which the Italian scholars took inspiration to design the actual legislation.

The last section offers a first review of the Italian crowdfunding environment, with an analysis on the active platforms and a research about the rootedness of this discipline in this country. The goal is to understand the regulations of the most developed countries, in order to comprehend from which ones Italian rules took inspiration, and how they link to the common law of EU markets.

#### 3.1 USA: the JOBS Act

The development of crowdfunding in USA market (above all the social lending and financial) knew a remarkable breakthrough in 2012, when the Commission approved the J.O.B.S. Act, a law created to boost company formation and facilitate transactions through crowdfunding<sup>44</sup>. This process was necessary to help economic growth and provide jobs and financial instruments to entrepreneurs who were hardly hit by the economic crisis. President Obama, which converted it into law on April 5, 2002, personally promoted the J.O.B.S (Jumpstart Our Business Start-ups) Act<sup>45</sup>. This act is the main and most effective law that regulates crowdfunding market in USA, and mainly affects social lending and equity crowdfunding; those two typologies knew a sudden rise

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<sup>44</sup> For further informations <http://www.sec.gov/news/pressrelease/2015-249.html>

<sup>45</sup> *Implement JOBS Act crowdfunding rule now*, p. 3, research by Eric Cantor, former House majority leader,

right after the approval of this law. However, what are the contents and the advantages of the JOBS Act? Before 2012, portals and startups operating through crowdfunding had to register to SEC, according to the Securities Act of 1933. In fact, the act classified them as normal “security solder”, with all the consequent obligations.

The registration concerned all the company’s aspects, like description of property and businesses, description of the security offered and information about the management.

This process enables potential investors to obtain information and make judgements about the purchasing of a company’s securities. This situation was of course unsustainable for small crowdfunding transactions and for companies, which operates with small amount of money, due to the costs of registrations. Moreover, under the Securities Act, a site operating as an intermediary in crowdfunding transactions must register on the Commission as a broker-dealer and comply with the laws and regulations applicable to broker-dealers.<sup>46</sup> This norm of course strongly limited the activity of crowdfunding intermediaries that should have operated under the full broker-dealers regulation<sup>47</sup>. To make an example, a platform named ProFounder, in June 2011, closed its activity due to the actions with which the California Department of Corporations interdicted its operations until its registration as *broker-dealer*. The JOBS Act (Title III) provide some exemptions in registrations for certain crowdfunding transactions; to be classified as “exempt”, they have to meet specific requirements, in particular:

- The total amount raised by a project must not exceed \$ 1 million in a 12-month period. This is not an obstacle, considered that most projects have a much smaller target amount.
- Individual investments, in a 12-month period, are limited to:
  - A maximum amount of \$ 2.000 or not more than 5% of annual income or net worth, if investor’s annual income or net worth is inferior to \$ 100.000

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<sup>46</sup> *Securities and Exchange Commission (Federal registered version)*, S.G Abero, J.Dickerson, 2014, p.9

<sup>47</sup> Because brokers and dealers both register as broker-dealers (i.e., there is no separate “broker” or “dealer” registration under Exchange Act Section 15(b)), is preferable to use the term “broker-dealer” in this paragraph.

- An amount equal to 10% of annual income (not exceeding \$ 100.000) if investor's net worth or annual income is equal to \$ 100.000 or greater.
- The transactions have to be carried out by an intermediary that is registered to SEC as a broker or as a new entity, named "funding portal".

JOBBS Act introduces a new typology of enterprise, called "Emerging Growth Company, (E.G.C)", define as an issuer that, in the last fiscal year, maintained a "gross annual revenue" inferior to \$ 1 billion. "Total annual gross revenues" means total revenues as presented on the income statement presentation under the U.S. G.A.A.P. The company maintains the status if it emits, in the first five years, no more than \$ 1 billion in debt securities (not convertible for a period of three years). Of course, this definition comprises almost all the startups. This status enable EGC to obtain some benefits:

- They are exempt from disclosure requirements on executive compensation.
- Have less accounting requirements (for example an E.G.C have to present no more than 2 years of audit in the IPO registration).
- They have flexible conditions regarding the communication to investors. An E.G.C can openly communicate with them, if they are qualified buyers or accredited investors.

Crowdfunding operations have to be conducted through a professional broker or a registered portal, classified by law as "funding portal". The portal has to conduct due diligence procedures, to reduce the risk of fraud, as check and verify the identity, history and main officers of issuers. Portals have also to control investor education in similar operations and to "educate" investors, making them understand the risk to lose all the investment (generally they make it with a questionnaire where investor must show the understood risk of illiquidity). The figure of the "funding portals" was introduced by the JOBBS Act, which classifies them as *"subjects that, through the Web or with the aid of*

*electronical instruments, act as intermediaries in a transaction that involves the offer or sale of securities on behalf of others*<sup>48</sup>. They maintain this status, providing that:

- There's no recommendations or investment advices
- Does not compensate employees or other person for giving solicitations on investments, or with remuneration based on the sales of the securities published in the website.
- Does not hold nor possess issuers' equities or securities.
- Never takes part on the investments offered on the website.

The necessity to promulgate such a detailed regulation for equity crowdfunding was made for the growing amount of the money exchanged with this method among the USA. The need for regulating securities was mainly due to investor protections, because of the intangible nature of securities, their easiness to deceit and the information asymmetry present between issuer and investor. The rules, providing a maximum amount to invest and clear rules on the information both companies and portals have to give to investors, act as a shield from fraud and deception. However, although it might seem a perfect law, the JOBS Act (before the vote on October 2015) does not allow many average people to invest in crowdfunding; in fact, at the moment of writing, the crowdfunding transactions are permitted only to accredited investors. Accredited investors, following the definition given by the Dodd-Frank Consumer Reform and Protection Act, are those who<sup>49</sup> *"Have a net worth of at least \$1 million, not including the value of a primary residence; or have an annual income of at least \$200,000 for an individual, or \$300,000 for a married couple. The income must have been reached in each of the past two years, and there must be a sensible expectation that it will continue to be reached in the coming years."* This rule (active until the vote of the Commission on October 2015) allowed only 7% of American households to invest in crowdfunding, putting an entry barrier that knocks out small non-accredited investors. Of course, this definition about who can

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<sup>48</sup> *Fundamental of JOBS Act*, T.A. Martin, 2013, p. 11, paper available at <http://ssrn.com/abstract=2040953>

<sup>49</sup> *CrowdFundBeat*, J.Newbery, 2013, article available at <http://crowdfundbeat.com/2015/06/18/are-you-an-accredited-investor-it-may-not-matter-soon/>



invest in crowdfunding makes the previous rules on net assets superfluous, at least until the part of the law regarding non-accredited investors will take effect.

On June 2015, many American states, tired of waiting for a federal regulation that seems still far, took action, passing crowdfunding laws among their legislations to let local businesses raise money thanks to residents.<sup>50</sup> This movement is growing fast: at the present date, about 22 states have promulgated such rules, and other eleven are considering acting in the same way. The new state laws every country is approving increased the number of potential investors: in Texas, where non-accredit investing for crowdfunding became legal in November 2014, they raised to 20 million, thanks to the Texas Intrastate Crowdfunding Law<sup>51</sup>. In Vermont, their number climbed to 500.000 and it continues to growth. Of course these laws have restrictions, which vary state by state; the most common one is that the investments can be made by raising money only in that state, most of the times excluding the possibility to operate with intra-state actions. For example, a physical person located in Texas who might desire to support a project of a Californian proponent, finds an insuperable legal barrier. The amount of money that can be collected for every operation is relatively small: it varies depending on states, but its limit is about 1 or 2 million. The total money each individual investor can give is about \$ 10,000 (for non-accredited investors). In many states, businesses are encouraged, and in some cases, obliged, to advertise their offerings through online portals. Some of the main problems that arises, however, is a lack of awareness of potential non-accredited investors; the equity crowdfunding market, for common people, in USA, struggling to take off. It is probably an effect of mistrust, because it is not a federal fact. In October 2015, SEC just voted on the approval of the Title III of the Jobs Act, which finally gives the opportunity also to non-accredited investors to operate with crowdfunding. Now potential lenders have only to wait 90 days, the required time for commenting period to take place and the new final rulings will be published in the Federal Register. When equity crowdfunding with non-accredited investors will finally come into effect, it will have massive implications for startups and investors alike, allowing everyday citizens to invest in startups. Jobs Act was the first regulation for equity crowdfunding, and it is facing in recent period its completeness.

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<sup>50</sup> *Tired of Waiting for U.S. to Act, States Pass Crowdfunding Laws and Rules*, S.Cowley, 2015, article available at <http://nyti.ms/1GZlym1>

## **3.2 The regulation of crowdfunding in E.U**

The second paragraph aims to analyse how crowdfunding is regulated in the European Union, and if there are reasonable motivations to believe in a quick and fast development of an intra-state crowdfunding market.

The role of the E.U Commission is, in this situation, central and focal; the members have to understand the growing importance of alternative finance, and the risk that this business remains undeveloped only for a lack of common regulation.

The lack of harmonization at a European level could be an obstacle to the growth of this market, like it as happened in the past for venture capital funds.

The present situation, as the above paragraph explains, denotes a proven consciousness about the importance of crowdfunding and its growth (alternative finance market raised about 144% in recent years), but at the same time an obvious slowness caused by bureaucratic papers.

### **3.2.1 The present situation and the lack of common norms**

The present situation of crowdfunding across the EU is still very fragmented.

The different crowdfunding types are regulated state by state, and there is also a lack of common legislation.

Reward-based and donation-based are the most common and developed models; although they are ruled in different ways by every nation, there is a general simplicity in the norms.

Because they not involve the exchange of risk capital, but simply donations and charities, they are not subject to all the norms regulating lending and equity crowdfunding.

In most countries donations or reward models are outside the financial regulations, since they not provide financial return; these platforms often do not require any regulations (like in Croatia or Denmark), while in other cases they have to register as

non-profit or charitable organizations. In France and in other countries there is also the possibility to deduct part of the donation from the income tax of the relevant year.<sup>52</sup>

Regarding the financial-returns models of crowdfunding, Europe still does not have a common legislation that can harmonise the different protectives of the member countries.

Generally, the European Commission has already showed its intention to support crowdfunding policies and to provide a common legislation to create a unique European market without boundaries. For example, in the Green Paper on long-term financing published on March 2013, the Commission did a public consultation to ask “*how alternative finance, especially crowdfunding, can be supported*”.<sup>53</sup>

For the first time, in this paper, the Commission discussed on the heavily dependence on bank-intermediation for financing and on the low flexibility of its financial system. The commissioners recognised the need for a more diversified system and discuss about possible alternative financial sources, including crowdfunding.

One of the main arguments was how to overcome the difficulties encountered by SME in accessing capital and resources, and the consciousness that crowdfunding became a more and more used method in accessing funds. However, on the other side, despite the intention to create alternative way of funding, the Commission stated also the need to reinforce and assure investors’ protection, in order to avoid other collapses like those of 2008.

They open the way to “*a more open and competitive financial market, but with a restore stability and confidence*”.<sup>54</sup>

Moreover, according to an official communication about this meeting, Commission declared it aims to unleash the potential of crowdfunding in the E.U, like said in the official report “ *Unleashing the potential of Crowdfunding in the European Union*”, of March 2014.

This communicate presented a detailed research about crowdfunding situation in E.U, and a research about the possible European legislations under which the discipline could fall.

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<sup>52</sup> *Review of crowdfunding regulations 2014* , p. Published by the European Crowdfunding Network AISBL, Oliver Gajda editor

<sup>53</sup> *Green paper long-term financing of the European economy*,p.2 final available at [http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1433318086120&uri=CELEX:52013DC0150R\(01\)](http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1433318086120&uri=CELEX:52013DC0150R(01))

<sup>54</sup> *Green paper long-term financing of the European economy*. 7

The main problems that the paper underlines regard the fear of fraud, money laundering and intellectual property protection.

One of the major problem was the current fragmented system of patents protection among members, which does not assure perfect warranties. One of the main defies is to create a European patent system, with unitary effects: to this purpose, in 2012, a cooperation agreement was made among the Members to set up an Unified Patent Court, which process is still on approval.

The present laws from which crowdfunding (especially the financial-return one) might be interested are:

- ***Markets in Financial Instruments Directive***, created in April 2004 to improve the competitiveness in the financial market of the Union, by creating a unified market for investments activities and ensure a higher degree of investor's protection.
- ***Distance Marketing of Financial Services Directive*** adopted in 2002 and reviewed in 2006. Its purpose is to impel consumers' trust about Internet transactions by establishing fundamental rights for the users.
- ***Regulation on European Social Entrepreneurship Funds*** of 2013, that set out a new "European Social Entrepreneurship Fund" label, under which entrepreneurs can identify businesses that focus on E.U social business, and market their funds across Europe.
- ***Capital requirements regulation and directive***, of June 2013, about the access to the activity of credit institutions, and supervision of credit institutions and investing firms.

These of course are only the main directives under which crowdfunding a potential common legislation could regulate crowdfunding, but there are other minor laws that could be interested by this discipline.

A public consultation made in 2014 stated that the situation for the development of financial-return crowdfunding was not so good as it might seem<sup>55</sup>:

Only 38% of the companies that answered the consultation operated cross-borders, and about half of them would like to operate in this way in the future, but is doubtful for the lack of a harmonised legislation.

The 44% of all the platforms claimed the lack of clear information on how to operate in more than one E.U country, and 27% of them underlined the high costs of providing the authorization for another country<sup>56</sup>.

The situation of non-financial crowdfunding was a little better, with 81% of the answering firms operating in more than one country. This is due to the simplicity of non-profit regulations, which are common to most countries, and generally requires very low costs.

However, considering that social lending and equity crowdfunding are the models that move investments is easy to understand how the situation is problematic.

For the future, the European Commission is still studying the phenomenon and waiting to understand how to act. The consciousness about its importance is high, however Commission wants to avoid the risk to act too soon and lack some points that could reveal as crucial.

A first study has also been made by the European Securities and Markets Authority (ESMA), called "*Opinion along with an Advice on Investment-based crowdfunding*"<sup>57</sup>.

The Opinion is like a proof that E.U is looking with interest at this market and has the intention to regulate it soon (at least, at words...).

The Opinion is an analysis on how crowdfunding applies to E.U existing common rules, depending on the specific model used.

It also acts as a guidance to NCAs who may want to regulate platforms acting outside the scope of the harmonised EU rules on the risks inherent to crowdfunding and the key components of a good regulatory regime to address them.

In the opinion of Oliver Gajda, director of the *European Crowdfunding Network (ECN)*, it is a curious document, because they explain how to regulate crowdfunding while they still don't have a harmonised regulation.<sup>58</sup>

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<sup>55</sup> *Unleashing the potential of Crowdfunding in the European Union*, p. 8. Official report of E.U Commission

<sup>56</sup> For more informations

[http://ec.europa.eu/internal\\_market/consultations/2013/crowdfunding/index\\_en.htm](http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/index_en.htm)

<sup>57</sup> *Investment-based crowdfunding needs EU wide common approach*, p.1, ESMA, 2014

The opinion of Gajda is that they will make a common regulation, but it would take a long, long time. The question mark is if the E.C will adopt the same rigid rules of financial markets, or will act with a *deregulation*.

### 3.2.2 Crowdfunding policies among the main EU Members

The lack of common European standards contrasts with the present situation of crowdfunding development among Members.

In most experts' opinion, although the European Commission and the competent authorities has never been too proactive in recognising several changes in economy, they are lacking the opportunity to act soon, to seize the full potential of his discipline.

With this situation, it is impossible to offer a good analysis on crowdfunding regulation on EU, but is more realistic to study how it works among the principal Members.

The scope of this paragraph is to understand crowdfunding regulations in the three main EU countries (France, Germany and UK), and, how we can make a comparison with Italian rules.

- **France:** this country has great numbers on crowdfunding. A report from the *French Crowdfunding Association Finance Participative* (crowdfunding in France is called "*financement participatif* ") attested that, between 2008 and 2015 crowdfunding sponsors were more than a million, with more than 40.000 projects were proposed on web.

In a document of 2014, platforms obtained two possible different statuses, C.I.P (*conseil en investissement participatif*) and I.F.P (*intermédiaire en financement participatif*).<sup>59</sup>

C.I.P status is required to operate in equity crowdfunding. C.I.Ps must be legal entities located in France. Although no license is required, C.I.Ps are placed under the supervision of the A.M.F (*Autorité des Marchés Financiers*), being submitted to registration obligations. Equity investments are limited to ordinary shares and fixed interests bonds. Securities like warrants, convertible bonds, and others are

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<sup>58</sup> *Il Crowdfunding in italia:una regolamentazione all'avanguardia o un'occasione mancata?*,p. 128, U.Piattelli, Giappichelli editore, 2013

<sup>59</sup> ECN-Review of crowdfunding regulation, p 93, ECN paper, Oliver Gajda editor,2014

excluded from the scope authorised on Crowdfunding investment platforms. Equity Model platforms cannot take shares in the companies they organise sponsoring for.

Consequently, they can no longer have seats at the board of directors of the relevant companies<sup>60</sup>.

I.F.P status is for portals that propose Lending and Donation/Reward crowdfunding. To be qualified as I.F.Ps, a platform shall register with the O.R.I.A.S<sup>61</sup>, present certain moral guarantees, subscribe specific insurance policies and be subjected to a good conduct code. I.F.Ps are viewed as legal entities (not necessarily established in France) that put in contact, through a website, people who carry projects and people financing such projects by loans or donations, under limits set forth in article D548-1 of the CMF with regard to loans.<sup>62</sup>

- **Germany:** here the situation is a little bit more complicated, at least regarding financial return crowdfunding.

Entrepreneurs and businesspersons who want to issue some kind of securities or investment products to investors might be subject to a prospectus requirement that is the requirement to publish a prospectus approved by BaFin under the German Securities Prospectus Act. BaFin, the German financial authority has to release an authorization for each securities transaction, except for tacit sales of equity. Therefore, equity crowdfunding transactions are actually limited to these instruments. These operations cannot exceed the maximum amount of € 100.000. To overcome these limits, some platforms created the “Partiarisches Darlehen”, approved by BaFin. These are debt instruments allowing the participations to profit, without obtaining corporate rights and participating in losses.

Reward and donation based platforms are not qualified as investment platforms, and fall outside Germany’s financial service regulations,<sup>63</sup> above all the first ones, that are settled as normal charities organizations.

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<sup>60</sup> ECN-Review of crowdfunding regulation, p 94, ECN paper, Oliver Gajda editor,2014

<sup>61</sup> Details at <https://www.orias.fr/espace-consommateur>

<sup>62</sup> ECN-Review of crowdfunding regulation, p 98, ECN paper, Oliver Gajda editor,2014

<sup>63</sup> *Regulation of Crowdfunding in Germany, the UK, Spain and Italy and the Impact of the European Single Market*, T.Nagel,,T.A Florange.P. 9, ECN publication, 2013

- **UK:** the Financial Conduct Authority's ("F.C.A") approach was to admit the permissibility of investment-based Crowdfunding as a valid business model.

This model should operate under the existing regime, but with fewer amendments.

Usually, a financial promotion cannot be directed towards an investment audience unless the promotion is communicated and approved by a firm authorised by the FCA or it benefits from some type of exemptions. There are some exemptions for these platforms to avoid the costs of registering as financial promoters.

However, this type of crowdfunding is only to professional investors, due to the risk it bears.

Instead, donation/reward models fall outside the financial regulation, and in most cases fall under the legislation of non-profit or charitable entities.

### **3.2.3 The path for a harmonised legislation: lessons to be learned**

Analysing the crowdfunding regulations among the main member countries (usually the engine of EU), it is possible to extract some guidelines that would be useful for a harmonised regulations among Members. The first step, since investors' protection appears to be the priority for the Commission, could be to limit the amount a person can invest.

Following the example of the JOBS Act, or the regulations present in member countries, to put a borderline on how everyone can invest or donate, will ensure individuals do not expose too much on a project.

Another step could be the limitation of the maximum amount a platform can collect for a single operation; this might be a useful move to allow the sector to develop without pressure from banks and credit institutions. These companies, in fact, should not see crowdfunding as an "enemy" for their activities, or might try to wipe out its development.

A key point must be to overcome the strictly rules and costs of the financing world, which are impossible to follow for small portals.



There is the need, as proven by the countries explained above, for flexible and simple regulations, which also common people have to understand. If some young entrepreneurs want to start a crowdfunding platform, they must not lose into intricate bureaucratic labyrinths. Implementing a reliability label assigned by public authorities might help crowdfunding to be seen as worthy of trust, winning the mistrust towards it.

The Commission has to closely follow the efforts made by associations, to promote the development of common standards at national and at European level on transparency and best practices, with the scope of informing users and to protect contributors.

Of course one of the main obstacles to a harmonised legislation is the difficulty to reach an agreement between all the EU members, and everybody knows that it usually requires very long times for every argument.

The fact is that many local legislations have already been implemented, requiring long steps and a national harmonization of new crowdfunding rules to existing regulations, in some cases with heavy modifications also to other sectors. The main difficult is so to convince politicians and scholars to change again (because certainly national laws will encounter some modifications in case of an EU common regulation) and maybe to renounce to the efforts made until now to encounter the exigencies of a stranger counterpart.

Another point to consider is that EU regulation may provide all regulatory ingredients necessary to develop market trust and allow operations across borders, but it might not work in practice.

The first reason is that even if EU regulations, given as European Directive might exists, local governments may interpret it in different ways. Local authorities also have to respond to local demand by SMEs and crowdfunding platforms, so they are influenced also by their needs<sup>64</sup>. The scope of this chapter was to understand the regulations of main countries.

The thesis is coming close to the focal argument; the illustration of the Italian crowdfunding market will start from the next chapter. The thesis is coming next to its focal argument, the crowdfunding in the Italian market; this chapter was an obliged step to understand how the Italian crowdfunding works and in what kind of environment is absorbed.

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<sup>64</sup> European Crowdfunding Convention <http://www.crowdfundinsider.com/2015/10/76509-its-a-long-way-to-european-equity-crowdfunding-regulation/>



## CHAPTER FOUR

### 4. THE CROWDFUNDING IN THE ITALIAN MARKET

The previous chapters focused on a general overview about crowdfunding, its history and its policies.

The first two chapters gave a first explanation of this new funding method, introducing and explaining it to inexperienced people. The third chapter focused on the main crowdfunding regulation in USA and Europe, in order to introduce the possible sources from which it took inspiration.

In this chapter, the thesis starts to analyse its main argument, introducing the crowdfunding on the Italian market. The goal of this chapter is to give, first a general description about history, diffusion and subjects of Italian crowdfunding; then the chapter introduces the current regulations for portals and investors, giving particular importance to the Consob Regulation.

#### 4.1 The composition of the Italian market

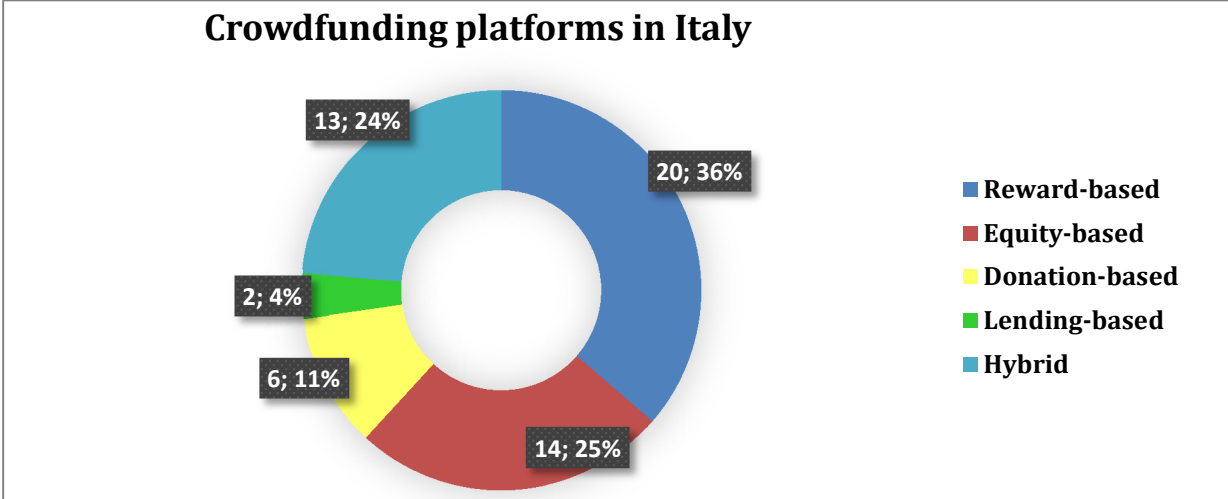
Within the European context, Italy is, together with France and Great Britain, the country that is strongly pushing the growth of crowdfunding.

The “Crowdfunding Revolution” arrived in Italy about ten years ago, with the foundation of Produzioni Dal Basso, the first Italian platform. This platform aims to propose itself like a donation/reward based above all for social funding. The platform was born in 2005, thanks to an intuition of its founder, who was influenced by the new-born American platforms.

This sector started to rise in 2009/2011, when creators founded most of the actual platforms (Smartika, Eppela, BuonaCausa and others...).

The Italian platforms divided into four traditional categories<sup>65</sup> (donation, reward, equity and lending based) and a fifth one, composed by hybrid platforms. Hybrid platforms are portals that is not possible to identify with in a classic group, since they provide different funding method (for example royalties, like Starteed) or propose more than one model (ex: reward and donation). At September 2015 (last data available), the number of the Italian platforms amounted to 55, a data that underlines the amazing growth of this market, considering that at the end of 2013 there were 27 platforms. Of course, there are tons of projects that entrepreneurs and potential start-ups propose to the portals, but not everyone sees the light. In a study conducted by the ICN (Italian Crowdfunding Network)<sup>66</sup>, about 80% of the platforms declared to practice a selection between the proposed ideas; of all the projects, about 26% of the total is finally allowed to publication.. The offer seems to grow faster than demand. The success rate is equal to the average of 76% in donations, 46% in reward-based, 38% in lending-based and 25% in equity-based.<sup>67</sup> *Graphic 4.1* shows the actual fragmentation of the Italian market.

**Graphic 4.1**



**Source: Analysis of Italian Crowdfunding Platforms, ICN publications, published 20 May 2014**

<sup>65</sup> *Analisi piattaforme italiane di Crowdfunding*, D.Castrataro, I.Pais, p. 3, 2014, paper of ICN.

<sup>66</sup> *Analisi piattaforme italiane di Crowdfunding*, D.Castrataro, I.Pais, p. 6, 2014, ICN paper.

<sup>67</sup> Economy Up, *l'Italia che vuol crescere*, C.Desando, July 2015, article available at [http://www.economyup.it/startup/2092\\_tutto-quello-che-bisogna-sapere-per-usare-55-piattaforme-di-crowdfunding.htm](http://www.economyup.it/startup/2092_tutto-quello-che-bisogna-sapere-per-usare-55-piattaforme-di-crowdfunding.htm)

### 4.1.1 The reward-based platforms in Italy

In Italy, there are 20 platform practising this type of crowdfunding, most of which publishing art-related project; the most important ones are:

- ***Eppela***, probably the most famous Italian platform, with projects that covers different fields, from art to social, from movies to technology.  
This platform is famous for its severe judgment rate, because only 10% of the proposals become a published project. Eppela is also the first Italian platform trying to operate abroad, with three technological project launched in 2015 in the United States.
- ***Distribuzioni Dal Basso***, the first Italian platform, founded in 2005. It defines itself like a new way to make cinema and inquiries, with a portal dedicated to video-production.
- ***Kendoo***, launched in 2012, its business concerns the development of innovative web-products, social media, mobile, e-commerce, but also social causes.
- ***Finanziami il tuo futuro***, a local-crowdfunding platform, aiming to promote ideas and initiatives for the development of the territory. It wants to integrate and rediscover the local-economy sectors thanks to the innovation coming from the surroundings.

Reward-based platforms are the majority in number, but not for money raised; in fact, at the moment of writing, the total sum of funds obtained is 1.045.500 euro, which is the second lowest amount.

In total, there are 640 published project until the present date, 295 of which financed for more than 100%.

Considering the platform with a take-it-all model, the total number of financed projects amount to 325, 30 of which financed for less than the total sum and with the funds kept by issuers.

#### 4.1.2 Equity based crowdfunding: the first regulation in the world

The second largest crowdfunding category in Italy is the equity one; in fact, 18 platforms belong to this funding typology, with a stunning increase in the last two years, after the approval of the Consob Regulation in June 2013.

*Equity crowdfunding* is starting to affirm like a real alternative to traditional funding, thanks to the innovative regulation approved by the Italian government, which makes Italy the first country in the world to have a specific regulation for equity crowdfunding.

The platforms were almost all born between 2013 and 2014, and the main ones are:

- **Starsup**, the first portal to have the authorization of the Consob for risk-capitals collection on behalf to innovative start-ups, which gives great spaces to innovative projects.
- **Crowdfundme.com**, a young crowdfunding platform whose maxim is “invest, innovate and grow” and where is possible to invest a maximum amount of 990 euros.
- **Siamosoci**, allows investors to find companies understanding their businesses and shortens the distance between enterprise, innovation and funding.
- **Unicaseed** an equity platform owned by Unicasim, a real estate society, which permits to the visitors three different levels of operations (*public area* where someone can simply surf the site and watch the projects, *registered area*, where visitor can access to a deeper level of information, and *identified area*, where people can start to propose or to invest in projects.)

Although is the most regulated form of crowdfunding, the equity type is encountering difficulties into its consecration in the Italian market. In its *European Alternative Finance Benchmarking Report*,<sup>68</sup> Cambridge University says that PeerToPeer and equity Crowdfunding have collected almost 3 billion euro in Europe, with an increase in 2014

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<sup>68</sup> *Moving Mainstream* The European Alternative Finance Benchmarking Report, p.13 Robert Wardrop, Bryan Zhang, Raghavendra Rau and Mia Gray, EY

of 144% respect to \$ 1.2 billion of 2013. Excluding the United Kingdom, which is the leading country in terms of online alternative finance, the market for the rest of Europe rose from 338 million in 2013 to 620 of 2014.

The Italian problem, in fact, is that the current regulation of Consob brakes investors rather than facilitate them. If it is true, that the Investment Compact has expanded, the rose of the financeable companies to innovative SMEs and to private equity operators, it is also true that the experts continue to point out there's a number of other issues considered crucial to really make the market start.<sup>69</sup>

In particular, in Italy to invest more than 500 million euro per year in equity crowdfunding, investors should prepare a model for looming (Mifid), sign it by hand, and physically deliver it to bank indicated by the platform, which should also open an account<sup>70</sup>. It is of course, in practice a deterrent, because is a mechanism that makes things more complicated and requires the investor to go to a bank that is not his their one to open a new account, just because this one cannot be satisfied with the fact that another bank has already profiled the investor.

This affects also the investments of foreigners who might not fulfil this procedure by their own.

The paradox is thus that an Italian for example, can easily invest in the UK, but not an English man is not able to invest in Italy. In fact, CONSOB was very (maybe excessively) proactive, enabling a regulation when the equity crowdfunding was not even in its early stage and no international benchmark could be possible yet.

### **4.1.3 The donation based platforms**

Returning to the classification of platforms, although they were between the most diffused crowdfunding platforms, and move a significant portion of crowdfunding Italian market, due to the recent developments in regulations their number shifted to the third position.

They are the *donation-based platforms*, whose number has remained stagnant during last years, probably due to the rise of equity and reward based portals.

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<sup>69</sup> Equity crowdfunding, collected only 1.7 millions. That's why in Italy platforms are struggling, article by Bebez

<sup>70</sup> *Italian Equity Crowdfunding Market: Difficulties and Opportunities*, article by VC Group

In Italy, nowadays there are six active donation based platforms, which promote solidarity and charity projects, both internationals and locals. The main platforms of the Italian scenery are<sup>71</sup>:

- ***Shinynote*** born with the exigence to find for people a space of emotional and social sharing. The platform is a shared space between non-profit organizations and citizen-users, which tell stories more or less positive about ordinary people and finance solidarity projects.
- ***Let's donation***, whose slogan is “profit sustains non-profit”, born to finance charity projects, both nationals and internationals.
- ***Retedeldono***, crowdfunding platform for the collection of online donations, for social utility and non-profit projects.
- ***Iodono***, the first donation crowdfunding platform in Italy, its goal is to allow people to donate online and gather funds for social causes near them.

#### **4.1.4 The lending based model in Italy**

In 2014, these platforms raised more than 23 million euros<sup>72</sup>, contributing for about the 75% of the overall amount.

This is probably due to the higher amount of this type of projects, and to the recent difficulties encountered by equity crowdfunding, despite a favourable regulation. The Italian platforms nowadays are only three, and they are:

***Smartika***, classified by Forbes as one of the first ten social lending platforms in Europe, Smartika allows users to lend money between them without needing bank intermediations.

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<sup>71</sup> *Il Crowdfunding in italia, una regolamentazione all'avanguardia o occasione mancata?* P. 20, U.Piattelli, 2014, Giappichelli Editions

<sup>72</sup> *Analisi piattaforme italiane di Crowdfunding*, D.Castrataro, I.Pais, p. 19, 2014, ICN.paper



- ***Prestiamoci***, the only platform authorised by the Bank of Italy for the management of a social lending portal.
- ***Terzo valore*** a service of Banca Prossima, part of the bank group Intesa Sanpaolo, is a service where physical person can lend directly to non-profit organizations who are customers of Banca Prossima. The bank select projects and finance minimum 33% plus the difference of what it collected for crowdfunding.

#### 4.1.5 The Hybrid platforms

A separate category of crowdfunding platforms concerns the hybrid ones. This typology is called “hybrid” because these platforms can contains more than a single funding model (usually there’s a combination of donations and rewards) or offers a repayment method that is very different by the others (royalties). To make an example, in Italy a recent platform called Starteed<sup>73</sup> offers a crowdfunding model based on royalties. What does it means? It means that investors’ contribution does not stop with funding, but can continues with active promotion of the idea (for example on social media), and a series of actions to contribute to project’s promotion.

This type of investors are called “*influencers*”, because their role is to “influence” the crowd towards their business, and not be mere financiers. However, the most part of platforms is reward plus donation based, meaning that they offer both type of crowdfunding, and a combination of them. This type of portals might have a great diffusion in the future, because it allows users to have the advantages of multiple type of platforms, and is a efficient way to offer returns that are different from the competitors’ ones. The most famous (in Italy) are<sup>74</sup>:

- ***Buona Causa***, a civic and ethic crowdfunding site, dedicated to social causes. The platform enables organizations, public agencies, testimonial, companies,

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<sup>73</sup> For more information, visit the website of Starteed at <http://www.starteed.com/>

<sup>74</sup> Economy Up, l’Italia che vuol crescere, C.Desando, July 2015, article available at [http://www.economyup.it/startup/2092\\_tutto-quello-che-bisogna-sapere-per-usare-55-piattaforme-di-crowdfunding.htm](http://www.economyup.it/startup/2092_tutto-quello-che-bisogna-sapere-per-usare-55-piattaforme-di-crowdfunding.htm).

supporters and activists to work together on initiatives and crowdsourcing projects of social value.

- **Crowdfunding-Italia**, a generalist platform, born in October 2012. It's an Ltd based in London. Registration on Crowdfunding-Italia is free there are no fee on the funds collected.
- **De Rev** through which, every day thousands of people create campaigns and initiatives, support and finance the more valid projects, discuss and spread the best ideas to generate change and social innovation.
- **Funditaly** conceived on December 2013 and born on May 2014 is the first Italian platform of cooperative crowdfunding. The goal is to support a renewed and sincere cooperation between people, by developing a new way to support common causes through internet.

The composition of the Italian market, as is possible to see is nowadays very fragmented, including all the existing categories of platforms. In the next paragraph, this thesis analyses the legislative environment of Italy concerning not only crowdfunding, but all the financial intermediaries.

The Italian norms, as described in paragraph 4.2 are very different depending on the classification of platform, on the type of return given and provide specific rules to respect to be considered as a crowdfunding active operator.

Not only the Consob Regulation will be analysed, but also all the previous regulation that might possibly apply to this discipline.

The goal, in fact, is not to start a mere and descriptive picture of the actual legislation, but to provide a complete path about the trails that brought Italy to be the most innovative country in terms of crowdfunding legislation. To make this is fundamental to analyse also the previous law on the Italian legislations.

All the main regulation in terms of financial instruments will be analysed and compared to the present Consob norms, in order to understand the origin of our legislation, that, with all its pro and cons, is considered a model for benchmarking by other countries.

## 4.2 The origin of the present legislation: U.T.F and applicable norms

Without doubts Italy is one of the most innovative and avant-garde countries in all over the world.

After the analysis of the models and the main type of crowdfunding platforms presented in previous chapters, the aim of the following paragraphs (and of the fifth chapter) is to understand the current regulation in Italy.

The starting point is of course the law n°221, published in the *Gazzetta Ufficiale* on December 2012, that introduced in Italy the actual regulatory.

However, if is already there a law that governs crowdfunding processes, is necessary to start a deeper analysis?

The answer is yes, because actual laws covers only a limited part of the overall market of online platform: for example, this law says nothing about *lending crowdfunding*, the most profitable kind of platform.

The first ensemble of norms is appropriate to analyse is the *Unique Text of Finance (U.T.F)*<sup>75</sup>, which regulates the public offering of financial instruments.

Another text regulating this economic field is the *11971/1999 Consob Regulation* that will be better analysed subsequently, in the part dedicated to the Consob Regulation.

One of the most important changes U.T.F encountered was the insertion of the subparagraph *5-novies*, containing the definition of "*portals for capital raising for innovative start-ups*".

Modifications to the U.T.F continues with the insertion of a new article (100-ter), which says that "*public financial offering, made through online portals can regards only the subscription of financial instruments issued by innovative start-ups, and must have an overall amount inferior to the one determined by CONSOB.*"<sup>76</sup>

The same articles provides the need that professional investors (or categories indicated by CONSOB) underwrite a part of the financial instruments if the offer is not only towards professional investors.

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<sup>75</sup> L.Decree of February 1998, n°58, *Unique text of disposition concerning financial intermediation* and articles 8 and 21 of the law 6 February 1996.

<sup>76</sup> Il Crowdfunding in italia, una regolamentazione all'avanguardia o occasione mancata? P. 27, U.Piattelli, 2014, Giappichelli Editions

Another important difference that emerges confronting UTF with the actual Consob Regulation, is the article 34-ter of the *Issuers Regulation*. It states that an offer concerning a financial product with an amount inferior to 5 million euros in a 12-months period is not classified as a public financial offer; however, if this one is made using an online platform, it will be subject to the Consob Regulation.

Like explained above, the recent changes to UTF introduced the definition of “*online platform for capital collection for innovative start-ups*”, defining themselves like the subjects that professionally exercises the service of crowdfunding portal’s management. To use the appropriate definition, it’s “*the online platform having as exclusive goal the facilitation of risk capital raising by start-ups*”.

The portal can be considered as a website, coordinated by its responsible, absolving a role of intermediation between societies and funders.

One thing to notice is the use of the word “exclusive”, which means that these portals must have only this activity, and no secondary ones are admitted (in the same sites, of course).

In this first analysis, the goal is to understand the paths that brought Italy to the emission of the Consob Regulation, showing how previous law were not suitable.

The article 1 of the U.T.F defines public offering of financial products as “*every communication addressed to people, with every form and way, that presents enough information on financial products in order to enable a potential investor to decide their purchase or subscription*”<sup>77</sup>. For “financial products” legislators intend financial instruments and every other investment of financial nature.

Under U.T.F legislation, the activity identified by this article is relevant only if the portals have for core business at least one of the following activities: negotiation of capitals for their own, orders implementations under customers’ request, placement of financial instruments, managing of customers’ titles, transmission of investments orders or financial consulting.

The only relevant voices that might possibly apply to crowdfunding portals are the last two; however there are several reasons that qualified them as not suitable for crowdfunding platforms.

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<sup>77</sup> Consob, with a communication in April 2001, qualified as “financial investment” every investment proposal that bear an expectation of profit and a risk.

First of all the “*transmission of financial orders*” is described as activity of mediation, where a subject (in this case the platform) put two other subjects in contact making possible an operation of financial products trade. Although this interpretation might perfectly reflects their activity, the definition covers only the “*financial product trade*”, and not the “*financial product emission*”, which means that this services already exist, while often they still have to be issued.

Another point is that the definition talks about “*two investors*”, but there is to consider that a subject is an investor, but the other is the issuer, and not a pure investor.

The other point that could make UTF possible to apply on crowdfunding platform is the “*financial consulting*” one.

However, one of the particularity of the portals is their absolute abstinence for what concerns any kind of advice and consulting on potentially profitable projects. The activity of portals’ managers is only to publicize the projects, without making any evaluation about them. To confirm this point arrives the recent disposition contained in article 13 of the Consob Regulation, which imposes to managers the prohibition to make any judgement or evaluation about projects.

Another recent legislation that might possibly have influenced the composition of the legislation about crowdfunding is the directive 2007/64/CE called “*Payment Service Directive*” in relation to the activity of reward and lending based crowdfunding, since the portals of equity crowdfunding, for law definition, cannot detain money on behalf of third parties.

European Parliament approved the norm on April 2007, in order to favour competition between operators, bypassing the traditional monopolistic position of classic intermediaries. The intention was to create a new figure called “*Payment Institutes*” alternative to banks.

Without entering into details, is simply possible to say that it aimed to reduce obstacles in the birth of alternative payment institutes, of course given certain transparency and reliability criteria.<sup>78</sup> Payment institutes can, if authorised, operate directly with public, emit payment instruments, like credit cards, and retain customers’ accounts.

The answer legislators posed concerned the possible classification of lending and reward crowdfunding under this norm.

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<sup>78</sup> Norm of the European parliament, 13 November 2007, that repeals the directive 97/5/CE, text available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:0036:it:PDF>.

The answer, of course, depends on the conditions and ways portals are managed, and by the eventual permissions they required in terms of payment: for example, there might be a reward based portal that is authorised to retain lenders' sums, and another that rely on external services (es. Paypal).

This last solution is the preferred by most portals that act only as a showcase for projects, delegating external payments to authorised intermediaries, relying on banks or payment institute, as Paypal.

The administration of the portals, and consequently of the personal data and intellectual property of borrowers, a detail that has not to be underestimate.

In Italy one of the main laws regarding the privacy protection is the "*Code concerning the protection of personal data and privacy*", adopted with legislative decree in June 2003 and valid from January 2004. The particularity is that it reserved to "*personal data protection*" a more focused part respect to the generic "*right to privacy*".

The text is composed by several parts that obliged the counterpart to ask for permission to use personal data and to use them only for purposes agreed with customers.

The regulation, despite is appreciable, revealed itself as less effective with the diffusion of web and particular activities ac crowdfunding.

The rise of web for trading has increased the risks of non-authorised access to personal data that clients placed into servers. For this reason, the Italian government adopted the legislative decree 28 May 2012, number 69 that specifically faced the question of personal data transmission through Internet, giving them more protection against an unwanted and fraudulent use.

The crowdfunding managers must operate in order to respect these dispositions, and the "*Regulation on the protection and free movement of personal data*", which aims to harmonize the European norms in terms of privacy, and adequate it to technological development<sup>79</sup>. To conclude is obvious that any crowdfunding manager must commit himself to for the protection of personal data of individuals who interact with him.

An anticipation of the Consob Regulation about this is given by article 14, that oblige managers to publish (on the portal) the information concerning the measures used to guarantee the correct treatment of personal data and every information received by investors.

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<sup>79</sup> European Parliament legislative resolution of 12 March 2014 on the proposal for a regulation of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and the free movement of such data (General Regulation on the protection of data).

## 4.3 The Consob Regulation

Italy is currently the only country that enacted a complete legislation, anticipating even the United States, who first enacted a primary legislation (Jobs Act), but where the SEC at the time is yet to enact the implementing regulation.

The Law Decree n. 179/2012 in reality makes no specific reference to the phenomenon of crowdfunding, but we can say that it introduces the basis for discipline him.

It was governed by the detailed implementing legislation delegated to Consob, which on 26 June 2013 adopted the resolution no. 18592/2013 to approve it.

Rules contained on Consob Regulation of course regards the raise of risk capital and actually do not affect the form of crowdfunding that do not provide equities or other risk capital instruments.

### 4.3.1 The subscription of platforms on the Register

The register of Italian Portals is kept by Consob and distinguishes between the managers of authorized portals registered in the ordinary section and managers of portals that do not require authorization, which are investment firms and banks, certified in the special section.

The main reason is that Consob wants to give a comprehensive understanding of the operators on the market, but also meet the needs of advertising and identification.

There is a major difference from the operating point of view, as managers who are registered in the ordinary section cannot lead the entire process of financing, but have to transmit orders regarding the subscription and purchase of financial instruments only to banks and investment firms that to ensure investor protection.<sup>80</sup>

This solution is based on an analysis of the competences thanks to which to each subject is assigned a role. The platform is seen exclusively as the communication vehicle led by the manager, while the financial intermediary carries out the practical parts of the investment, focused on the fund collection. The registration process in the Register is

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<sup>80</sup> Art. 50 *quinquies*, subparagraph 2,UTF

governed by article 50 of U.T.F, article 7 of Consob Regulation and the General Regulation on procedures administrative established by Consob of 28 November 2012<sup>81</sup>. The assessment phase of the proceedings is based on the verification of the ability of the subject to properly exercise his control on the platform. Without having previous activities to base on, the instructor office are based solely on papers presented by the company at the time of application submitting<sup>82</sup>.

Consob, within seven days from the receipt of the request, verifies the correctness and completeness of the application and notify to the applicant company possible missing documentations, which it is forwarded to Consob within thirty days after the receipt of the notice. During the investigation, Consob may request additional information.

Any change in the register requirements that might intervene during the investigation has to be communicated immediately to the Consob.

Consob decides on the application within a period of sixty days and the registration is denied if the applicant company is not in possession of the requirements prescribed by article 50-quinquies of the Unique Text, and from articles 8 and 9 or when it results from the assessment of the report contents.

An important condition to obtain the authorization from Consob is, like in every business, not have been convicted with an irrevocable judgment, not having been subjected to precautionary measures imposed by the court, the prohibition of being in condition of incapacitation, disqualification and not to have been sentenced to a punishment that involves disqualification, even temporary, from public offices.

#### **4.3.2 The management of a platform**

The Italian legislature has chosen to create a new figure which is precisely the "*manager of portals for the capital raising for innovative start-ups*" with the establishment of the relative register and the definition about the applicable rules. For the subjects recorded in this register there is a series of simplified authorization charges respect to those applied to subjects that perform traditional investment services. The legislation applicable to financial intermediaries provides a set of principles relating to conflict of

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<sup>81</sup> Il Crowdfunding in italia, una regolamentazione all'avanguardia o occasione mancata? P. 30, U.Piattelli, 2014, Giappichelli Editions

<sup>82</sup> Art. 50quinquies, subparagraph 3, lett. a) UTF



interest focused on measures to provide prior information, business risk management activities and forecasting of specific provisions to protect investors.

Here there are the main features a portal must have, according to the norms contained in the Consob Regulation:

- They may take the legal form of a limited company, a limited-by-shares company and a Ltd
- The registered and administrative headquarters must be in Italy. Individuals who have based legal or administrative central offices in another EU country can still perform this activity in Italy, but in this case they must set a stable organization
- Platforms managers must exercise in a professional way the service of capital raising for innovative start-ups
- As expected for the brokers who work in the financial markets, the requirements directors must have to obtain permission to carry out the activity are those of *integrity* and *professionalism*

The first paragraph of art. 13 Consob Regulations require that the operator must act with "*diligence, fairness and transparency, avoiding any conflicts of interest that may arise in the performance of portal's direction, affecting the interests of investors and issuers, ensuring equal treatment to the recipients of the offers that are in identical conditions.*"<sup>83</sup>

One of the main issues that might be raised is whether it is up to the manager to make a prior due diligence activity on information made available by the issuer and then if the responsibility about the correctness of the information provided fall on him or not.

Due to the comprehensible impossibility of this work (there might then be accurate controls for every project), the legislator establishes that the platform, since it acts as an intermediate, is responsible only of the clear and accurate publication of the furnished data, giving all responsibility to the creator.

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<sup>83</sup> Art. 13, subparagraph 1, Consob Regulation.

The supervision of managers of portals is entrusted to Consob: it is explicitly 50quinquies wrote in the article 50quinquies, paragraph 6. The manners to conduct it are contained in the Consob Regulation.

With reference to platforms, Consob can ask in communication of data and information, and the transmission of records and documents. Consob can also establishes the terms of eventual inspections.

Consob powers of investigation can be divided into three main categories:

- *Data and news communication*: there may be standards information flow to conduct supervision or at the exceeding of certain offer thresholds.
- *Data and documents transmission*: here we mean the preliminary investigation on certain operations.
- *The carrying out of inspections*: Consob can it has the power to go to the head or administrative offices to carry out checks, report documents and records, control possible violations to the legislation .

As regards the sanctioning procedure, for the authorised platforms the penalties are fixed by the article 50quinquies, paragraph 7 the amount range for what concerns the monetary penalties; the amount will be determined according to the severity of the rule violation contained in the same article and in the related implementing rules.

As mentioned previously, an investor who desire to invest in a particular project, have to pass a procedure to be declared as “able” to invest in a particular project: if the investor does not pass the “exam”, the managers cannot allow him to adhere to the offers present on the portal.

Under the present regulation (also known as "MiFID discipline" because of its derivation of the European norm) banks and S.I.Ms will need to carry out the activity in compliance with the regulations on investment services that provides a number of disclosure and behaviour towards investors (including the so-called "customer profiling").

Once the investor decides to invest in a start-up, the operator must convey the participation order to a bank or an authorised investment firm that will refine the

underwriting of securities (and collect the sums involved in account side-lined in favour of the issuer).

To encourage the development of crowdfunding and thus facilitate access to finance for innovative start-ups, the Regulation provides an exemption from the application of the discipline on investment services, if they are below a certain threshold equal to<sup>84</sup>:

- 500 euro for a single order, and 1,000 euro for multiple orders per year, for physical persons.
- 5,000 euro for a single order, and 10,000 euro for multiple orders per year, for legal entities.

The case is quite different if a bank or a broker company manages the portal.

In fact, banks and brokerage companies do not need authorization from Consob to manage a portal for raising capital for innovative start-ups (as they are already authorized to provide investment services) but are simply recorded in the special section of the portals register after notifying their intention to the Consob.

Such entities are not subject to the more restrictive rules of the operators on the ordinary section of the register (prohibition to retain sums of money and obligation to forward the orders to banks and investment societies) and can manage the whole process of raising capital of innovative start-ups. Conversely, they do not benefit of the exemption from the rules, as provided by the intermediaries registered in the ordinary section.

The manager ensures the confidentiality of information received by investors and issuers, except if they allow its diffusion, of any purposes connected with the completion of the offer permits their revelation, and in any case never without the permission of the investors and issuers<sup>85</sup>.

For what concerns the obligations about documentation, the operator is required to maintain for at least five years, in electronic or paper form, a copy of the contractual documents and correspondence related to the management of the portal activities.<sup>86</sup>

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<sup>84</sup> *Resolution no. 18592* Adoption of the "Regulations on venture capital raising from innovative start-ups through online portals" under Article 50 and Article 100-d-ter of 24 February 1998 and following edits.

<sup>85</sup> Article 19, *Confidentiality Obligations*, Resolution no. 18592

<sup>86</sup> Article 20, *Confidentiality Obligations*, Resolution no. 18592

### 4.3.3 Sanctions and decay

Consob may also revoke or suspend the manager from the register of operators.

The activity of a portal's manager can be suspended in cases regarding where violation of rules conduct contained in Title II of Consob Regulation and therefore in case:

- Does not act with diligence, fairness and transparency avoiding possible conflicts of interest that may the interests of investors.
- The information published on the portal are not easily understandable or miss an information specifically required by art. 14.
- The manager dedicates to the improvement of market orders without an authorized intermediary.
- Fails to submit the information if required by the Consob, as explicitly indicated by article 21.
- The information provided are not detailed and clear or that are not available for the fixed dates.

The cases in which a manager can be wiped out from the register of portals are listed in art.23 and are very serious, because they affect the core business of crowdfunding an example might be the utilization of the site for activities that are external to what specified by Consob Regulation<sup>87</sup>.

A person who carries out any crowdfunding activity without authorization will subjected to administrative sanction from € 2,500 up to a maximum of € 250,000.

If a manager ask for it, a platform can be erased from the register, or if they lose the requirements for the subscription or in case of missed payment of the supervision fee in the amount determined annually by Consob<sup>88</sup>.

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<sup>87</sup> Article 12, *Deletion from the register*, Title III, Rules of Conduct

<sup>88</sup> Article 12, *Deletion from the register*, Resolution no. 18592

## **4.4 The Decree of Growth 2.0 and 3.0: Startups and Innovative SMEs**

On 25 January 2015, entered into force, the Decree of Growth 3.0 also called Decree of Law of 01/24/2015. Among the measures contained in this decree, many of them concerned the enlargement of equity crowdfunding over the already covered field of the start-ups. The norms contained into the decree Integrate with those contained in the previous Decree of Growth (2.0), bringing the equity crowdfunding market to a more complete definition.

The last decree in fact introduced the definition of “Innovative Start-ups”, placing them as the only addressee of equity crowdfunding, namely the only entities that could start this type of campaign.

These two decrees have certainly paved the way for something new, regulating some realities that were still not included in Italian law (hoping that even Consob will do this soon).

The last decree introduced also the concept of innovative SME, a legal entity still absent in the Italian legislation, including it in the addressees of equity crowdfunding.

### **4.4.1 The Start-ups in the Italian legislation**

At the end of November 2015 the number of innovative start-ups subscribed in the special section of the Companies Register, amounted to 5.01689, recording an increase of 1.837 units compared to the end of December 2014 (+57,6%). Actually start-ups represent about 0 31% of the one million and an half Italian corporate companies. The share capital of the start-up reaches an overall total sum of 192 million euro, which corresponds to approximately 52,000 euro for every business. The average capital increased by 7,5% compared to the fourth quarter of 2014.

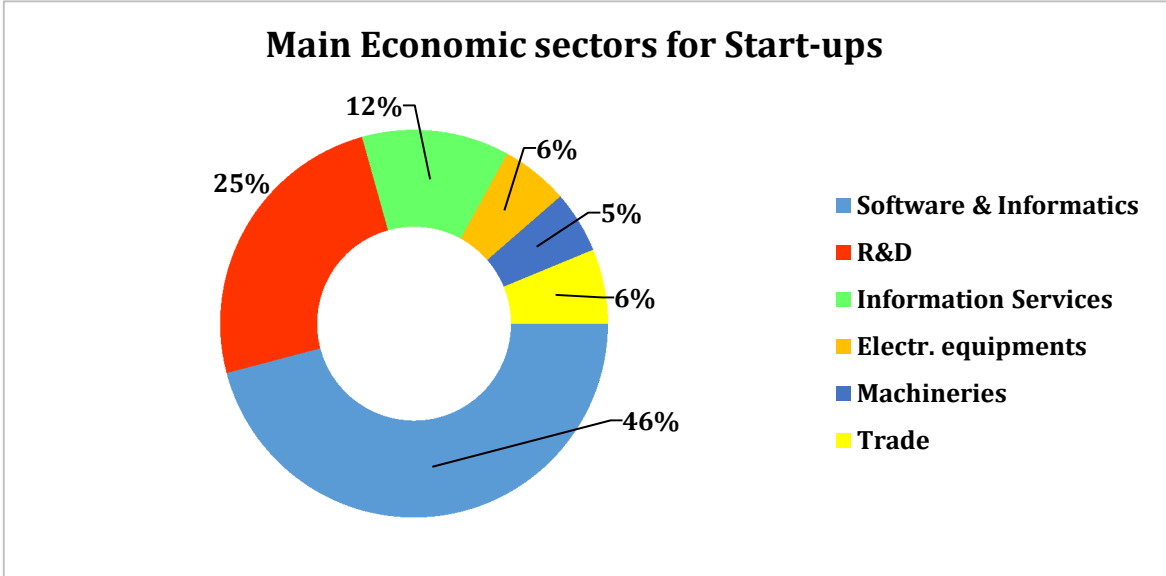
*Graphic 4.2* explains the fragmentation of Italian start-ups market showing the main sectors in which they are present

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<sup>89</sup> <http://www.ilsole24ore.com/art/tecnologie/2015-12-09/startup-quota-5mila-su-5-e-lombardia-094136.shtml?uuid=ACadqopB>

From a sector perspective, 73% of innovative start-ups provides business services (in particular, prevail the following areas: production of software and IT consultancy, R & D, business services information), 18.2% work in industry-related sectors (computer and electronical manufacturing, optical products, manufacture of electrical equipment) and 6% in trade<sup>90</sup>. The remaining percentage spreads through various economic field, but the listed ones are those where the presence of innovative enterprises is more popular.

**Graphic 4.2**



*Source: Infocamere, Panel of Statistics Indicators of Innovative Start-up*

The need to encourage the innovation process is not a new matter in Italian politics. It already emerged during the *National Reform Program* of 2012<sup>91</sup>, in which Italian authorities become aware of the need to create conditions whereby young people with talent, energy and creativity would have the possibility to started business projects and make them flourish.

With the adoption of Decree n. 179 of 18 October 2012, converted into Law n. 221 of 17 December 2012, the scholars devoted special attention to manage the regulation of business in innovative start-ups.

In this way for the first time, the Italian legislation created a framework of coherent

<sup>90</sup> Infocamere, *Panel of Statistics Indicators of Innovative Start-ups*, p.3  
<sup>91</sup> To see the full text. [http://ec.europa.eu/europe2020/pdf/nd/nrp2012\\_italy\\_it.pdf](http://ec.europa.eu/europe2020/pdf/nd/nrp2012_italy_it.pdf)

national reference for these societies. Start-ups in fact operate below a particular discipline under which they benefit of certain exemptions and a privileged legal regime. The article n. 25 of the Decree mentioned above defines the innovative start-up as a "*corporate company, established even in the form of a cooperative, whose shares are not listed on a regulated market or a MTF. It includes, therefore, both Ltd, (including the new form of simplified or reduced capital Ltd.) and cooperatives*".

In order to benefit of the special framework reserved to them, they had to register in the Special Section of the Companies Register, as written in the art. 2188 c.c.6. This aimed to increase the transparency of information concerning the life and activities of start-ups, as they enjoy a privileged legal status. In order to be able to enrol, the start-up has to be organized as a capital company, including cooperatives type.

#### **4.4.2 The regulation of a Start-up**

The first requirement concerns the legal form that an innovative start up may take. In fact, the current definition shows that it can establish itself only as a corporate enterprise. This means that the only typologies admitted by Italian legislation are those that the legislator recognises as "corporations", excluding then the partnerships<sup>92</sup>.

This choice is present because partnerships do not have a perfect patrimonial autonomy or a juridical personality, and associates have unlimited liability with their assets.

The law n.99 promulgated on 9 August 2013 has significantly changed the law of the limited liability company, eliminating the reduced-capital ltd. It allowed "ordinary" ltd to be established with a social capital inferior to euro 10.000 and has changed the discipline of simplified ltd no longer restricting itself to the members under the age of 35 years, and admitting the presence of non-members administrators. Start-ups that opted for the form of ltd with a sole beneficiary shareholder has some exemptions in terms of corporate obligations, tax and bankruptcy proceedings, but they have no permission in accessing equity crowdfunding, because in that case could not remain with a sole shareholder, because the lenders in the equity crowdfunding become full members of the society.

For what concerns the revenues, the article 25 of the decree n. 179/2012 says that "*From*

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<sup>92</sup> For details, see the special section of the Register:<http://startup.registroimpresa.it/report/startup.pdf>

*the second year of activity of the innovative start-ups, the total value of annual production, as well as proved by the latest balance sheet approved within six months from the end of the economic year, must be not superior to 5 million euros*". The so-called start-ups must ultimately presents the following characteristics:

- Are new-born or still have less than 5 years of active operations
- Have their headquarters in Italy, or in another EU member state that signed the agreement on the European Economic Area, but only if they possesses a branch in Italy;
- Have an annual turnover less than € 5 million;
- They not distribute profits;
- They have as corporate purpose (exclusively or primarily) the development, production and commercialization of innovative products or services with high technological value;
- They have not been formed with merger, corporate split or because of the sale of business units, (they must be totally new-born).
- Finally, the innovative firm is identified also with the possession of at least one of the three following criteria:
  - At least 15% of the greater between total revenue and annual costs can be attributed to research and development activities;
  - The total workforce consists of at least 1/3 of PhD students, postdocs or researchers, or for at least 2/3 of members or collaborators having any Master Degree title.
  - The company is the owner, custodian or a licensee of a registered patent.<sup>93</sup>

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<sup>93</sup> For further [http://startup.registroimprese.it/document/Guida\\_startup.pdf](http://startup.registroimprese.it/document/Guida_startup.pdf)



The innovative start-ups are subject to a special registration regime. In first place they must enrol in the in the special section of the commercial register or they cannot benefit from the special discipline.

For innovative start-ups, at the moment of registration, there's the exemption from the payment of the stamp tax and the administrative fees. For the period in which the company has the status of innovative start-up (so for a maximum of 4 years) is also exempted from paying the annual charge due to the Chamber of Commerce (€ 200 per year).

Registration takes place broadcasting to the Chamber of Commerce of the territorial jurisdiction a self-certification statement of having the requirements set out above. This flexibility is balanced by two counterweights: the competent authorities to verify the effective possession of the requirements carry out ex-post controls; the obligation to update every six months the data provided at the registration in special section. They must also confirm once a year the possession of the requirements, or they risk losing their special status and all the related advantages.

In case of losses, start-ups enjoy a special treatment on the reduction of the capital share, including a one-year moratorium for the losses exceeding one third (the date postpones to the second year)<sup>94</sup>.

#### **4.4.3 The Fund for Italian start-ups**

The so-called innovative start-ups have free access to the Fund of Guarantee for Small and Medium Companies, and can take advantaged assistance from ICE, the Agency for the promotion abroad and internalization of Italian firms<sup>95</sup>.

The Guarantee Fund for small and medium enterprises, the European Union helps Italian companies having difficulty in accessing bank credit, because they do not have sufficient collaterals. The public guarantee, in practice, replaces the costly securities normally required to obtain financing. This fund is a facility provided by the Ministry of Economic Development, financed with the European resources of national and inter-regional operational programs dated 2007-2013.

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<sup>94</sup> Infocamere, *Panel of Statistics Indicators of Innovative Start-ups*, p.17

<sup>95</sup> FONTINA C., *Per le startup innovative agevolazioni fiscali fino a 99mila euro annui*, 2013, Il sole 24 ore.

The company or the professional has to results as subjects capable to repay the guaranteed loan. They must therefore be considered economically and financially healthy based on appropriate valuation models, using the balance sheet data (or tax returns) of the previous two years.

New-born start-ups are instead valued because of their business plan.

The maximum amount the Guarantee Fund for small and medium-sized enterprises can provide is equal to 2.5 million euros for every single innovative start-up, and can cover until eighty percent of the total credit amount.

The Fund grants the project up to a maximum of 80% of financing on every type of operations both in the short and medium-long term. The 20% of the financial transaction remains in charge to the lender as not accompanied by any guarantee, insurance or banking one; it is noted, therefore, a certain degree of Bank involvement, because it has more relevant information on the company and can more easily carry out a proper assessment of the development strategies.

Considering that a start-up cannot exceeds 5 million in annual revenue, it is clear that the amount of collateral is high, but in any case it will never be able to cover more than 80% of the fund. It is an important support for the start-ups ecosystem, as a so high coverage represents for the lender an incentive to invest on companies that, given their high-risk rate would face many difficulties in finance accessing.

#### **4.4.4. The Innovative SMEs**

On January 25, 2015 the Law Decree n. 3 of 01/24/2015 (so-called "Fiscal Compact" ) came into force, which introduced in the legal system a new type of society: the Small and Medium Innovative Enterprise ("Innovative SMEs") and brought some major changes on equity crowdfunding. Integration with pre-existing rules in the so-called Decree of Growth 2.0 leads us to rename the regulatory body "Decree Growth 3.0".

This new economic entity (Innovative SME), following the description made into the Decree, has to present the following characteristics:

- It must presents the features of SMEs that means it does not have more than 250 workers, an annual revenue superior to 50 million euro, or the annual balance

sheet not exceeding 43 million Euros.

- It must have the characteristics of an innovative enterprise. This means that the total spending on research and development is equal to or greater than 3 percent of the greater between the cost of production and its total value, as results from the last approved financial statements.
- It employs as employees or contractors for any reason: doctors, PhD students or graduates who have completed at least three years of research at a certified research institutes, for at least 20% of the total workforce. Or master graduates for at least 33% of the total workforce.
- It has the ownership or license of at least: an industrial patent related to an invention in industrial biotechnology, a topography of semiconductor product or a new variety of plant ; or it has the ownership (and not license) of the rights related to a primary computer program.

With regard for the enrolment in the Register of Enterprises, there is a procedure similar to that of start-ups, in a separate and special section of the Register of Enterprises.

A difference is that. While in the previous text, the start-ups had to be "an Italian company or an European society resident in Italy", now for SMEs and start-ups there are no restrictions on nationality, replaced by a requirement of residence.

Innovative SMEs also have several benefits, similar to the ones already provided for innovative start-ups. In particular, they have the possibility to extend the deadline for the reduction of losses to less than a third of the social capital, the possibility of operations on their shares, according to stock option plans. They are also exempt from the payment of the stamp duty, from the legal secretary of the register of companies and the annual fees of the Chambers of Commerce.

As regards the tax incentives, individuals are entitled to a deduction of 19 percent of the amount invested, with a maximum limit of 500,000 euro for the tax period, if participation remains for two years. Companies are entitled to a deduction from taxable of 20 percent of the amount invested, with a maximum limit of € 1,800,000 for the tax period, if they do not disinvest the participation for two years.



## CHAPTER FIVE

# 5. THE CROWDFUNDING PROJECTS IN THE ITALIAN MARKET: ANALYSIS AND CONSIDERATIONS

In the previous chapters, this thesis analysed the crowdfunding situation in the Italian market from a legislative point of view, offering a vision of this discipline only explaining the norms and rules that regulate it. This last chapter wants to give to the readers a complete perspective also from the economical point of view, explaining in detail the composition of the Italian market of crowdfunding. The goal is to understand how this discipline is divided into its main types (reward-based, donation-based and all the others) and understand which categories of projects are the most successful for each typology. The title of this elaborate is in fact “opportunities, advantages and risks”, which means the reader must have a complete overview of all the aspects that concerns an investment in a crowdfunding project. However, to understand this, is necessary to analyse the market in all its compositions, in order to have a complete vision of which projects might be successful and which ones are, with a great probability, destined to failure. This vision will then allow a potential investor to understand where he can invest (opportunities) and what might be potential economic gains (advantages). For this reason, the following research is very detailed and offers a complete overview on crowdfunding market. The following analysis observes and studies all the crowdfunding platforms that are actually operating in the Italian context. The goal is to understand how the projects divide among themselves (categories) and eventually study the presence of potential subcategories. The goal of this research is to comprehend which are the most successful categories of crowdfunding projects, the ones that meet the appreciation of the public (in every typology of crowdfunding), and which are the ones that does not meet the interest of the crowd. Due to the natural impossibility to offer a detailed analysis of how much every subcategory is funded, only the projects that obtained the best (and worst) funding percentage are highlighted.

## 5.1 Methodology

The crowdfunding platforms analysed for this research are the ones indicated by EconomyUp.it, in a list that followed the indications given by the data of the researches made by Italia Startup and the Observatory of the Polytechnic of Milan<sup>96</sup> and indicated in the elaborate "*The Italian Startup Ecosystem: Who's who*"<sup>97</sup>. In particular, the results presented here stem from different research activities personally made by the author of this thesis:

- The analysis of every crowdfunding platform in Italy, as indicated in the map of Italia Startup.
- The exclusion of the platforms which are not currently operating, due to failure or closure, and the removal of the platforms that offer only fundraising (and not crowdfunding) projects.
- The analysis of every finished campaign (the ones that were still active at the moment of the research are not counted in this list), both funded and not funded.
- The subdivision of projects into specific categories and eventually in subcategories, to understand the field of competence.
- An assessment to understand the average funding amount for each category and subcategory, both for successful and failed projects. This valuation was made to understand which are the most funded categories, that might encounter an highest interest from lenders.
- The compilation of a detailed script to offer a complete vision of the market, and understand the pro and cons of this discipline.

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<sup>96</sup> C.Desando "*All you need to know to use the 55 crowdfunding platforms in Italy*", Startup Ecosystem, article available at [http://www.economyup.it/startup/2092\\_tutto-quello-che-bisogna-sapere-per-usare-55-piattaforme-di-crowdfunding.htm](http://www.economyup.it/startup/2092_tutto-quello-che-bisogna-sapere-per-usare-55-piattaforme-di-crowdfunding.htm)

<sup>97</sup> "*The Italian Startup Ecosystem, Who's Who*", Second Edition, 2014

In particular, to comprehend the terms of this research, and the exclusion of certain projects or platforms, here there is an explanation of the criteria followed in this study:

- The term "*crowdfunding project*" refers only to projects with a determined amount to reach in a specific duration of time, beyond which a potential lender could no longer finance the campaign. So, all the projects of simple fundraising (that means there is no limit in time to fund a project, or lenders give money to an association even if it does not have an active idea) has been excluded. Moreover, some of the platform listed in the chart mentioned above are not active nowadays (they are waiting for the authorization or have just obtained it), and, at the present day, are online just for marketing reasons; of course, they are excluded from this research, because they never had active projects.
- The projects analysed are the ones present on active platforms (the closed ones were excluded, due to the impossibility to reach adequate data), so they might not represent all the proposed ones, but only a great part. The primary goal is to understand which categories are the most successful on active platforms, where people can actually invest.
- Another important criteria is that a potential lender must have complete freedom in choosing a project to fund; so, the sites where the projects to fund were decided by contests or games, where excluded. In fact, in these platforms the money given by lenders go to the project that "wins" the contest, independently from the intentions of the moneylender.

The projects analysed belong to the following categories:

- ***Equity based:*** projects where the lender has the possibility to invest a certain amount of risk capital into a specific company (start-up or others), becoming a participant of the society.
- ***Reward based:*** projects with non-profit goals, where the creators offer a reward (a letter, a gadget, the possibility to purchase the product at a lower price respect to others).

- **Donation-based:** category of projects funded entirely by “donations”, without any reward for lenders.
- **Social lending:** in this case they are not true projects, but peer-to-peer lending, where a private citizen loan an amount of money to a borrower, to be repaid with interests.

The research concerns the projects (and not the platforms), so every category includes all the projects of that type, without distinguishing the portal they belong. Every project was included only in a category, eliminating all the duplications present on the platforms, where many projects belong to more categories, also for a question of visibility. The inclusion of a project in a certain category was made observing both the final goal and the instruments used to reach that goal. For example, a project in a reward-based platform that concerns the creation of an online portal for the reservation of medical visits follow the subsequent classification:

- **Typology:** Reward-based
- **Category:** Digital
- **Subcategory:** Online platforms

The analysis of equity-based projects follow a more detailed classification, with the insertion of a second and deeper subcategory, in order to understand the specific matter of the project. Equity crowdfunding is probably the most important type for the economic world, and a field where Italy distinguishes itself, being the only country to have a specific regulation. Due to its growing importance for start-ups and innovative projects (almost every one of them ask for funding on equity-based platforms), equity crowdfunding is worth to be analysed in a more detailed way, since the lender obtains a participation title in a society. The analysis of the projects comprehend 42 active crowdfunding platforms of the 55 listed by Italia Startup. Thirteen platforms has been excluded for the reasons explained above.

The analysis aims to discover the categories of projects with the highest success rate, and how crowdfunding can be an instrument to support initiatives that won't be considered with the traditional funding instruments.



## 5.2 The Donation-Based projects

The following analysis comprehends all the crowdfunding projects funded entirely with donations, and they are above all charity initiatives. The active platforms studied to make this classification are: Let's Donation, ShinyNote and Rete del Dono, which are half of the ones listed by Italia Startup. The three platforms excluded from the analysis are IoDono (that is a fundraising platform), Leevia (it is no more a crowdfunding platform) and PensiamociNoi (it is not active now). The total number of the finished projects, both funded and not funded is 1.511. They divide in five main categories:

- **Culture:** comprehends all the projects related to the field of culture (as music, literature, cinema, and everything related with cultural matters).
- **Beneficence:** includes the projects to the “charity” field, funded to help needy and less fortunate people, or to promote campaigns of safeguard of populations and environment conservation. These enclose matters like medical assistance to fourth and third world countries, the supply of food and water, projects against deforestation and many other.
- **Manufacturing:** this category include all the projects of artisanship and constructions of tools, robot, everything that can be made using hands, of course not dedicated to beneficence projects.
- **Science:** the goal of these projects was to provide fund for every type of scientific research (medical, alternative materials and other), or to fund the purchase of scientific instruments for hospitals, laboratories or universities.
- **Public/Social** comprehends the projects of social utility, like the construction of public parks, the renovation of a building or a public area. The goal of these projects was to give a final service to all the citizens.

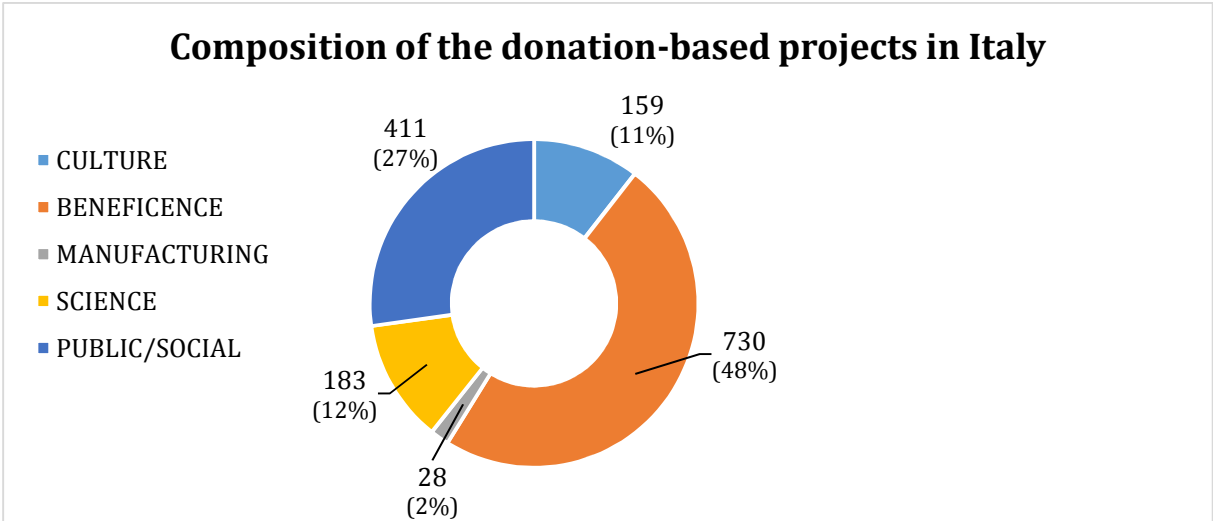
*Graphic 5.1* shows the composition of the donation-based crowdfunding market in Italy. As is possible to see, the great part of the projects (nearly the half) belong to the

category “Beneficence”, which is the dominant one of this particular form of crowdfunding, having about 716 projects proposed.. This of course is due to the large use of donations that non-profit and charity associations make when it’s time to finance an initiative. The second largest category is “Public/Social”, which takes the 27% of the total field, with 411 closed initiatives. This category comprehends all the projects related the requalification of an area, and leverages on people’s sense of belonging to the community (in a similar way as happened with the Rotterdam Bridge).

Other two categories that have a good portion of the market are “Science” and “Culture” respectively with the 12% and the 11% of the market. The class “Science” comprehends 183 closed initiatives, and the category “Culture” has 159 finished campaigns. The last class is “Manufacturing”, with only the 2% of the market. Is important to remember that the graphic includes both funded and non-funded projects.

The reason why this class occupies the last place is that is a category more prone to have projects of reward-based crowdfunding.

**Graphic 5.1**



*Source: Research made by the author analysing all the finished projects in the donation-based crowdfunding platforms*

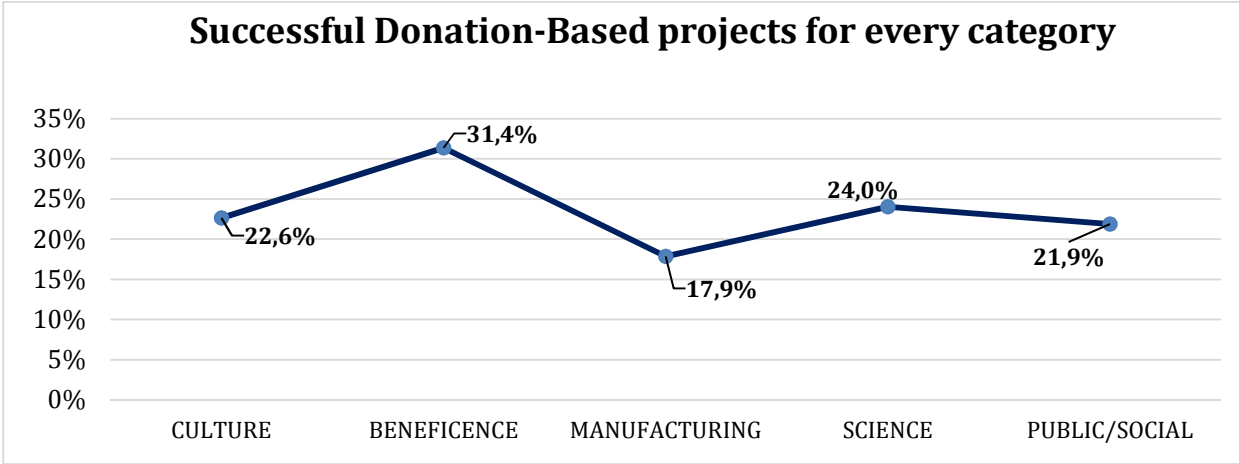
Graphic 5.2 instead represents the percentage of funded projects (on total) of the donation based crowdfunding market. The dominant category is again “Beneficence”, with the 31% of the overall projects funded. This is due to the straight belonging of this

category with the world of donations, to the sensibility of people towards charity initiatives and the relatively small amount asked from the creators.

The second most funded category is “Science”, with the 24% of the project funded. It is followed by “Culture” and “Public/Social” respectively with the 23% and 22% of successful initiatives. It is interesting to notice as Graphic 5.2 does not follow the same line as the previous one, where “Public/Social” was the second most present category, and here is the penultimate in terms of financed projects.

This shows as the trend of successful projects does not follow the one related to their presence in the market, and the percentage of success does not depend by the numerosity of campaigns, but by the interest of the people, the final goal, the presentation they offer to the public, the impression they give and the amount of money required. In fact, “Public/Social” is less funded also because of the high amount of resources required by the projects (most of them asked more than € 50.000).

**Graphic 5.2**



*Source: Research made by the author analysing all the finished projects in the donation-based crowdfunding platforms*

After the analysis of the most successful projects, it is interesting to understand what kind of initiatives are the most funded for every category.

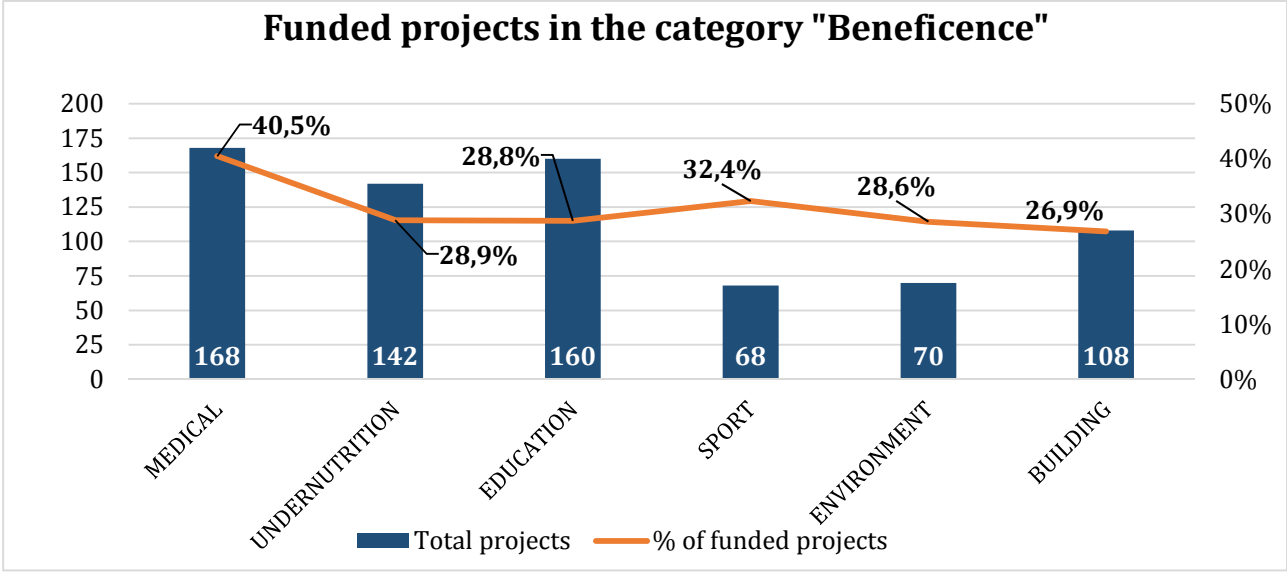
To understand this, is possible to fragment every category in more subcategories, each one containing projects with similar goals that aimed to pursue the same objective (excluded Manufacturing, due to the small amount of projects and their close

resemblance). This is useful to comprehend what are the types of donation-based projects people like most and are more prone to finance. Of course, given to the fact that these projects are donation-based there is a higher percentage of successful ones, in comparison to other categories as the equity-based. The first category to be fragmented is “Beneficence”, and it divides in the following subcategories:

- **Medical:** refers to all the projects that aim to give medical assistance to every people in the world, both bringing medicines and making medical visits. It refers to all the projects that want to fight the “sanitary emergency” all over the world.
- **Undernutrition:** projects that fight hunger and thirst bringing food and water to malnourished people.
- **Education:** projects that have the goal to provide instruction and education in Third-World countries to illiterate populations.
- **Sport:** all the initiatives that want to build something related to the sports (football fields, sport schools and others).
- **Environment:** this subcategory includes all the projects made by environmental groups in order to preserve the nature and the ecosystem (campaigns against deforestation, preservation of animal species and others).
- **Building:** refers to the initiatives that aim to build something useful to promote the development of a community (a well, a road, houses, etc...)

*Graphic 5.3* shows for each class the overall number of projects (blue column) and the percentage of funded initiatives (the orange line). As is possible to notice, the most successful voice is “Medical”, with the 40% of projects funded (that means 67 on a total number of 168), and is the most present category for number of projects. This is probably due to the large diffusion of charity associations that practice this type of initiatives and contribute to the development of these campaigns, both supporting with the name and sometimes with funds.

**Graphic 5.3**



*Source: Research made by the author analysing the crowdfunding projects focused on charity*

The second most-funded set of campaigns is the “Sport” one, with the 32% of successful projects (22), despite a relatively modest amount of 68 total ideas. At the third position, as percentage of successful campaigns there are “Undernutrition”, “Environment” and “Education”, with 29% of success rate. The last position is occupied by “Building” that has a success rate of 27% (still good). The second subdivision of the donation-based projects regards the category “Science”. As showed in the *Graphic 5.4* it divides into four subcategories:

- **Medical research:** that includes all the funds required to support medical and sanity research, both in universities and hospitals.
- **Alternative materials:** includes all the crowdfunding projects aimed to finance the research on materials that might be used instead of the traditional ones (i.d a natural stuff instead of plastic). The projects distinguish themselves because the author specifies that the promotion or creation of an alternative material is the final goal.
- **Science equipment:** these projects have the goal to provide funds for the

purchase and supply of medical and scientific equipment, like machineries.

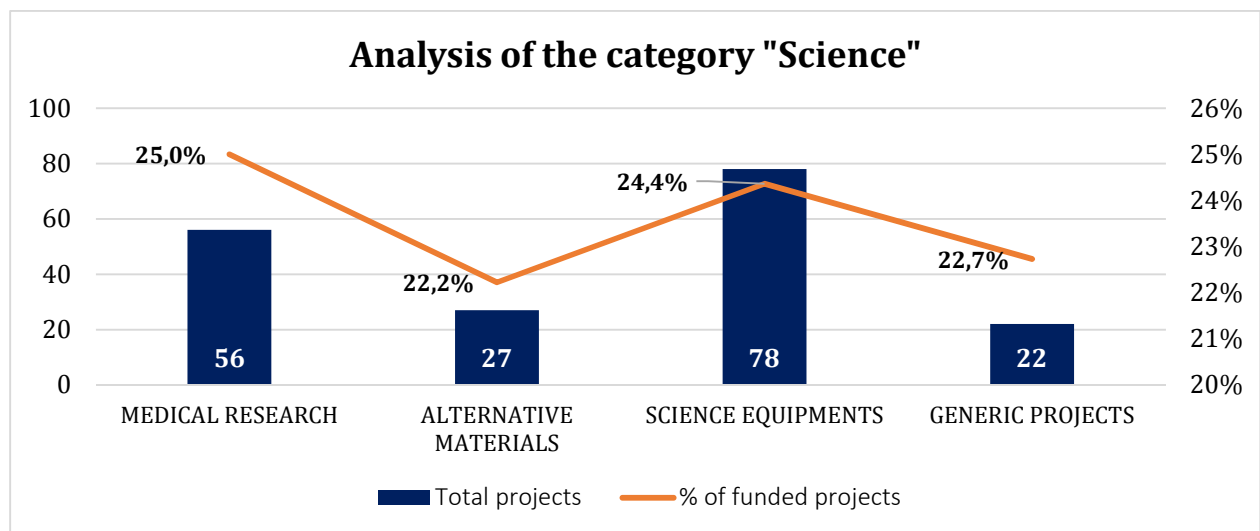
- **Generic projects:** all the other scientific projects, excluded from the medical research (biology, biotechnology or others.)

The graphic shows the total amount of projects for every category and the percentage of successful ones. As it is possible to see, also in this graph the project related with the medical sector obtained the highest performances, with 25% of successful initiatives (that means 14 projects on 56). The success rate for the projects belonging to “Science” is relatively equal for the four categories, with a success rate of 24%, 23% and 22% respectively for “Science Equipment”, “Generic projects” and “Alternative materials”.

Universities and research institutes often used (and use nowadays) crowdfunding to obtain fund for their researches, due to the lack of resources they face every day.

This table shows as, despite with still low percentages, crowdfunding contributed to the advancing of research in many areas.

**Graphic 5.4**



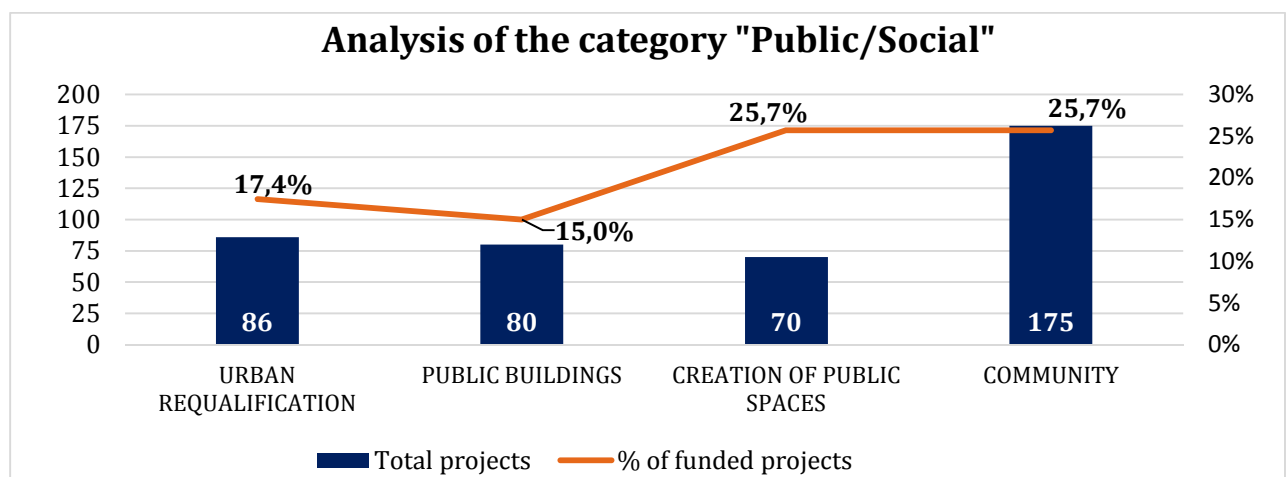
**Source:** Research made by the author analysing the crowdfunding projects focused on science

The third category of the donation-based projects is “Public/Social”, and refers to all the projects related with public utility and valorisation of public spaces.

This category contains four different groups of initiatives, as showed in *Graphic 5.5*:

- **Urban requalification:** includes all the projects that aim to redevelop an urban area, such as a park or a run-down area (not projects including single constructions).
- **Public buildings:** similar to Urban requalification, but it includes the restoration or construction of single public buildings (schools, institutes etc...).
- **Creation of public spaces:** projects like bike paths, parks, playgrounds, all the public spaces that might be useful for the community and that everyone can use. The majors in cities that lack funds usually promote these projects.
- **Community:** it includes all the projects that aim to offer a public service to a community of people, like free transport or food delivery for the elderly, assistance for single moms and other. It's the beneficence directed towards Italian citizens.

**Graphic 5.5**



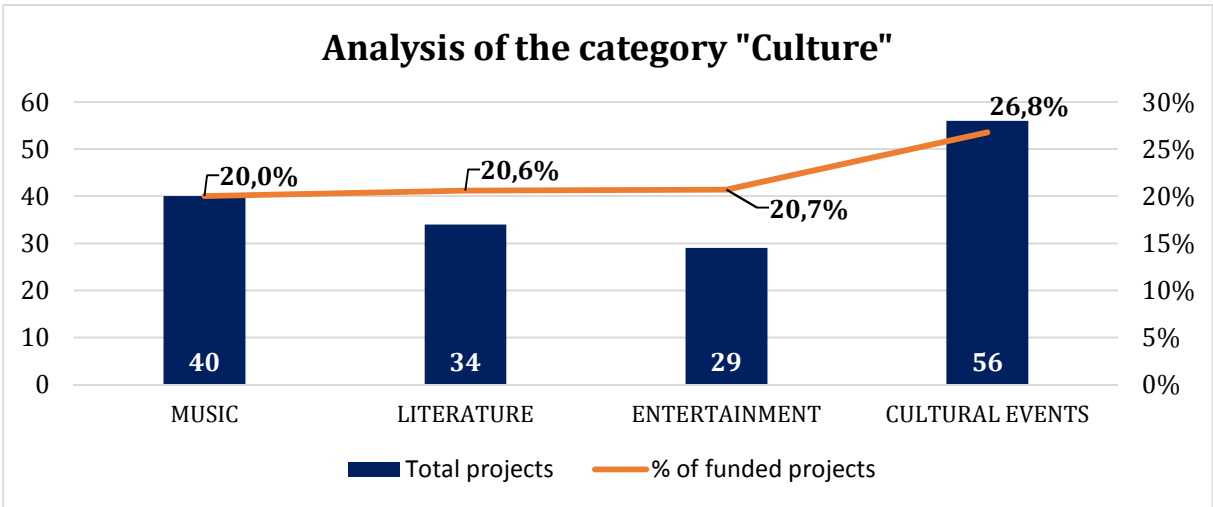
*Source: Research made by the author analysing the crowdfunding projects focused on public utility*

The graphic shows as the most successful categories for the public/social projects are “Community” and “Creation of public spaces”, both with a success rate of 26%. This means that for the group of “Community” there are 45 projects funded and for the other

group 18. The difference is net with the other two categories that register a success rate of 17% (Urban requalification, with 15 projects funded) and 15% (Public buildings, with 12 successful projects). This data are influenced by the great amount of money required to realize these projects (about € 40.000, the average request for each campaign). The last groups of donation-based projects, “Culture” contains four subcategories, each one related to a different field of culture or art:

- **Music:** live exhibitions, creation of album and CDs, tours, all the project related to the music sector
- **Literature:** publication of books, novels, comics.
- **Entertainment:** includes the creation of film, live shows and theatre exhibitions.
- **Cultural events:** projects where the borrower ask fund to promote a cultural event in his city

**Graphic 5.6**



*Source: Research made by the author analysing the crowdfunding projects focused on culture*

The graphic shows as the highest success rate belongs to the class of “Cultural Events”, with 15 projects financed (27%).

The second position is occupied by “Entertainment” and “Literature”, with a rate of 21% each one.



### 5.3 The Equity-Based projects

The second sector analysed in this research is the Equity-Based crowdfunding, the one that had the greatest development in recent years, also thanks to the special laws enacted by the Italian government, as explained in the previous chapter.

The composition of this market is apparently less fragmented respect to the donation-based sector, given that the projects composing it belong only into four categories, as explained in Graphic 5.7.

This modest subdivision must not be cause of misleading, because if it is true that the categories "Green Economy", "Biotech" and "Manufacturing" do not have other subsets within them, the same cannot be said for the "Digital" category.

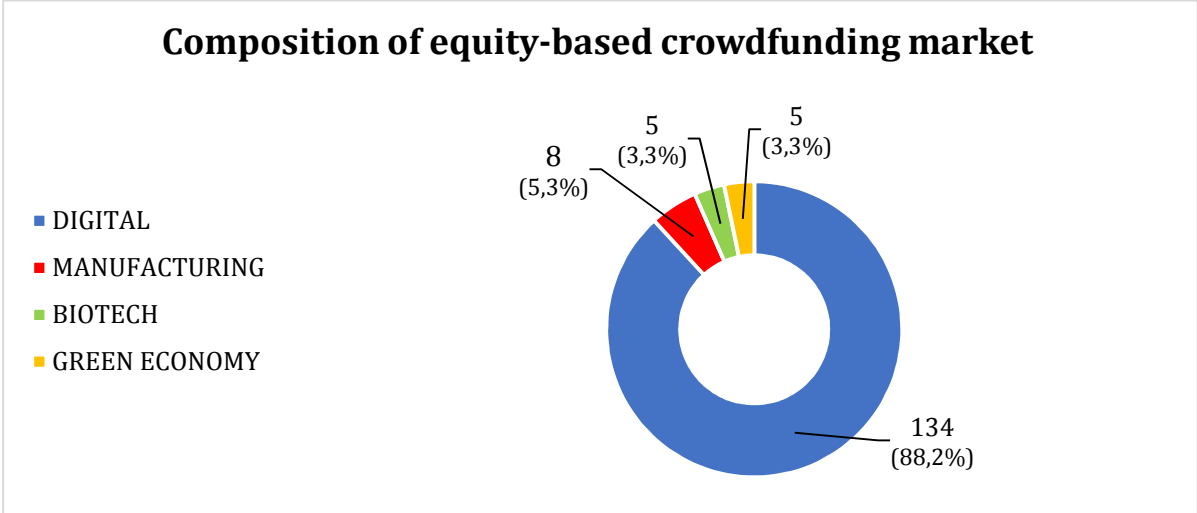
This group in fact, includes within it the vast majority of equity-based projects, and although each subset has a modest amount of campaigns, this fragmentation is required since there are very heterogeneous initiatives.

The four categories shown in the chart are divided as follows:

- **Digital:** category that includes all projects that require the use of the Internet and digital technologies, like apps. This group contains projects regarding the creation of social networks for interests sharing, the implementation of mobile application and the creation of online platforms for booking travels, e-commerce, file storage and more. This class divides into two subcategories, "App" and "Online Platforms", which will be explained below.
- **Biotech:** it includes all projects linked with biotechnologies.
- **Manufacturing:** it includes projects related to artisanship, to the construction of technological equipment such as small robots, and any idea includes a pure manual job for the creation.
- **Green Economy:** an industry field where is possible to find projects related to the Green sector, as patents for energy efficiency, organic farming techniques, eco-homes buildings.

As it is possible to see from the chart, most of the projects (89%) belongs to the "Digital" category, which indicates a high prevalence of virtual projects, rather than physical ones. The digital sector in crowdfunding reflects what it is happening in economy and technology, which are evolving toward increasingly digital contexts. To have an example, think about the projects submitted by start-ups in recent years, where the great majority of them belonged to digital. Crowdfunding also follows this trend, and the digital ideas seem to be considered the most feasible and profitable, as well as the most simple to implement, given the very low cost and widespread computer literacy, especially among young people.

**Graphic 5.7**

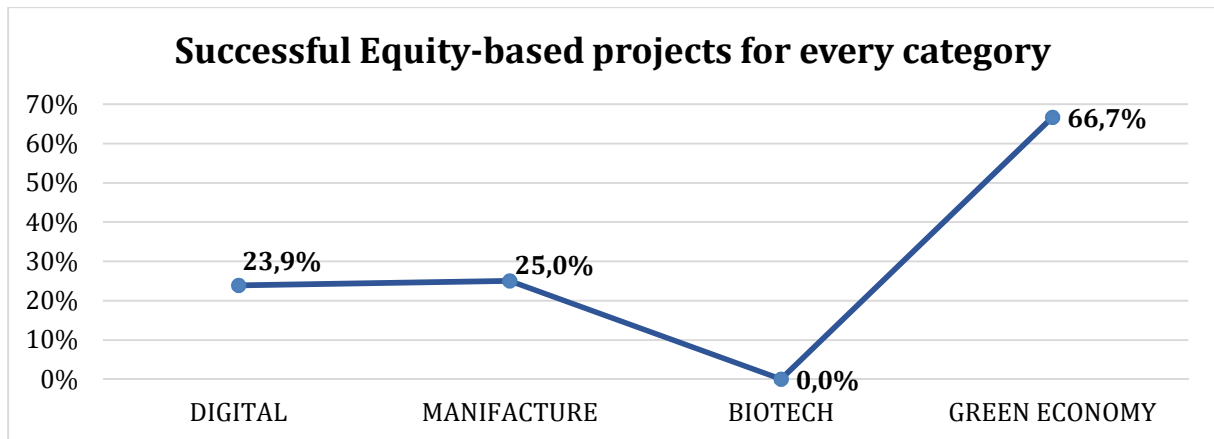


*Source: Research made by the author analysing the equity crowdfunding projects present on the Italian platforms*

The second category for number of projects is manufacturing, although it presents a very small percentage (5%) and only 8 projects. The categories "Green Economy" and "Biotech" divide the remainder of the equity-based market, with respectively 0.7% and 3.3% of the total. *Graphic 5.8* shows the percentage of projects funded in each category. A surprise, in spite of the very limited number of projects proposed, the category "Green Economy" is the one that presents the highest success rate. This data must take into consideration also that there are only five projects finished until the present day; it's too soon to make judgments with certainty, but the data collected until now indicate a good

users' propensity to invest in projects related to the Green sector. Crowdfunding reflects once again the performance of the economy and the main areas of innovation, in which is possible to observe a gradual emergence of green ideas and environmentally friendly technologies.

**Graphic 5.8**



*Source: Research made by the author analysing the equity crowdfunding projects present on the Italian platforms*

The categories "Digital" and "Manufacture" have a success rate equal to a quarter of the total projects, while for the "Biotech" sector there are no funded projects. Probably this area is not considered as potentially profitable by possible investors.

The category "Digital" divides into two minor subcategories, to understand the specific composition of the projects. The first category is "App" which includes all the projects relating to applications for smartphones and tablets.

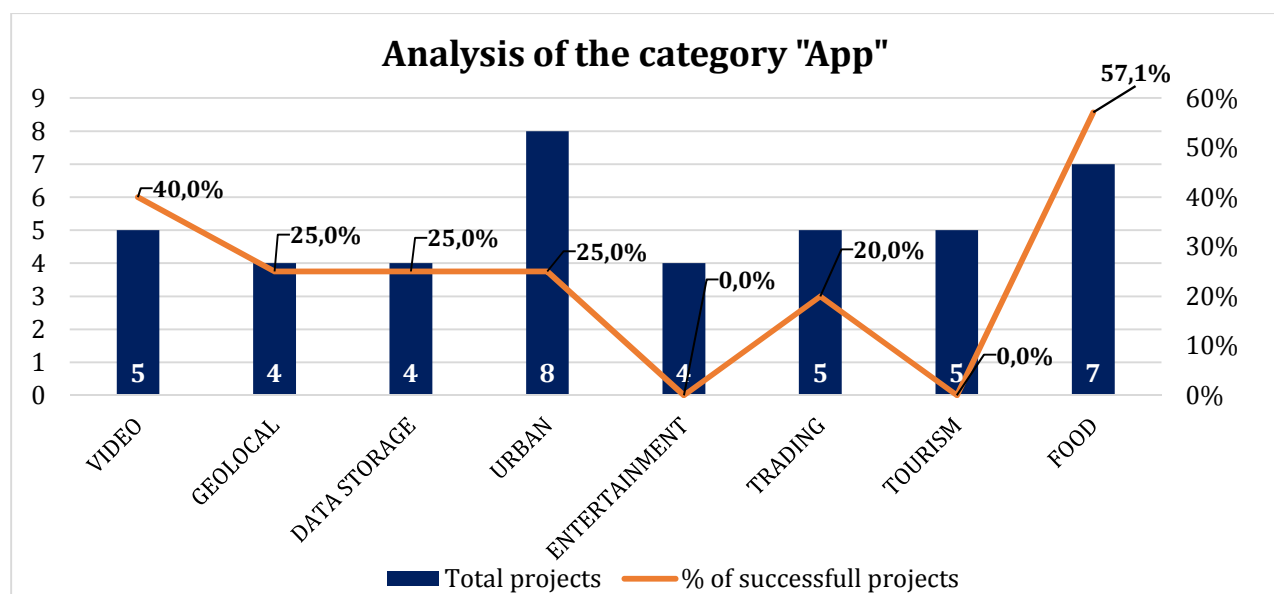
The classes that compose this category are:

- **Video:** comprehends all the apps that have of video editing or modification.
- **Geolocal:** app including geolocation services.
- **Data Storage:** app including storage services and documentation of files.
- **Urban:** It includes urban mobility and parking services.
- **Entertainment:** app of games, entertainment and education.
- **Trading**

- **Food:** projects that include the booking of wine tours, documentation about food, wine tastings and more.
- **Tourism:** travel booking, accommodations, comparison of tourist areas and other.

As you can see from the *Graphic 5.9*, the category of app that has the highest success rate is "Food", where as many as 57% of the projects was able to get the necessary funding. Although the number of these projects is still low (6), the high proportion of loans obtained bodes well for future development of this type of application. The second category with the highest rate of success is "Video", with 40% of completed projects. This positive data for the video, as we shall see, confirms a predilection of the Italians for publishing programs, video editing, and graphic activities in general.

**Graphic 5.9**



**Source:** Research made by the author analysing the equity crowdfunding projects focusing on the creation of apps

The other categories stood at relatively homogeneous levels, with success rates ranging from 20% to 25 %%. The only exceptions are "Tourism" and "Entertainment", which do not experience any successful project.

These data still represent only a first study, on the few projects available. The app sector is showing up as one of the favourite tools by young entrepreneurs, and also many of the

projects in this category have a support rate equal to or higher than the other crowdfunding initiatives.

The other category that composes the totality of the digital projects on equity-based crowdfunding is "Online Platforms", and includes all types of sites or digital platforms (like social networks, e-commerce sites, platforms about information and reservations, and more).

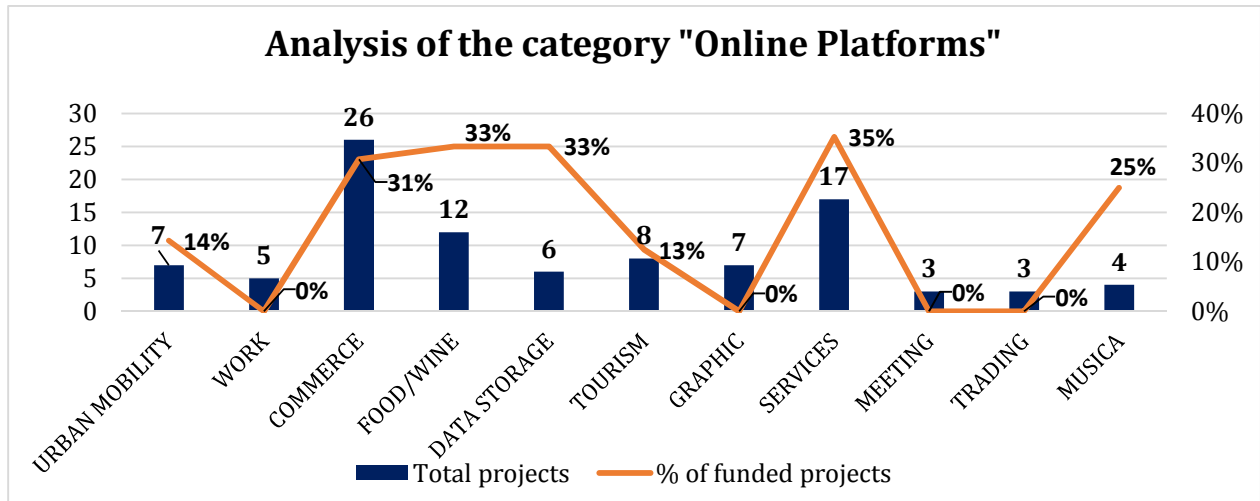
This category is one of the most varied between those studied until now, given that the projects proposed by entrepreneurs include as many as 11 different sets of initiatives. Diversification confirms itself as one of the strengths of this area, which can potentially accommodate all types of projects.

*Graphic 5.10* shows the success rate of the projects of the category "Online Platforms". The graph is very uneven, and this shows a very different rate of funding for each category of project.

The groups of projects that compose this part of digital crowdfunding belong to a lot of different fields, to prove that there are a lot of business sectors that might be financed with crowdfunding:

- **Urban Mobility:** the same category of the voice "App".
- **Work:** platforms to find/offer jobs and works, in a similar way as LinkedIn.
- **Commerce:** e-commerce platforms, to propose discounts, offers, sale of certain assets.
- **Food/Wine:** projects that include the booking of wine tours, documentation about food, wine tastings and more.
- **Data storage:** apps that include storage services and documentation of files.
- **Tourism:** travel booking, accommodations, comparison of tourist areas and other.
- **Graphic:** sites for the elaboration and editing of graphic projects.
- **Services:** platforms that provide various services (car rent, car workshop, transport and others).
- **Meeting:** dating sites for love and friendship
- **Trading**
- **Music:** sites or social network for the exchange of interests regarding music.

**Graphic 5.10**



*Source: Research made by the author analysing the equity crowdfunding projects focusing on the creation of online platforms*

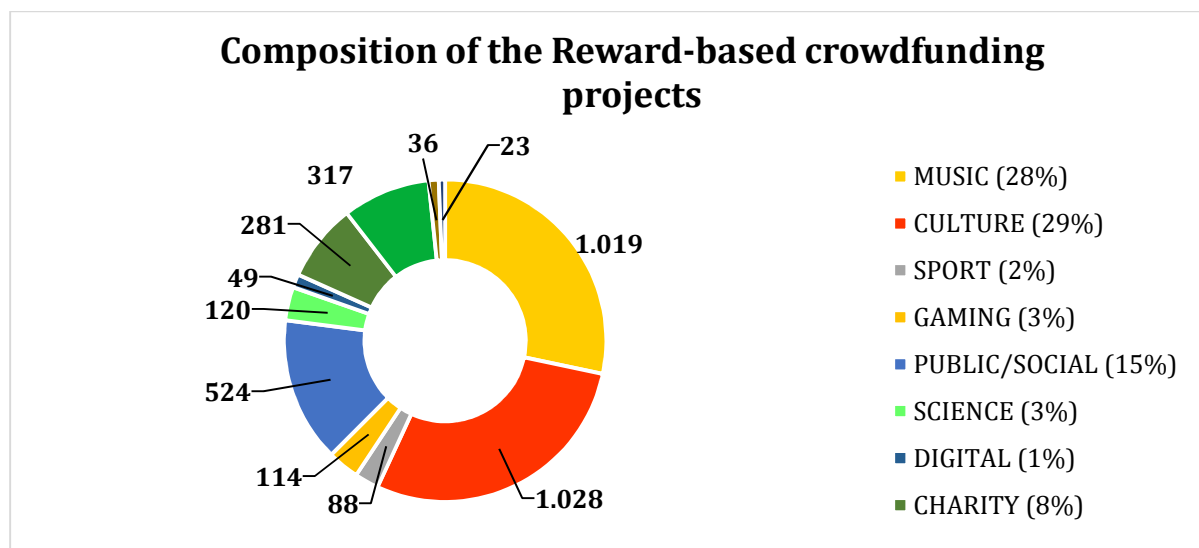
The graph shows that the projects of this category do not show a success rate highest than those seen so far, reaching, at the highest level, 35% in the category "Services", which is also the largest with 17 projects (and 6 funded). Two groups that share the same percentage of funding (33%), that are "Food & Wine" and "Data Storage", occupy the second position. The figure is more significant on the first group, which has twice the number of projects of the second (12 vs 6), thus confirming the good results that had already seen the group on the category "App". The data of crowdfunding reflects one again those of Italian economy that strongly rely on food and wine projects and businesses. These fields are between the favourites of the young entrepreneurs, because, together with an historical cultural identity in this field, they are very likely to have success. This is due mainly to the traditional appreciation of Italian people for this type of projects, and probably because potential investors think that in a country like Italy these are initiatives that can see light very easily respect to other categories of businesses. The data of the digital group underline as the start-ups of the gastronomic sector might have a powerful ally in crowdfunding, using it as an instrument not only for funding, but also for marketing and advertising. Data storage platforms might be considered useful, because of the growing digitalization of documents and bills. The categories that have instead a success rate equal to zero are three: "Work", "Graphic" and "Trading".

## 5.4 The Reward-Based projects

The reward-based crowdfunding is undoubtedly the most numerous and diverse category, as well as being the most practiced by the promoters of campaigns.

This type, as specified above, differs from the donation-based for the biggest variety of objectives and the presence of a return for the investor, in the form of reward. The two dominant categories in this area, as can be seen from *Graphic 5.11*, are "Music" and "Culture". The first includes all varieties of projects related to the field of music, as CD recording, a live exhibition or the creation of a video for a song. The category "Culture" includes several groups of projects related with the cultural sector, such as literature, music, or the promotion of cultural events. In the third place there is the category "Public / Social", whose projects share the same goals of the same category in the Donation-Based. The weakest category, excluding "Other", is "Business", related to business initiatives that promoters try to start using crowdfunding. The other categories occupy a relatively small proportion of the total. Nevertheless, consider that although the proportion is low, the large amount of reward-based projects makes also those categories to count on a large number of initiatives.

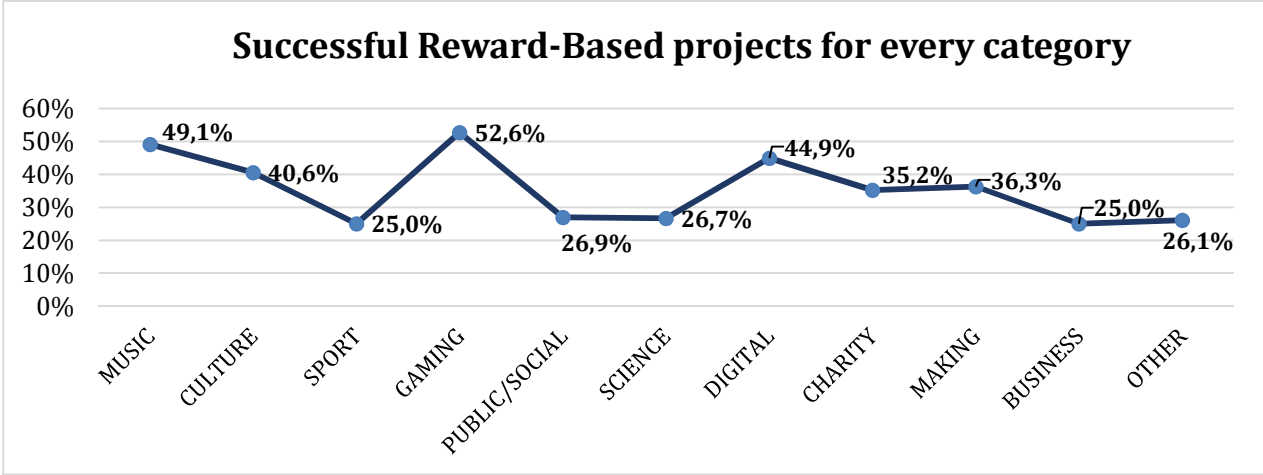
**Graphic 5.11**



*Source: Research made by the author analysing the finished projects on the reward-based crowdfunding platforms*

Analysing the reward-based projects it turns out that the success rates in financing are, for this category, generally higher than other types of crowdfunding. The *Graphic 5.12* evidences that there are three categories of projects that achieve a success rate close to 50%. In particular, the category "Gaming" gets 53% of successfully completed projects, implementing 60 projects on 114. The second group with the highest percentage is "Music", with 49,1% and over 500 projects funded on 1.019. These hit is helped by the existence of specific platforms dedicated to music promotion, which encounter the approval of people, thanks to the Web that allows discovering new types of music and having songs and CDs in preview. Despite from the modest number of initiatives (49), the category "Digital" registers a very good quantity of success in reaching the necessary amounts, with 22 campaigns funded and a rate of 44,9%. In general, also the other groups register a good funding rate, with many of them attesting around the 30%. The lowest one is "Sport" with the 25%, a data inferior to the one registered in Donation-based (32,4%), but that still remains to good levels.

**Graphic 5.12**



*Source: Research made by the author analysing the finished projects on the reward-based crowdfunding platforms*

The high success rate of reward-based projects is also due to the existence of numerous thematic platforms, especially in the field of music and culture, which act as a meeting place for fans of the genre, greatly increasing the chances that they support a project.

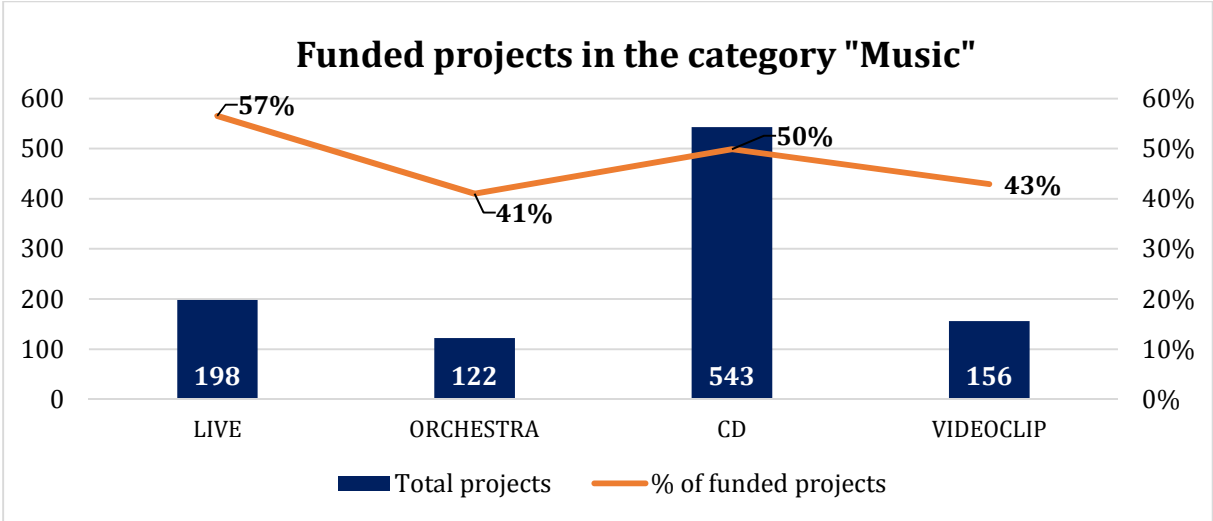


The presence of a reward, of whatever kind, acts as an incentive for the lenders, who in this category support almost exclusively for personal interest for the topic of the project. The ability to contribute in an active way to something of their interest, moreover on the receipt of a premium is the reason that explains why the success rate is so high for certain reward-based categories.

Even for this type of project, there is an analysis of the different voices, dividing them into smaller groups to better understand the entity of the projects, and what are the ones obtaining the greater appreciation. Of course, not all the categories were fragmented, but only the ones that includes different types of projects that are very heterogeneous among them. The first category to be analysed is "Music, and is divided into four diverse subcategories, as presented in *Graphic 5.13*:

- **Live:** includes all the initiatives aimed to fund live exhibitions of singers or tours
- **Orchestra:** the same goals above, with specific references to orchestras
- **CD:** creation of CD, or any type of disk (vinyls etc...).
- **Videoclip:** creation of video clips for songs

**Graphic 5.13**



*Source: Research of the author analysing the reward-based projects focusing on Music*

The chart shows that the category with the highest success-rate is Live, with the 57% and 112 funded projects on a total of 198. The second-best is CD, that registers a rate of 50%, with 271 funded projects, on an overall total of 543. This is also the subcategory

that has the highest average payment-rate per project, with 126% of the total required by borrowers, registering an overfunding of 26%.

The other two groups, Videoclip and Orchestra have both a good completion rate, that stands around 40%, very satisfying, considering average data seen so far.

Overall "Music" is revealed as one of the kinds of projects with the highest success, both for the presence of many dedicated platforms and a high appreciation from users, who often employ crowdfunding to support their favourite artists.

A second defragmentation was performed with the projects of the category "Culture", divided into seven different areas depending on topic. The subcategories, showed in *Graphic 5.13*, of this group are:

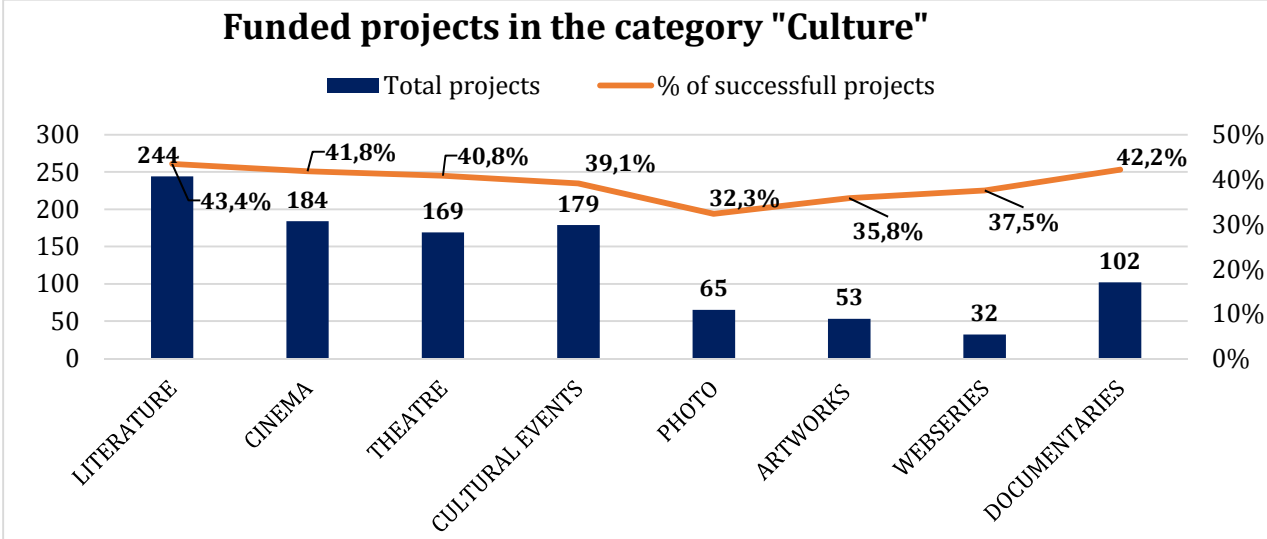
- **Literature:** comprehends all the literary and activities linked to them, such as the publication of a book.
- **Cinema:** creation and promotion of a movie, a cartoon or a short film.
- **Theatre:** financing of theatrical dramas and spectacles.
- **Cultural events:** promotion of events such as cultural festivals, art galleries, workshops, conferences, etc.
- **Photo:** creation of photo albums and organization of photo galleries and exposures.
- **Artworks:** realization or restoration of art projects, like a a painting, a sculpture or a work of modern art.
- **Webseries:** projects aimed to fund telefilms like Tv series, but destined to the Web.
- **Documentaries:** the same as Cinema, but concentrated on documentaries.

As showed in the graph below, the sub-category of projects with the highest success rate (43,4%) is Literature, with 106 projects completed on 244. Even here, the presence of dedicated platforms is of great help to the conclusion of the initiatives, giving to promoters a good chance of success.

Right after there are Documentaries, with 42% of projects funded (43 on102) and Cinema, with a slightly lower index (41,8%, and 77 projects out of a total of 184). In general, Culture repeats the good results seen on the donation-based, confirming as projects involving video or movies are among the favourites of supporters. The other

categories amounted to still very good levels (Theatre presents 69 of 169 total funding, and immediately after there is Cultural Events with a rate of 39.1%).

**Graphic 5.14**



*Source: Research of the author analysing the reward-based projects focused on Culture*

The less-funded category is Photo, that still get a great rate of 32.3%. This figure is the proof of the overall success of the Culture category.

The third group of projects to be fragmented and analysed is “Public/Social” (*Graphic 5.15*) which is divided into the same categories already presented in the donation-based projects. The success-rates of the categories composing this group are, in general, lower than those observed on the two previous charts. The highest one, as presented on the same list in the donation-based chart is Community, regarding all the services directed to public citizens. The rate is 28,9%, with 56 funded projects on a total of 194. The second one, with a rate just below the first, belongs to Creation of Public Spaces, and is 28,2%. The creation of public spaces is probably appreciated by the community living around there, and this is the reason why nearly a project on three see light.

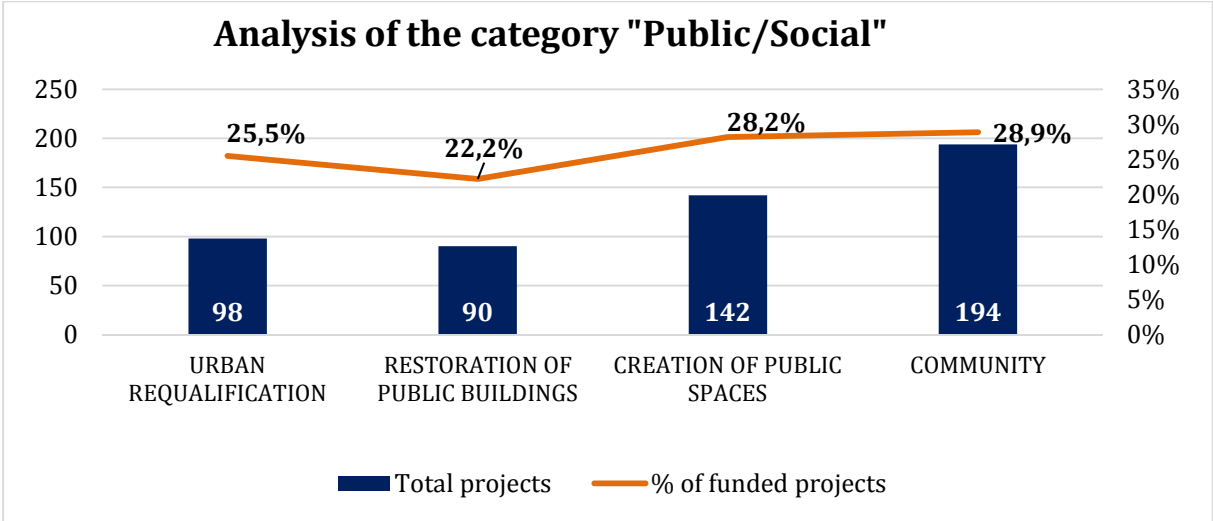
The other two groups, Urban Requalification and Restoration of Public Buildings register a completion rate respectively of 25,5% and 22,2%.

The main reason of the lowest success of the category “Public/Social” is probably the high amount of money required by promoter to complete the initiative (most of them

exceed 50.000 euro), and the absence of a tangible rewards, since the majority of them were simple email of thanks.

However also this analysis shows that crowdfunding can be a powerful ally in building restorations for institutions without funds.

**Graphic 5.15**



*Source: Research of the author analysing the reward-based projects focused on public and social initiatives*

The next group is "Science" and has the same division of the same one into the donation-based projects, with the absence of the voice Alternative Materials, whose projects are not present in this category of crowdfunding.

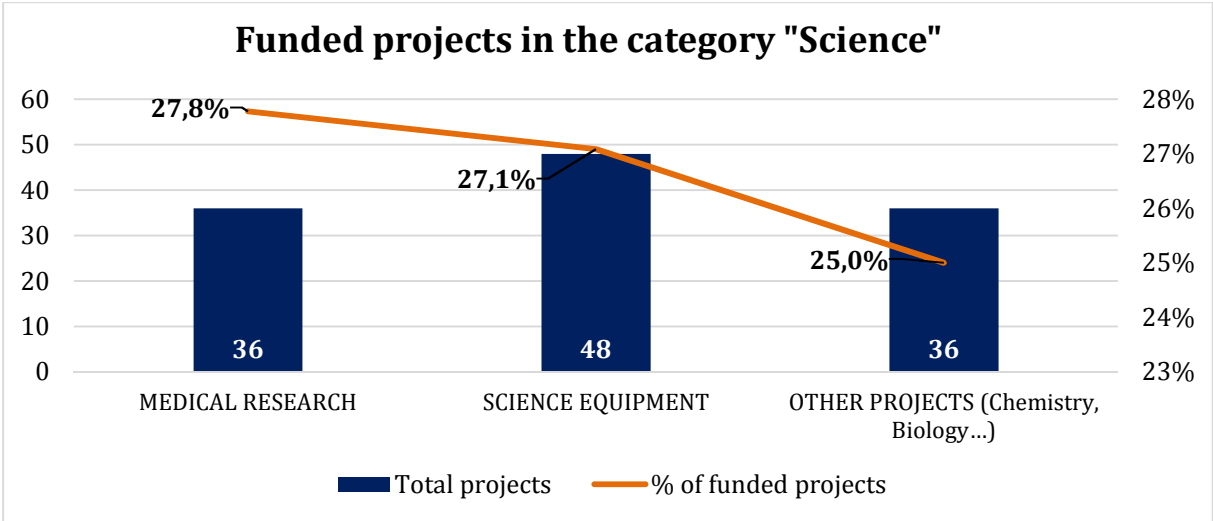
The *Graphic 5.15* presents the completion-rate of the campaigns, and is possible to see how the highest success brock belongs to the subcategory Medical research (as in the donation-based chart), with a percentage of completion of 27,8% and 10 projects completed on 36. The number of campaigns is relatively low, due to the fact that this category is almost viewed as a donation-one, and the difficulty to provide a reward on the medical field.

Science equipment is the second most funded group of projects, with a success rate of 27,1% and 13 finished initiatives on 48.

The last one of the list is Other projects, which refers to all the campaigns aimed to fund scientific researches that do not belong to the medical sector (chemistry, biology and other). The completion rate is 25%, and comprehend nine funded projects on 36.

The data of this graphic show an appreciation rate from users (since the funding percentage reflects also the opinion of lenders) inferior to the categories analysed above. This is because of the high funds required by certain projects, which cannot be covered only with crowdfunding.

**Graphic 5.16**

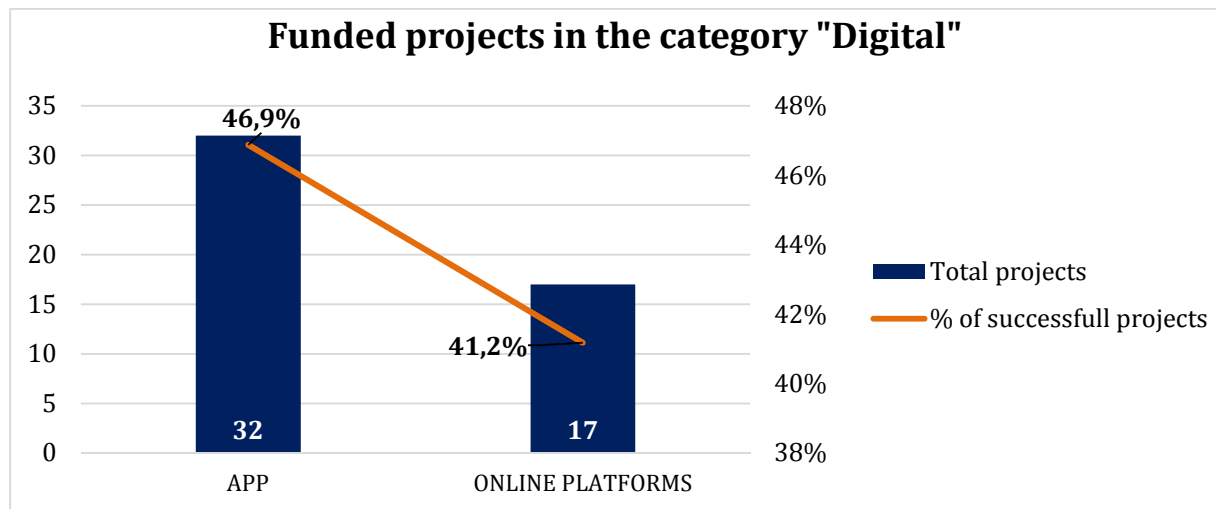


*Source: Research of the author analysing the reward-based projects focused on science and medical research*

The following category concerns all the projects related with the digital and the use of Internet. The goal of these campaigns is in fact the creation of app, online platforms and social network. The subdivision is the same of the equity-based group, since there are only two main group of projects. The only difference is that there are no further fragmentation, given the very small number of projects. *Graphic 5.16* shows, once again, as the projects related with apps meet the favour of funders, since there are 15 finished campaigns on 32 (46,9%).

The reward in this case consists in the possibility to have the app in preview before its release on the market, or to download it for free. The second group, Online Platforms, registers a good success rate, with seven funded projects on an overall total of seventeen. The number of campaigns here is relatively limited, because app creators tend to ask for support in equity-based platforms, but it confirms again the good achievements made by this type of projects.

**Graphic 5.17**



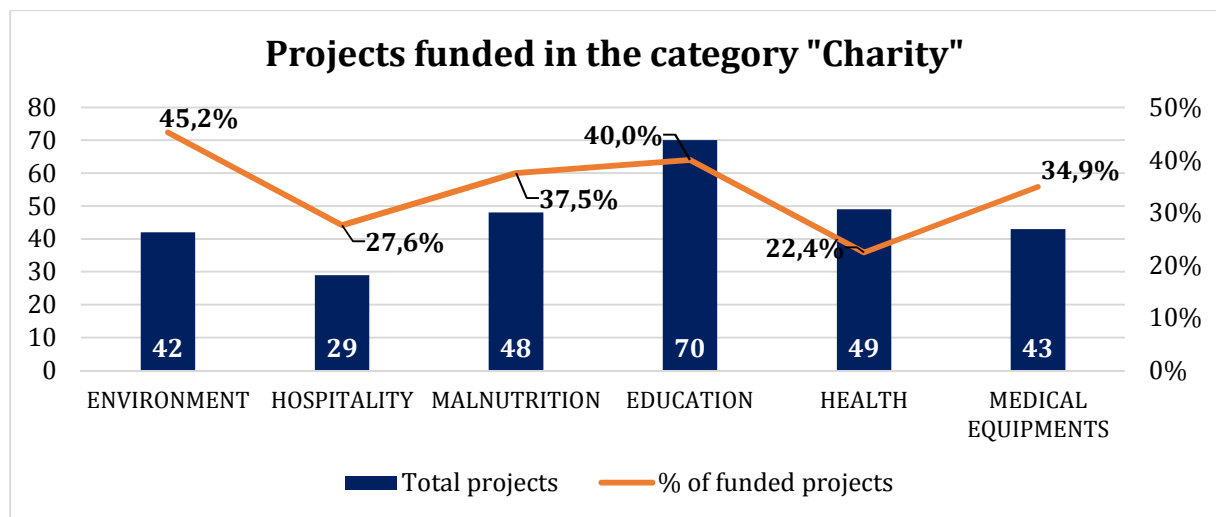
*Source: Research of the author analysing the reward-based projects focused on digital and informatics*

The reward in this case consists in the possibility to have the app in preview before its release on the market, or to download it for free. The second group, Online Platforms, registers a good success rate, with seven funded projects on an overall total of seventeen. The number of campaigns here is relatively limited, because app creators tend to ask for support in equity-based platforms, but it confirms again the good achievements made by this type of projects. In Graphic 5.18 the category “Charity” presents six different classes of projects, every one focused on charity, but concerning different fields. The difference with the donation-based charity group is that here the funders are rewarded (with a thanks letter, a gadget or something else). Of course, the overall number of projects is inferior, but the total number of funded projects is still high, with 99 successful campaigns on 281 (35%). The subcategories composing this group are:

- **Environment:** project related with environmental protection, animal welfare and nature conservation.
- **Hospitality:** reception projects for refugees and immigrants
- **Malnutrition:** help against hunger and thirst.
- **Education:** projects targeted to children education and instruction.

- **Health:** collection of drugs, medicines and vaccines for medical care
- **Medical equipment:** projects aimed to raise funds for the purchase of medical equipment

**Graphic 5.18**



*Source: Research of the author analysing the reward-based projects focusing on beneficence*

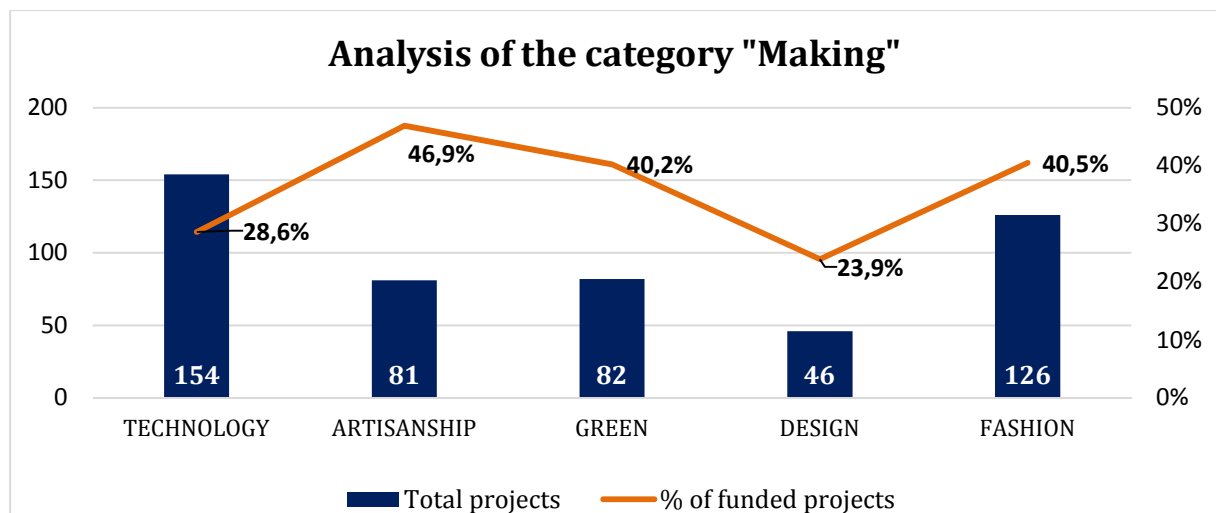
Environment is the most funded category with a success rate of 45,2% and 19 completed projects on a total of 42. The second top-funded group is Education that has a completion rate of 40%, with 28 successful initiatives on 70. Between the top voices is possible to find also Malnutrition, that registers a good rate of 37,5%, and 18 completed projects on a total of 48. This group has also a good funding rate, since a successful project is, on average, overfunded by 10% of the necessary amount. The last subcategory is Health, some because of the high amounts, some due to the absence of tangible rewards, except thank you letters. The last group of projects that is possible to analyse operating a fragmentation between the different campaigns is “Making”, and regards all the projects which involve the use of a manual skills, and which are made mainly through manual work. *Graphic 5.19* presents this division, with the category “Making”. It divides into five different categories, each one implying a different ability:

- **Technology:** all the projects related with technology and cybernetics
- **Artisanship:** manual projects regarding manufacture and handicraft.

- **Green:** manual projects regarding environmental-friendly technologies and buildings
- **Design:** the making of accessories and objects with an innovative design, where the pursuit of a particular form or pattern is a central goal of the author.
- **Fashion:** making of clothes, shorts, skirts and apparel .

The most successful one is Artisanry, confirming the good results made by the same category in the previous analysis. The percentage of completed and realized campaigns is 46,9%, and this group presents 38 realized projects on a total of 81. Artisanry confirms itself as one of the most successful type of crowdfunding projects, making it a category in which anyone, can build a business that has a good chance of realization. Soon after this, there are two types of projects with a very similar rate of implementation, “Fashion” and “Green”, respectively with a rate of 40,5% and 40,2%.

**Graphic 5.19**



*Source: Research of the author analysing the reward-based projects focusing on artisanry*

The category with the lowest success rate is Design, that registers a 23,9% of projects financed, remaining still at good levels, with 11 finished campaigns on 46. The category Making while not presenting funding levels as high as the previous groups (this is partly due to the lack of thematic platforms, as is there for culture or music) records anyway good percentages of financing.



## 5.5 The Social-Lending market

The last category of crowdfunding that this thesis is going to analyse is Social Lending. As explained in the previous chapters, this particular form of crowdfunding differs from others since there are no projects to support, but lending request between private citizens. In fact, the only possible fragmentation in this category is about the interest rate (or expected return rate) that every operation carries on.

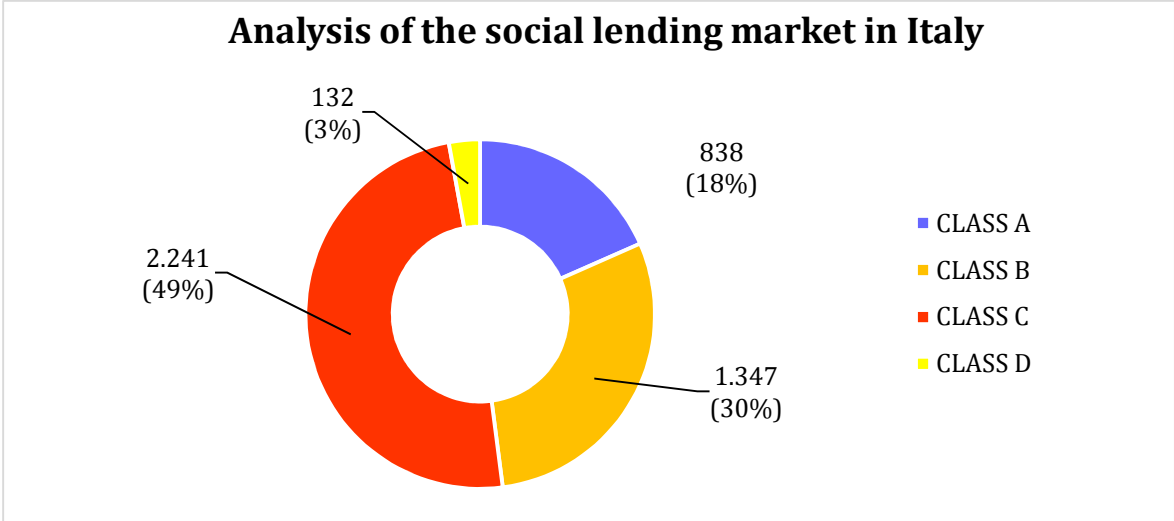
Looking at the three platforms authorized to operate with social lending (Prestiamoci, Smartika and TerzoValore), is immediately possible to note that there is a certain homogeneity between the expected return rate that the platforms propose to the lenders. The platforms analyse the request of the borrower (who give the authorization to examine his bank documents to understand its solvency. If the applicant is classified as reliable, the platform accepts to publish his loan application. The loan application is then inserted (depending on the creditworthiness of the borrower, the type of application and the expected risk for a similar operation) in a risk class (each platform has its own classes), which corresponds to a certain expected return.

Usually the expected return is calculated as the difference between the TAN assigned to that particular class, and the expected rate of loss. In some cases however it depends on the availability of the borrower (as in TerzoValore), which establishes a valour (usually very low) when he publices the demand. The lender can usually choose between two different ways of investment: the manual, where he personally chooses the operations and loans to support, and the automatic one. In the automatic one, the lender does not choose himself the loans to finance but it creates a profile corresponding to a certain expected return (i.e. he enrolls at the profile A, which corresponds to a return of 4%). The platform then selects the projects to invest in for the applicant, to remain at that particular rate of return. In this way, he minimizes the risk. The loans are required for various reasons (university fees, honeymooners ...) and are usually for small operations and personal use. A classification by topics is therefore impossible to do, while more appropriate is a segmentation depending on the rate of return. The classification of the expected rates of return was made creating classes of performance in a similar manner to the platforms did. These classes were created grouping the projects on the platforms into four groups, depending on their performance and return rate. Each class ranges from a maximum value to a minimum value, and represents the average profitability of

the projects included. *Graphic 5.20* represents the subdivision of the projects into the four categories. In particular, imaging a return rate equal to  $i$ , given by the difference between the average TAN for the category and the average expected loss rate:

- **Class A:** the return  $i$  is inferior or equal to 4%.
- **Class B:** the return  $i$  is superior to 4% and inferior or equal to 5%.
- **Class C:** the return  $i$  is superior to 5% and inferior or equal to 6%.
- **Class D:** the return  $i$  is superior to 6%.

**Graphic 5.20**



*Source: Research made by the author analysing the loans on the social lending platforms*

The graphic shows a clearly preference of Italians for the projects belonging to Class C; in fact this category occupies nearly the half of the overall amount of projects (49%) with 2.241 completed loans. The second most present class is Class D, with an average return superior to 6%, that presents 1.347 total funded loans. This data reflects an a propensity of Italians towards high-return investments (with higher risk), probably attracted by the opportunity of a higher gain. A proof of this is that the Class A (the one with lower efficiency) has only 838 projects, and covers 18% of the total. This figure proves something surprising, considering the relative risk aversion of Italian people, and the data shown in the analysis precedent, that indicated a preference for investments in sectors with relatively safe yield.

## 5.6 Conclusions

The analysis carried out in this thesis have led to very interesting results regarding a future development of crowdfunding in Italy. With regard to the funding rates for each category, we have seen how they attest to an average of 30%, noting a good response from Italian lenders and donator. As regards the non-financed campaigns, which have failed to reach the necessary amount, the research done on the projects (analysed one by one) has shown that in approximately 30% of them there were no video or presentation slides, and there it was only a textual description of the project. Many of the projects funded (approximately 25%) also miss a link to contact the authors of the initiative, and the potential lender can ask for information only to the platform. With the same percentage, many projects cannot be viewed (even the basic information) if you are not registered in the platform. All this, even acting as a protection for the promoters 'idea, require the user to release personal information to be able to view any detail, limiting the possibility that he chooses this "closed" projects. Undoubtedly, especially in a matter of development of Italian businesses, the equity crowdfunding is the branch that most matters the lenders. The data collected show a clear preference of the promoters for the digital projects, considered as the most profitable and least expensive.

The most appreciated sectors are the Food / Wine, Digital and Green (although in the equity-based there is still a small number of projects), and it is from them that Italy has to start the full development of its crowdfunding market. Many steps have been made in regulating the equity crowdfunding with an appropriate legislation, the first in the world; however there are still some limitations. Today the equity crowdfunding is reserved for start-ups and innovative SMEs. Definitely, a great way for young companies to start a business, but according to experts it should be extended to all SMEs, without charge, to support any project.

From the point of view of the platforms, the situation in the equity crowdfunding is not very positive, with only 4 active platforms and six about to be launched (but who know how many of them will survive in the long period). The projects funded at this date are 42, few if you think that the regulation entered into force two years ago. According to Alessandro M. Lerro, General Counsel of the EECA<sup>98</sup>, Italy still lacks an investment

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<sup>98</sup> See the full article at <http://bebeez.it/2015/07/13/lerro-aiiec-ecco-perche-italia-lequity-crowdfunding-e-ritardo/>

mentality that is instead present in other countries, with difficulties even in the Venture Capital and Angel Investor market. Certainly, the enlargement of equity crowdfunding also to innovative SMEs (safer than start-ups in terms of investment) will lead to an enlargement of the pool of potential lenders. From another point of view however, the measure is disruptive: for the first time in the world it is not only about online capital raising only for a specific project, but also for the capitalization of an investment fund or a venture capital firm, always provided that they invest primarily in start-ups and innovative SMEs. Which means that there might be interesting scenarios. In addition, if the measure had not been limited to start-ups and SMEs, and it had been more "courageous", Italy would certainly have been able to aspire to a role of international collector of venture capital, qualifying as a first mover in the market that will be filled soon.

According to Marco Bicocchi Picchi<sup>99</sup>, CEO of Symbid Italia, the latent potential of equity crowdfunding is 50 billion euro that can be invested in venture capital. The problem is that families "lock down" their savings, as noted by Nomisma, for which 54% of households that have an adequate profile to make an investment, 3/4 do not place funds into the real economy. They are real "inactive angel investors", which, however, thanks to equity crowdfunding, could easily access to investments in the real economy, and thus release a mass of very considerable unproductive funds. The role of platforms is to bring this unspoken question to new investment opportunities, selecting the initiatives with the greatest potential for growth, and involving angels and VC, as co-investors in the individual campaigns. In this way, the investor has an expert reference - the lead investor - and can better spread the risk.

Multiple solutions can be implemented, for example to raise the MiFID threshold to at least EUR 10,000 and eliminate the long bureaucratic procedures that hamper investments. Another solution is the digitization of the MiFID procedure and the reliance to the platforms for these documents. An ideal move would be the abolition of the minimum funding of 5% that a professional investor should bring to the project. This is a drag, given that few banks have an incentive to invest few money in a risky project, and it does not work as a security, because the investor knows that the bank invests because "obliged" by the law. This discourages the development of projects, because if

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<sup>99</sup> Full interview at <http://www.crowdfundingbuzz.it/la-potenziale-raccolta-dellequity-crowdfunding-in-italia-e-di-e50-miliardi-ma-il-regolamento-consob-deve-cambiare/>, made by Fabio Allergeni

they do not find lenders who support them, they cannot start. In addition, the user is already logged with the MiFID profile, and that itself should give guarantee of security. Not to mention that confidence in banks is at the lowest level ever. It would be better to encourage the entry of Business Angels or Venture Capitals.

For what concerns the other forms of crowdfunding, Social Lending is on the right road for a good development. Actually there are only three platforms authorized to operate with this particular form of crowdfunding, but the capital raised and the amount of loans released present encouraging data.

The donation-based projects presents a good funding level, considering that the lender has nothing in return for funding. Since they are above all charity projects and they are supported by famous non-profit organizations, the development of equity-based crowdfunding can only see a brilliant future.

The reward-based projects showed very interesting results in term of appreciation from users, having the highest success rate of the four categories. Apart from the projects related to Music, crowdfunding can be a precious ally for public and social initiatives (requalification of an area, creation of public spaces) and a support for all the Italian cities that lack funds to make intervention of requalification or that have the resources blocked by the Stability Pact.

The protection of the culture and the landscapes looks like one of the categories that could best benefit of crowdfunding, whereas too often the Italian artistic heritage is neglected.

Of course, the proponents do not have to consider crowdfunding as an alternative to traditional funding instruments, but consider it as a complementary resource, an external aid. Crowdfunding will never be able to replace traditional funding instruments for big projects requiring high amount of money and this is the most common mistake that borrowers make.

Of course, not every idea can find support in crowdfunding (more projects uploaded mean lesser interest and attention from users), without considering that if someone already funded a projects, he will not do it again in the short period.

In summary, the crowdfunding is a valuable tool for those projects that otherwise would never even be considered, but like all things it should not be abused, but used properly, and especially the users should not be considered as "cash cows", asking for exaggerate amounts that will never be reached.



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