УДК 336

CROWDINVESTING AS A FINANCING INSTRUMENT FOR STARTUPS

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Crowdinvesting is a very new research area for academia. It has been analyzed in the context of research on crowdsourcing and crowdfunding, where it has been addressed by articles, master theses and study works.

Crowdinvesting is much like crowdfunding, but instead of consumers, it's aimed at investors. It is designed to give a startup the push it needs to be able to handle things such as mass production beyond crowdfunding, distribution and staffing. Unlike crowdfunding, where you invest in a product, crowdinvesting is an investment in the company, where you can become a shareholder and benefit from the current and future successes [1].

There are four different types of crowdfunding:

- **donation based crowdfunding:** people donate small amounts of money and get no consideration. The aim is to support cultural and creative projects.
- **reward based crowdfunding:** the consideration consists of rewards in kind or acknowledgement. There can be also a possibility to use a product before sales launch. Supporters do not get money back.
- **lending based crowdfunding (subordinated loans):** the sponsor lends his money through a crowdinvesting–platform or directly to a business of his choice. The consideration consists of interest. The interest and the repayment of the loan will only be paid, if the business can afford that without becoming insolvent. In case of an insolvency all other outstanding receivables of prior creditors will be paid and then the outstanding receivables of secondary creditors, if this is possible. Because of the subordinated status higher interests will be paid.
- **equity based crowdfunding (crowdinvesting):** this form is also called "crowdinvesting", because investors get a participation, a participation certificate or become a silent partner. The investors can maximally lose their contribution [1].

Crowdinvestment can be seen as the second generation of crowd–based venture financing and the latest trend in using the crowd for different purposes. It is a subset of crowdfunding, that is used as a method for financing companies. Unlike crowdfunding, crowdinvesting concentrates mainly on financing young ventures or commercial projects by equity or mezzanine capital through the issue of shares and thereby requires a legal body. Compared to crowdfunding, the participation is not mainly rewarded by gifts or material incentives, but by the return on the investment.

The innovative idea is that anyone can offer investment possibilities to a platform and to investors (if minimum standards regarding the sustainability are fulfilled) and anyone can invest in it.

Therefore we can define crowdinvesting:

"Crowdinvesting is a financing method for young ventures and other commercial projects that supports the acquisition of equity by coordinating the submission of different forms of shares to an undefined group of possible investors through social virtual communities." [2]

Besides the access to capital sources, crowdinvestment has, like crowdfunding, positive side effects regarding the evaluation of the business model: founders can test the reaction of the market to their product. Based on the agreement to buy shares, founders can derive the favor of their product or service by an interest to buy it, assuming that investors would only buy shares if they are attracted by the business idea or at least believe that others could be attracted. Founders become a direct feedback from the market about their business idea. Through rating systems, like commenting functions or evaluation systems and internal market places, platforms provide the possibility to let the investor signal to other potential investors how valuable they evaluate the investment.

Crowdfunding and crowdinvesting have in common that the methods are applied on internet platforms, which lowers the costs for reaching potential supporters. The supporter is this case an investor; with his payment he obtains the right to participate in future cash–flows of the venture. Sometimes both crowdinvesting and crowdfunding are offered on one platform in order to attract a bigger group of potential customers.

Besides the close similarity to crowdfunding, crowdinvesting is comparable to venture capital financing. As an intermediary, the venture capital companies fulfill important economic functions regarding the transformation of lot–sizes, maturities, liquidity and risk.

Crowdinvesting contributes through the collection, coordination and distribution of the money crowdinvesting to the availability and allocation of needed capital. Furthermore, the intermediary provides the market with information and screens and selects the investment offers after the profitability.

A crowdinvesting platform combines the capital collection function and the capital investment function, but mostly without accounting for the collected money. Here it is forwarded directly to the startup. Comparable to the venture capital funds, crowdinvesting platforms split the default–risk into small parts and transfer it to the shareholders; crowdinvesting fulfills exactly the same risk transformation function like common funds.

On the contrary, crowdinvesting do not include milestones, ratchets, options, guarantees or governance agreements, but sometimes rudiments of anti–dilution protection and agreements in the case of disinvestment.

In this way, crowdinvesting is an alternative funding instrument for businesses. The main idea is, that investors do not invest high amounts in one project or business, but many investors small amounts. As a result, ambitious and risky projects can be realized, which a single investor would not have supported because of high risk. By investing small amounts in a number of projects, the risk profile will be diversified, the investor can build up his own portfolio and reduce the risk of the individual project. In general, it has to be considered, that investing by crowdfunding is always a high–risk investment.

References

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