



Trabajo Fin de Grado

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Crowdfunding: as a financial method for small and medium enterprises.

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0. Abstract:

In this report, I am going to explain the different ways of financing for small and medium enterprises. The main financial method explained is going to be crowdfunding, which is still developing in Spain and which is a great way for obtaining funds for companies rather than the traditional ways (bank loans for example). You will learn about how crowdfunding works and how the situation in Spain is for this type of financing, as well as the evolution for the next few years. The situation will be compared with other European countries as well as give a glimpse of the regulations among all of these countries. This report's purpose is to explore the alternative sources of financing of small and medium enterprises and startups as the special group of SMEs. There is no denying that SMEs have been offered a broad range of financing sources. However, the traditional one like conventional bank lending can be challenging to the SMEs market due to the high interest on loans. The authors' special attention was put to crowdfunding as an innovative method of financing with the potential to grow.

0. Resumen:

En este informe voy a explicar las diferentes formas de financiación para las pequeñas y medianas empresas. El principal método financiero explicado va a ser el crowdfunding, que todavía está en desarrollo en España y el cual es una gran forma de obtener fondos para las empresas frente a las formas tradicionales (préstamos bancarios, por ejemplo). Conocerás cómo funciona el crowdfunding y cómo está la situación en España para este tipo de financiación, así como la evolución para los próximos años. Se comparará la situación con otros países europeos y se dará un vistazo a las regulaciones entre todos estos países.

1. Introduction:

1.1 Motivation:

After attending the international banking program last year, I found that crowdfunding and other methods of financing are not used or not well enough in Spain. After the crisis, businesspersons have been very critical about investing and lending and borrowing money from banks or other financial entities, that is why it is a good moment for small and medium enterprises to start exploring new ways of financing that are not used in Spain but that are well settled in other countries.

From this program I learned a lot about the different visions of financing of the rest of the countries that were also involved in the program and thought these ways of financing should be taken into consideration also in Spain, especially crowdfunding, which has been proved in other countries and on multiple occasions to be extremely effective and useful.

With the current economic situation after the pandemic and the war, the future will be difficult for these small and medium enterprises, constantly trying to survive, which is also another determinant factor for studying financing alternatives.

1.2 Goal:

The objective of this work is to explore the different alternatives that small and medium enterprises have to finance themselves. The aim is also to introduce some new ways of financing that are not so popular in Spain and that could help entrepreneurs to start their business and to allow them achieve their business objectives. This report tries to deny some myths about these financing methods such as the fact that crowdfunding is only useful or available for start-ups.

2. Development:

2.1 What makes financing smaller companies and start-ups different from financing larger corporations?

Business financing can serve many purposes such as: it could be used for working capital, to start a business, it may be also used to fund the purchase of raw materials or inventory. On the other hand, a business may require financing to grow or expand, or to purchase equipment or land. A clear fact is that every business requires financing at some point and, more commonly, periodically throughout the life of the business. In fact, a business may choose from many financing options which will vary depending on the size of the business.

Debt and equity financing comparison:

The two categories for financing the small or either the larger businesses can be distinguished: using financing through debt or through equity.

Debt financing

The two categories for financing the small or either the larger businesses can be distinguished: using financing through debt or through equity. When a company borrows money (usually from banks), we can say that it has debt. Debt means that it will have to return the principal and in addition, pay a percentage of interest. We may think this is a disadvantage, but it is actually a positive situation because companies need to acquire debt to finance themselves, even the healthiest of corporate balance sheets will typically include some level of debt. It is also one of the most important implications for start-ups to begin running a company because it is needed to start its operations. The advantages of debt financing are; firstly, that the business still has control in its own hands. Secondly, the loan interest is tax deductible.

If we look at the disadvantages of debt financing; the business must be accepted first to borrow money, payments must be made on specified dates without fail, taking too much debt is negative for the cash flow in the business and lastly the lenders will demand that some assets of the company must be held as collateral.

Equity financing

When we talk about equity financing, we talk about investors who are prepared to invest money in the business, expecting an equity share or a profit share that are the results of different types of business activities. When we compare them, we can say that equity share is

the result of investing money into businesses, such as when starting a new company or when buying stocks of a publicly traded corporation. The other option is profit share, which is obtained from results of overall business operations, such as a business partner receiving a portion of profits earned from manufacturing products.

There are advantages to equity financing such as; having less risk because there will be no fixed monthly loan payments to make. This can be very interesting for new startup businesses who have a bad/negative cash flow. Interest rates can also be very high for debt financing because start-ups are new in the market, so they will have a bad credit score because they don't have enough experience and trust between them, there is also potentially more debts to pay because of new investments. Freedom from debt, potential venture capitalists (method for raising cash), public float (Shares issued to the public) are also some advantages. We can also mention that there is a lack of information about start-ups because they are new in the market, this will also have an effect on the financing part. In conclusion, this will lead to high payments and the financial growth could decrease. A disadvantage for equity financing is losing the control of the business because equity partners who own a big part, will be able to have a voice on the decisions of the business. Also, the personal relationships could be affected if the company fails (family and friends).

What are SME's?

The definition of SME is, Small- to medium-sized enterprises. These are businesses with assets, revenues and employees that fall below a certain level on the market. The criteria for determining an SME will vary between countries and industries. They are so important because they represent 99% of the businesses in the European Union. Each country sets its own definition for SMEs, and they decide certain limits for different industries. It is known that SMEs are often given incentives such as help for financing and favorable taxation.

In this paper we will focus more on start-ups rather than SMEs because there are too many subjects we could not focus on. The following parts will give more information about start-ups in the market. Also we want to focus on alternative financing methods in the countries we live in.

The struggle of SMEs in the market:

There is a high chance that SMEs struggle in accessing bank loans, one of the reasons for that can be the fact SMEs are much smaller than corporate businesses and they have less information that is publicly available. Investors have much less information than the

companies themselves, this is called “information asymmetry”). This causes difficulties in investigating the creditworthiness of SMEs, which hinders the process of obtaining a bank loan. Small businesses usually pursue financing in the form of traditional small business loans. These loans, although they are extremely beneficial for starting a business in order to create an initial cash flow or building working capital, can be difficult to qualify for. Small business funding can take a variety of forms: small businesses may acquire financing through personal loans, such as home equity. Home equity is the portion of your property that you truly “own.” For example, if you borrowed money to buy a home, your lender has an interest in the property until you pay off the loan, although you’re still considered the homeowner. Home equity is typically a homeowner’s most valuable asset. That asset can be used later in life for financing for example.

In addition to traditional small business loans, they can finance their pursuits through their own vendors, such as financing the purchase of equipment or exercising an option to pay over time, such as “Buy now, pay later”. Lastly, some small businesses may, in some circumstances, qualify for venture capital or government grants.

This is contrary to larger firms who have a lot of publicly available information and are very “opaque” (by opaque we understood that there is a lot of information, such as e.g. accounting records of multiple financial years, available to investigate the creditworthiness of a firm), easy to investigate and also already have a credit history. Large businesses have the same options that small businesses have but they enjoy a far greater variety. They may look to business loans for their financing needs (such as those offered by large banks and other financial institutions), or they may also take loans off their existing purchase orders or use accounts receivable factoring. Additionally, larger businesses commonly have more assets than the smaller ones, so they can use these assets to obtain a secured business loan or line of credit or they may also acquire financing through issuing equity.

Interestingly, banks who lend money to SMEs often have a more personal relationship with the SMEs. This relationship is built on gathered info that was not publicly available. As a result, SMEs do not quickly get access to funding by larger or international banks. These institutions usually don’t have time to set up a personal relationship and they are more likely to choose to fund a very “opaque” business (often big, corporate).

A lack of information about a company commonly leads to banks demanding higher collateral. Since SMEs are much smaller than larger corporations, they will not always have

enough assets to provide this high collateral. (*Obstacles to SME finance: World Bank Malaysia Hub, 09/10/2017*).

Tax deductions and lower interest rates are involved and interrelated. It is mainly the biggest attraction for debt financing. It reduces the taxable base before paying taxes, so the percentage applied to the income will be much lower and thus pay less. This could be more efficient for larger companies which normally have a bigger amount of income (and have to pay more taxes).

Obtaining debt is also important to a business owner to maintain ownership, so he becomes committed to complete the payments and therefore he retains the right to run the business.

If we look at disadvantages, the main one is repayment, which will be faced by every company. However, there can be higher interest rates in some cases due to macroeconomic situations in a region or country that can't be controlled, and will have more negative impact on start-up corporations. This type of business will also face another dilemma: they need to ensure that their business has enough income before they start the repayment. If they cannot fulfill their obligations, it will also have an impact on credit rating, which will decrease, and thus banks won't take the risk to lend them money (if they do it, it will be at a higher interest rate).

In conclusion, we can say that granting loans to SMEs and/or startups is much riskier than granting loans to larger corporations. Start-ups need to use debt financing to begin a company, and they have more difficulties to borrow money (also to repay) than larger companies, which primarily get financed to grow and increase their incomes. Banking institutions tend to choose the most secure and rewarding projects. Factors such as a financial crisis, or right now a global pandemic, elucidate this problem even more. The effect on businesses that the differences between large and small business financing have, means that larger companies can be more discriminating and also the larger company will also be able to secure financing at a lower cost than the small company because larger companies have less perceived risk and more documentation of its financial position.

We can also conclude that equity financing is very helpful for start-ups because there is less risk, there are less credit problems and the cash flow could be affected positively. The advantages of equity financing are more interesting for start-ups.

2.2 What is debt-based crowdfunding?

Debt-based crowdfunding (often also referred to as peer-to-peer lending or P2P) is one of the easiest ways to raise funds through crowdfunding. It is the crowdfunding model that is demonstrated to raise the biggest capital on various platforms. Obligation-based crowdfunding is used to raise capital by taking credits from a few financial backers (moneylenders) who hope to be reimbursed with an additional premium, the interest payments, as a return for their loan. The whole interaction happens through a crowdfunding platform.

This method has become successful because of the progressively-acquired popularity among both financial backers and organizations. The reason behind this being that it is a quick, simple, and secure approach to raise capital for organizations (everything is done online). It additionally offers financial backers better return rates contrasted with what they'd get from banks; particularly in the last years' low-interest climate.

There are also several risks associated with debt-based crowdfunding such as the loss of investments for investors because it is possible to lose all the money in one bad investment. Circumstances can arise like forced liquidation or bankruptcy, where the owners and the business become unable to repay the debt.

Nevertheless, there are also a lot of rewards or advantages of debt-based crowdfunding that have to be separated into two, the advantages for business owners, and the ones for investors. In terms of the rewards for owners, they can retain company ownership, which is an important advantage versus the equity-based option. Another advantage is that your relationship with your lender endures just as long as you have their obligation. When you've reimbursed the credit, all future income stays "in" the organization. You have no further commitments to the lender. This may bring about greater benefit for the business over the long haul. From the perspective of SMEs, one of the most relevant advantages of debt-based crowdfunding compared with other financing options such as a bank loan, is the shorter time needed to get the cash. SMEs are cash-flow sensitive, so getting the funds in a short time might be critical for them.

Now moving onto the rewards for investors, we have to highlight two main ones that are: the minimal risk for investors, because since the loan is shared among several investors, the amount you place at risk is lower; and better cash flow for investors, because your speculation creates interest installments consistently, or according to the concurred interest

installment plan for the credit understanding. This gives you better income from the board however long your credit reimbursement keeps going, which is normally three to five years.

2.3 How does Crowdfunding work?

Crowdfunding platforms make money collecting a portion of whatever the project raises, or charging a fee to the project-owners, never to the investors.

The cycle for crowdfunding donations is a piece contingent upon the platform. However, when in doubt, associations set up a donations page and direct people to that page. There, “allies” can vow to back the association or undertaking at different levels, which may have rewards joined to them.

Pledge drivers are normally changed at an expense by crowdfunding platforms if the raising money crusade has been fruitful. Consequently, crowdfunding platforms are required to give a safe and simple way to utilize administration.

Numerous platforms work as a win or bust subsidizing model. This implies that in the event that you arrive at your objective you get the cash and on the off chance that you don’t, everyone gets their cash back.

In order to understand what steps must be taken to set up crowdlending, we should take an in-depth look at what information is necessary and what factors have an influence on the lender’s decision-making process. We will look at the perspective of the borrower, the lender and the platform or intermediary.

2.4 How does debt-based crowdfunding work from the perspective of the borrower?

The precise process and terms for both lenders and borrowers will vary from platform to platform, but a general process can be established.

The first step is submitting a loan proposal and going through an initial eligibility test, in which the platform reviews the company asking for a loan. This has the objective of assessing that the company meets certain minimum criteria established by the platform (Katipult, 2018). No two platforms are the same, so these requirements will vary, some might require a minimum of years’ operating, or certain revenue or profitability levels. For example, the platform *October* requires a minimum turnover of €250,000 (October SA, 2021).

The initial analysis might be done through software or using a team of analysts. In some cases, it might require direct contact by telephone to discuss certain aspects about the business, and in other platforms this might be done fully online. They might ask the company for information regarding tax returns or business plans.

After assessing the suitability of the proposal, the platform will offer the rates and fees. This will be correlated to the level of risk the loan constitutes to investors (Vissers, 2020). Then, once the borrowing contract is accepted, the platform will publish it on the website for the investors. The time the projects are available for investors will vary by platform and project. In the case of *October*, it is approximately 3 days. Depending on the platforms, both individuals and institutional investors will lend their money. Including institutional investors works as a guarantee that all money requested will be lent (October SA, 2021).

What information should be provided specifically:

The borrower should be as transparent as possible when providing information about their project. Demographic information as well as a transparent and detailed business plan as well as personal information have a great effect on the lender's decision making process.

- *Personal and demographic information:*

Basic data such as a name, a profile picture, social media such as a LinkedIn account, information about previous (successful) projects, ... seem to have a great influence on the lender's process of choosing a certain project. The more information that is publicly available, the greater the chance that a lender is willing to invest money in a crowdfunding project. Demographic data such as age and location are also important. It has been proven that lenders are more likely to extend a loan to someone from the same geographic area and age group.

- *Business plan and introduction video:*

A clear and detailed business plan is very important in order to have a successful project. If the borrower can provide a solid business plan, with or without an introduction video, the lender will be more likely to opt for their project.

2.5 How does debt-based crowdfunding work from the perspective of the individual lender?

The individual lender's process is shorter than that of the borrower. The steps to take to be able to invest consist of registering in the platform, creating a profile with information including full name, date and place of birth, current address and national identification number. All this will be verified by uploading two different identification documents, e.g., passport and driver's license.

Then the wallet needs to be set up, for that the lender will need to upload a bank certificate including the IBAN, full name, and the bank's logo.

The next step is a knowledge assessment. This will ensure that the lender has enough financial knowledge and that they are aware of the risks involved in crowdlending.

Once this is done, and the platform has validated all the information provided, the lender will be allowed to start investing in the platform. In *October* this can be done with as little as 20€. They will receive the repayments, which could be reinvested or transferred back to the bank account (October SA, 2021).

What information should be provided specifically:

The lender will need to leave personal information, demographic information and credentials (creditworthiness etc) so the crowdfunding platform can verify their trustworthiness.

2.6 How does debt-based crowdfunding work from the perspective of the intermediary or platform?

It is up to the platform to set an amount of rules that take local regulations into consideration. The platform always secures a minimum amount of money (usually around €50.000) that has to be collected and a minimum time span (usually a minimum of two weeks) for a crowdfunding project. Apart from that, the platform verifies both the lender's and borrower's information. The crowdfunding platform creates a safe environment that puts lenders and borrowers in touch with each other so they can exchange information and decide on lending/borrowing money.

Credit scores and interest rates are also provided by crowdfunding platforms. They will do their research on the borrower in order to provide accurate information for the lenders:

A credit score indicates the risk of a certain project and the likelihood of return on investment. The lower the credit score, the higher the risk and the lower the likelihood of return on investment. The credit score is also reflected in the interest rate of a debt-based crowdfunding project. The lower the credit score, the higher the interest rate. A higher interest rate means higher profits when the project is successful. However, lenders tend to opt for a project with a lower interest rate since it is more likely that they will get their money back with a small profit. Credit scores can be provided by external institutes or by the crowdfunding platform itself based on extensive information that was provided by the borrower or information that is publicly available. The crowdfunding platform determines an interest rate for each project based on their findings. The borrower chooses to accept this rate and start their campaign or to deny this rate and go to another platform or even find an alternative source of finance.

Most of the time, the crowdfunding platform will also show how much money has already been raised, how many people have invested and the highest amount of money that has been invested. This information causes ‘herd behavior’ which means that lenders are more likely to follow the crowd and invest in projects that other lenders have also invested in.

2.7 How does regulation impact the crowdlending process?

Is there a difference in the regulatory landscape across Europe?

Comparative Table:

Title: Regulation comparison across Europe

	Belgium	Poland	Spain
Relevant Regulatory Authorities	Financial Services and Markets Authority (FSMA)	Polish Financial Supervision Authority (KNF)	National Stock Market Commission (CNMV) and Bank of Spain
Relevant Legislation, Regulation and Policies	- Crowdfunding law which states the required license	- The Civil Code: Regulations on the loan agreement and regulations on the	- Crowdfunding law which states the required license and

	- Tax advantages for investors to stimulate crowdfunding	permissible rate of principal and delay interest.	minimum capital of 60 thousand euros.
The maximum value of the raised funds	If total equivalent > 5 mil euro a prospectus needs to be published. If the total equivalent is between 500 thousand and 5 mil euro an information note suffices.	If total equivalent > 1 mil euro a prospectus needs to be published.	-qualified investors: 5 mil euro -non-qualified investors: 2 mil euros.
Common Regulation on EU level	<ul style="list-style-type: none"> - PSD2 - AML/CTF - MIFID II 		
In The Near Future	Regulation 2020/1503 on European crowdfunding service providers for business, goes into force from 10/11/2021.		

Source: Own

What steps are necessary to set up crowdlending considering the regulation?

Now that we have taken a look at what information is necessary to set up crowdfunding and the regulation in some European countries, we can take a look at the steps that must be taken considering (local) regulations in order to set up a credible and successful crowdfunding campaign.

In Belgium, credit and equity crowdfunding requires a license, in accordance with national regulation. The platforms which offer financial crowdfunding are also subject to regulation, as they require a license AFP, alternative financing platform. The crowdfunding process in Belgium is generally comprised of four steps:

- 1) The entrepreneur presents their project to the crowdfunding platform to be subjected to evaluation.

- 2) The entrepreneur provides the potential investors with all relevant information and they promote their project through a campaign. The investors then have the option to participate in the financing and deposit an amount they can choose themselves.
- 3) At the end of the predetermined financing period believers are no longer able to deposit investments. If the set target has not been reached, the investors receive their money back. If the target has been reached, the entrepreneur will receive the collected assets.
- 4) After the financing round there is still interaction between the entrepreneur and their investors, in case of equity crowdfunding this can be through their voting rights.

A final step that can be taken, albeit voluntarily, is the seeking of government assistance since the Belgian government offers support to entrepreneurs seeking financing through crowdfunding. It does so in 3 ways: a tax shelter for start-ups, a tax shelter for scale-ups and an exemption on the tax on interests on the loan.

2.8 Alternative financing methods for SMEs that have been successful across the developed world:

Private equity & venture capital

With the banks battered and becalmed, private equity has a significant role to play in driving economic growth by creating jobs, generating returns for its investors and building better businesses by creating real value. Private equity is the collective term for financing unlisted companies with private resources. It usually has duration of four to seven years

Venture capital is a part of private equity that specifically focuses on the funding of start-ups or young companies. A venture capitalist often provides capital to young companies with the aim to create added value and actively take part in the management of the company.

The fundamental reason behind private equity's growth is something so obvious: the firms' standard practice of buying businesses and then, after steering them through a transition of rapid performance improvement, selling them. That strategy, which embodies a combination of business and investment-portfolio management, is at the core of private equity's success.

Other reasons why private equity is so successful are that most private equity firms share:

- Understanding the need for research. Much of the return on investment is based on their ability to acquire businesses in the best way possible from the start and to minimize their risk.
- Exit planning. It invests based upon a shorter time horizon compared to strategic acquirers or existing business owners (the private equity investor expects to exit an acquired company in 3 to 5 years, and rarely more than 7 years) as mentioned in question 2.
- Use of leverage and cash flow. Private equity typically uses cash and debt to acquire businesses.
- Experienced in the upgrade. It focuses on establishing strong financial controls, internal reporting, eliminates unprofitable units, streamlines operations, and works with management to identify operational inefficiencies.
- Portfolio building. This is because acquisitions are their expertise, private equity uses acquisitions to add on to their existing portfolio companies whenever possible.

Venture Capital:

The success behind venture capital can be explained because of several factors such as for example the fact that it fills a void. Even though, contrary to popular perception, venture capital plays only a minor role in funding basic innovation, venture money plays an important role in the next stage of the innovation life cycle: the period in a company's life when it begins to commercialize its innovation.

Another important factor of the triumph of venture capital are the attractive returns for the VC because in return for financing one to two years of a company's start-up, venture capitalists expect a ten times return of capital over five years.

Types of Venture capital:

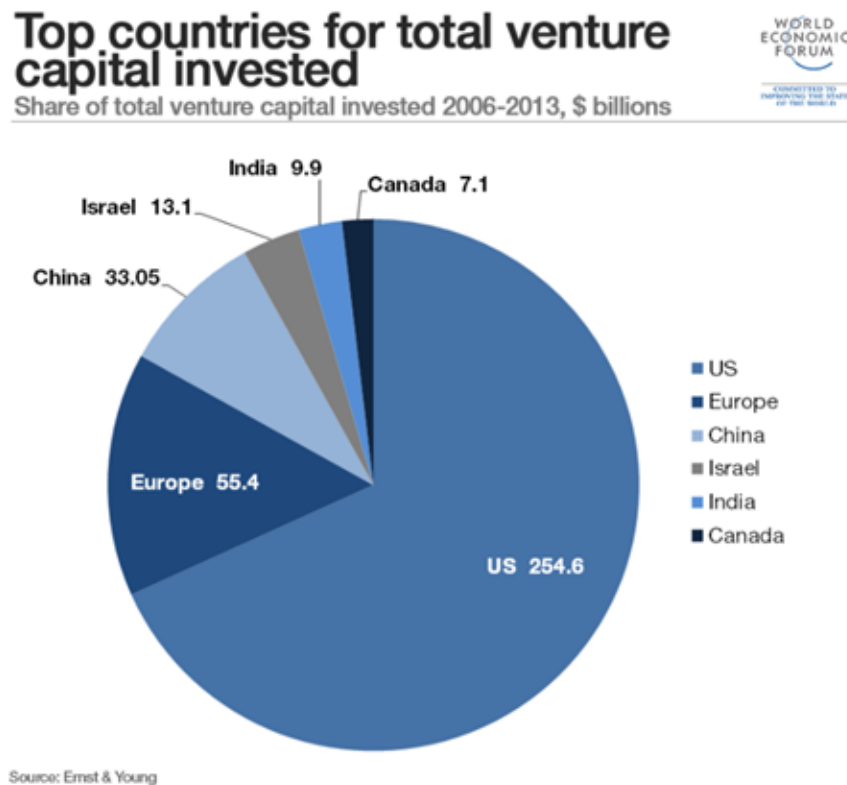
Seed capital: a first injection of capital that is often used for research & development, product design etc...

Start-up capital: capital that starting companies use for marketing, investments, ... before generating a first turnover.

Later stage capital: this capital injection is used to finance growth.

Both venture capital and private equity have an average duration of four to seven years. After this period of time, the investors will sell their participations with added value, which means the company has to have a lot of potential for growth and promise in order to be eligible for this alternative resource. (Laveren, E. & Engelen, P.-J. (2018)).

Figure 1: Top countries for total venture capital invested



Source: Ernest and Young, via;

<https://www.weforum.org/agenda/2015/07/which-countries-have-the-most-venture-capital-investments/>

The size of the venture capital market is very big; \$373 billion was invested worldwide. The United States has the most funds for venture capital of \$254.6 billion in 2013. While Europe had \$55.4 billion.

Is equity crowdfunding replacing the traditional type of financing start-ups?

Investing in an early-stage company that is not listed in the stock market in exchange for shares in that company is called equity crowdfunding. The working of this type of process is that shareholders have a partial ownership of a company, so they stand with the profit of the company or the loss when failure appears. Previously only wealthy individuals, venture

capitalists, and business angels could invest in startups. Equity crowdfunding has helped compensate for the investment process by opening the door to a larger pool of potential investors which is “the crowd”. So start-ups will have a higher chance to attract potential investors with equity crowdfunding.

Business Angels

Business angels are (former) entrepreneurs who wish to invest their knowledge, time and resources in promising start-ups or rapidly-growing businesses. Defined as the independent individuals who provide capital for the development of businesses.

Business angels have a lot in common with venture capitalists since they also take a participation in a company for a period of time of five to seven years with the aim to sell this participation with added value.

Business angels can choose to take an active role in the management, this is called a “deal”, or they can choose to finance the company without an active role.

Business angels distinguish themselves from venture capitalists since they are willing to invest in high risk profiles with a rather limited profit-risk ratio.

In a later stage of business angel financing, the business angels may sell their participations to venture capitalists. (Laveren, E. & Engelen, P.-J. (2018))

Leasing

A different form of flexible financing is leasing. It can be used to finance assets such as machinery, cars and Information Technology equipment.

How does leasing work?

When enterprises use leasing, they make a deposit and then make monthly payments on the equipment that are mentioned above. This has usually a term of five years or less. When the lease term is finished, you can own those equipment by making a minimal buyout payment. Businesses can also choose this financing form because there are tax benefits in comparison with a normal buy.

Factoring

Factoring is the sale of Book Debts (money owed to the bankrupt, partnership or company at the date of the insolvency order) by a firm (client) to a financial institution (factor) on the understanding that the Factor will pay for the Book Debts as and when they are collected or

on a guaranteed payment rate. The enterprise avoids the debtor risk and invoicing by this alternative.

Reverse factoring

When a finance company such as banks intervenes between a company and its suppliers and commits to pay the invoices of the company to the suppliers in exchange for a discount. This form of financing is known for its lower costs. This has benefits such as accelerating the cash flow.

In advanced economies or emerging markets, small and medium enterprises can be the guide to reach increasing levels of job creation and capable of fostering economic development in the future, but as we commented before, they have big difficulties finding funding. A typical problem that this kind of company normally has, is that they have lack of information about other funding alternatives. In the last years, there has been an emergence of this alternative financing which is based on new creative business models out of the conventional banking system and leads to creating new opportunities. There are also new business models that are emerging in the market such as online retail companies and online marketplaces. This has emerged as a result of the digital revolution that has afforded important changes in products and services on alternative financing. It also makes it possible for SMEs to adjust financing to their possibilities and preferences, such as faster loan approval process, smaller loan amounts, lower cost of transactions, lower cost of funds and alternative credit scoring model.

A very representative example is Financial Technology (also called Fintech) where both lenders and SMEs get benefits.

Traditional banks avoid giving small loans because it has higher costs and they get lower profits, while alternative finance platforms can offer any size or amount of loan. These kinds of platforms use technology to take advantage of it, so they need a lower cost to operate, and also SMEs get a lower cost on the financial products.

One of the best characteristics of alternative financing, that is responsible for letting SMEs get easier access to financing, are the methods used for assessment of creditworthiness, using also alternative credit scoring methods (could be combined with traditional credit scoring), which is possible by considering information from alternative sources. Some examples are information about sales level from Amazon, shipping history for postal services, activity on checking accounts and payment processors. These methods are criticized by traditional methods because it can lead to an inadequate evaluation of the companies that could commit

default on the loans. However, as we said, a new financing alternative enables increased access for companies, especially SMEs, and has a positive impact on this sector, increasing income and letting them succeed.

The difference between traditional and alternative credit scoring

Alternative and traditional credit scoring models aim to achieve the same purpose. The difference between them is the criteria they use to determine a borrower's score.

The traditional credit score is determined strictly by a borrower's lines of credit. A mix of information is needed for agencies to determine a credit score, including: Payment history, current debts, credit use ratio, number of open accounts, length of credit history. Information from public records can also be used by credit bureaus to gain a larger picture of the borrower's financial history. Alternative credit scoring gives borrowers without a strong past of credit, a chance to get a loan by basing their score on different criteria. We can talk about data such as; rent, shopping history and property records. Some alternative credit scoring models will also look more in depth, they can check information such as the education of the borrower and social media presence. All this information is used to understand and determine the risk of potential borrowers which is more detailed than a traditional credit score.

Now that we know the importance of alternative financing, we should have a look at the numerous alternative financing methods. Next, we will talk about the most important ones.

2.9 What are major challenges for SMEs in detecting the best financing fit?

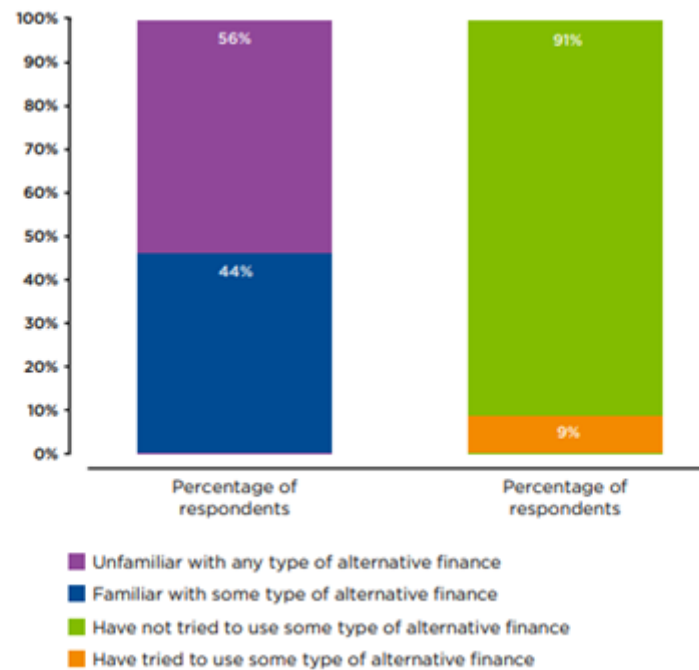
As we have talked about before, there are many ways of alternative financing for SMEs, but what is the best option of financing for these companies?

The answer is not clear, there are a lot of differences between firms that will make them select a specific way of financing, since "each company is a different world".

However, there are important factors that influence the decision making process: there is lack of awareness of the existence of the different alternative financing methods, so it is a big impediment to the broader use of these instruments

An example given by a survey, is that almost 60% of SMEs in the United Kingdom are unaware of the existence of more innovative finance instruments, such as p2p business lending, p2p consumer lending, crowdfunding and invoice trading (Baeck et al., 2014)

Figure 2: Global Crowdfunding Market



Source: UNDERSTANDING ALTERNATIVE FINANCE The UK Alternative Finance Industry Report 2014

<http://polskycenter.com/altfin/understanding-alternative-finance.pdf>

While awareness has certainly improved over the last couple of years, only roughly half of businesses that are aware of these types of finance could name a specific supplier of that type of finance, suggesting ample scope for improvement. For instance, while 60% of smaller businesses in the United Kingdom know of the existence of venture capital as a finance type, only 22% are aware of a specific fund to approach. (British Business Bank, 2016).

The general picture arising from these studies is that SMEs and entrepreneurs go to their main bank only right before they are in need of external finance and accept any given offer, unaware of non-bank financing sources and even of potential offers of rival banks, mostly without consulting external advisors.

At the same time, it does not appear sufficient to increase awareness of the existence of non-bank financial instruments to guarantee their increased use by SMEs. Even when entrepreneurs are aware of the existence of non-bank sources of finance and would like to access them, a lack of confidence in seeking and successfully attracting alternative sources of funding might be holding them back. The 2015 SAFE survey indicates that around two-thirds of surveyed SMEs in the EU 28 reported that they felt confident discussing with banks about

accessing finance and obtaining desired results, while around 22% did not. However, only 20% of SMEs felt confident in discussing financing and obtaining the desired results with equity investors and venture capital enterprises. 33% reported that they lacked confidence in that area, while the rest did not find the question applicable to them, strongly suggesting that SMEs find equity investors more intimidating to approach than commercial banks. According to the 2013 survey, only 24% of SME managers who found equity financing relevant considered that there were no barriers to acquiring this type of external funding. The high perceived cost and the unavailability of equity financing constitute the two most frequently reported barriers. That being said, it is important to note that innovative SMEs felt significantly more confident in accessing equity finance (European Commission, 2013).

Equity-type instruments require a high level of financial sophistication (by the business owner or entrepreneur looking for finance). Equity investing usually needs an elaborated business plan, in-depth financial information and seeks investments that satisfy their requirements, which might create difficulties for them. We can refer to it as investor readiness, and it can be defined as “the capacity of an SME or entrepreneur – who is looking for external finance, in particular equity finance- to understand the specific needs of an investor and to be able to respond to those needs by providing an appropriate structure and relevant information, by being credible and by creating confidence”

Poor governance of SMEs may thus explain to some extent why these firms face particularly difficult financing conditions. For example, mentoring and networking may be critical to the development of high-tech SMEs so that knowledge transfer can take place between those who have successfully developed new businesses and those who are just starting them. However, many firms at such an early development stage simply lack the resources and knowledge on how to build the necessary structures and this capacity internally. So we can say that investor readiness is a very important factor that makes some SMEs have better access to alternative financing.

If we want to know the best financing fit for SMEs, we can just look at their opinion about it. A survey about SMEs was done in the UK, asking these companies that are aware of alternative finance, that were presented with some hypothetical statements on what would make them more or less likely to use alternative finance platforms. From this survey, we can conclude that SMEs prefer, when using alternative financing, cheaper funding (46 per cent), and regulation (46 per cent). This was also followed by the fact that it is faster and less complex than traditional funders (40 per cent). The factors that would make them less likely

were if they believed most platforms would not be around in 10 years (37 per cent) or if platforms had a reputation of funding applicants regardless of quality (32 per cent) (Baeck et al., 2014).

2.10 What are the future perspectives in financing SME?

Policy makers well recognize the importance of SMEs in the market, their contribution to employment, economic growth and promotion of entrepreneur skills. The government in many European countries introduced the special programs made to the SMEs, however, tax incentives, favor industry or direct investment are not always enough to promote the growth of the SMEs and cannot replace the need of the financial inflow into their bank accounts. The second issue is the rapidly growing group of potential recipients who will need financial help to develop their business. Especially for small companies getting the financial support is difficult as they are heavily reliant on bank lending and that makes them vulnerable to banking system dynamics, additionally the time of financial stress like current COVID-19 pandemic do not make it easier. Therefore, it is necessary for the government to foster and increase knowledge about alternative financial instruments of the SMEs. That can be achieved by developing a data warehouse that could minimize asymmetric information and improve transparency so that investors can access investment opportunity information more easily. Introduction of such a solution would also have a positive impact on the private equity investments. The steady growth of this sector has been already noticed in OECD and non-OECD countries. The greatest success among investment in the private equity sector has so far enjoyed buyouts, but more and more formalization, the implementation of legal legislation and better organization have had an effect on the trend of venture capital and angel investment although their targets so far are mainly innovative start-ups.

In the past years the growth of crowdfunding can be observed even though it is mainly associated with the non-profit organization, more and more boldly goes to profit activities and businesses. It also drew the attention of policy makers to the need to create regulators to increase investors' risk awareness and consumer protection.

Intangible Asset Based Lending is a relatively new concept of SME financing, but it has development potential, especially in the pharmaceutical and biotechnology sectors, where interest in it is high. The loan can be backed not only by the common collateral such as real estate or receivables but also by the company's intellectual assets.

While these methods of financing will attract some of the SMEs, bank financing will continue to be crucial, therefore the changing will occur also there. Fintech is becoming a threat to banks on the market due to the fact that for a long time they have provided SMEs with poor product-fit and long delays to accessing finance. Challenger banks that want to gain market share in SMEs and expand in this sector have to have customer centric-culture and agility to serve the unmet and evolving needs of SMEs.

Do the traditional banks have a role to play? Instead of offering them finance, they can assist start-ups in finding the right financing alternatives.

2.11 Crowdfunding in the European Union:

The legislation concerning crowdfunding in different EU countries is still very fragmented. Which poses problems for SMEs as they are the main target of crowdfunding, since they are very cash flow sensitive, more so than large corporations. One thing that stands out for example is that the Belgian government creates incentives for investors to invest in crowdfunding projects, which will of course be aimed more towards SMEs. This is in contrast to the Spanish government, which limits this type of financing with strict regulations. The Polish government also limits this type of financing, albeit in a very different way. There it is the lack of regulatory framework and protection of investors that limits investment flow to these projects and companies. These differences might be solved by the EU regulation that comes into force november 10th, which aims to create a common framework surrounding crowdfunding legislation, eliminating differences between member states and stimulating transparency.

The Crowdfunding phenomenon is the thing to address and will proceed to develop and advance as it has done as such far. To finish up, since we have figured out how to comprehend what it is and how this new strategy for financing functions, just as the benefits and burdens it presents, its present circumstance in Europe and we have likewise concentrated a portion of diverse existing Crowdfunding platforms.

However on 10 November 2020, the Regulation on European Crowdfunding Service Providers (ECSP) for business entered into force. After a transition period of 12 months, the

rules will enter into application on 10 November 2021, applying directly all over the EU. The initiative was part of the European Commission's fintech action plan and the mid-term review of the capital markets union action plan. The ECSP regulation lays down uniform rules across the EU for the provision of investment-based and lending-based crowdfunding services related to business financing. It allows platforms to apply for an EU passport based on a single set of rules, which makes it easier for them to offer their services across the EU with a single authorisation.

3. Crowdfunding in Spain:

3.1 Why has crowdfunding been successful?

Crowdfunding is the aggregate exertion of an enormous number of people who organize and pool modest quantities of cash-flow to fund another or existing undertaking. Each mission is defined for an objective measure of cash and a fixed time span, every day is checked down and the cash raised will be counted up for guests to follow its prosperity. The size of the worldwide crowdfunding market is developing and the biggest business sectors are North America and Asia. The difference in the monetary environment following the 2008 monetary emergency has offered an ascend to the way of life of crowdfunding. The tough post-downturn loaning approaches examined by banks and the subsequent challenges experienced by independent companies to get credit have constrained individuals to look for methods for elective loaning as a method of evading bank advances. The measure of cash raised per crowdfunding effort overall develops from one year to another.

There are numerous possible reasons that crowdfunding has become such a phenomenon in the past years such as for example one of the reasons is that it supports new technological trends by using the internet to connect people with entrepreneurs, and gives both newfound opportunities to make money.

Another reason is that it is a great substitute to regular lenders, many of which (mostly banks) have shut their doors to small-size entrepreneurs. Actually, crowdfunding can work out much cheaper for the business owner in the long run, and it could help them gain access to a customer base (their investors) before they even market their service/product. Venture crowdfunding is an approach to source cash for an organization by requesting an enormous number from benefactors to each put a generally limited quantity in it. Consequently, supporters get value portions of the organization. Venture crowdfunding may involve acquiring obligations just as value stakes. Miniature advance suppliers are a wellspring of obligation ventures whereby a huge gathering of people may put resources into a little piece of a bigger advance. Banks ordinarily know the motivation behind the advance and the terms including financing cost, length of the advance, and assessed FICO score of the borrower. Moneylenders get a financing cost ordinarily higher than other obligation instruments because of the acknowledged hazard related for borrowers; nonetheless, they can spread a lot of cash gradually across an enormous number of credits. Borrowers may look for such a financing when conventional getting is excessively exorbitant, or isn't a possibility for them.

Both value and obligation venture crowdfunding can be hazardous, yet financial backers can expand an amount of cash across a wide scope of decisions. It very well may be an energizing route for people to help a startup that they feel associated with. Since the up front investment can be little for a value stake (frequently the organization can set the terms) it brings the hindrances down to section for singular financial backers and can be a helpful method to find out about startup contributing. All things considered, speculation crowdfunding should in any case be consigned to the less secure segment of any portfolio.

Pros of Crowdfunding:

- It centralizes communications: you can concentrate all of your investor discussion into a single place.
- It can mean not giving up equity: When buying a product that is crowdfunding, the audience is almost as investors and are being rewarded with perks not equity.
- It can be a great way to test the market without building out a full website and company.
- Your fundee finance your product: where the fundee can finance a round of production, or a service can be prepaid for.
- It builds your market: when running a crowdfunding project, you are going to be targeting a community, these people are the ideal market to begin with for the initial fundraise of the project.
- It can eventually raise a lot of money: you can raise significant capital that can kick-start your growth and business.
- It creates a network effect: that you can create on a portal that you can't simply get from keeping your fundraise hidden.
- It creates opportunity.
- It can accelerate your business: it can be a massive accelerant

Cons of Crowdfunding:

- It doesn't find investors for you.
- It is full of scammers: it is the biggest con of the crowdfunding space.

- It is a lot of work: to be really successful you likely need to do a full on launch campaign that is a lot of work and does cost money.
- You can get false positives: can be disastrous for startup companies.
- It takes a lot of preparation: there is going to be a cost in running a proper crowdfunding campaign.
- It can be expensive and if you don't invest enough you can end up losing money in the end.
- The negative feedback can be rough: It can be hateful or just negative.
- The scale and visibility of failure: crowdfunding brings the transparency of the outcome way up, failures can feel 100x harder.
- You still have to close every deal: you still have to reach out to each investor, set up meetings and convince them to part with their hard-earned capital.
- It can be a saturated market: it has begun to become saturated with similar and like products.
- Depending on the brand it might not be a good time.
- Crowdfund sets an arbitrary period: in which you must win or lose, when the reality is that is an unnecessary additional stressor on the business.

There is no doubt that crowdfunding will continue to grow and develop as a global phenomenon, as it gives business owners untold opportunities to get their business up and running. In the following graph you can see the evolution of crowdfunding globally and the expectations for 2025:

Figure 3: Global Crowdfunding Market



Source: IEEE future directions (2020) based on Valuates reports.

We can define crowdfunding as the investment made by a very large number of people utilizing small amounts of capital to finance a new business. It is a feasible way to invest due to the easy accessibility through the internet and social media. It allows anyone with a good business idea to post it in a forum waiting for investors. The crowdfunding market size has the potential to grow by €163.08 billion during 2021-2025, and the market's growth momentum will accelerate at a Compound Annual Growth Rate of 15.45%.

In general there are four types of crowdfunding:

- Debt-based crowdfunding, or P2P lending, where there is a loan which will be paid back with interest.
- Equity-based crowdfunding, investing in exchange for shares, so the investor has influence on management decisions (will not be big).
- Donation-based crowdfunding, where donors don't get anything back in return
- Reward-based crowdfunding. investors get a non-financial return, like the product itself

A common thought of crowdfunding is that it is only for startups, but nowadays, many SMEs are also using crowdfunding to finance their business. The use of it has arisen for different reasons:

Marketing is made easy by existing platforms and engaged funders. There are existing famous platforms like Kickstarter and Indiegogo where there is a large group of investors who normally invest, that will be potential investors to any new business. Additionally, it is very common that they share the business on social media and have a chance to reach virality. This channel of crowdfunding has no additional costs on marketing and will bring new customers. Moreover, they can also use marketing techniques without cost, for example, cross-Selling (purchase additional, complementary products) and Upselling (expensive upgraded version of the product), that becomes a big opportunity to increase revenue.

The firms can take advantage and try to validate their product, using feedback to improve the business before launching it. Many new companies fail due to a lack of market need. Crowdfunding will validate a business idea before investing in it, make adjustments on the product and improve, because of the fact that it permits the audience, customers, and investors to share their opinions about it.

Furthermore, SMEs can generate more revenue with less risk with this method. It permits pre-selling products, so companies don't need to buy or store big quantities of stock. As Ford writes, "All you need is a working prototype and a great marketing plan". In summary, it reduces financial risk, and capitalizes on economies of scale.

3.2 Situation of Crowdfunding in Spain

In times of crisis and difficult access to credit, crowdfunding has become a lifeline for many Spanish entrepreneurs who are looking for ways to get their projects off the ground. In Spain there are some platforms like, Lánzanos, Verkami, Safari Crowdfunding or Grow.ly, promoting crowdfunding as an alternative of finance and it is an increasingly popular financing model in Spain. Along these platforms, there are others like ideas4all, used for crowdsourcing of ideas, which have created a competition in association with Lánzanos for the crowdsourcing of entrepreneurial ideas.

The Spanish crowdfunding in figures can be explained in with just a few data to see actually how important it is becoming and how it is actually a successful finance method:

- In 2014, crowdfunding moved more than 62 Million €.
- There are 34 platforms of crowdfunding in Spain.
- The average contribution per published project is 4.853€.
- It takes 143 people to fund a project.
- The average of days needed to fund a campaign are 51.5 days.

It has a crowdfunding market with one of the highest rates of development in Europe. According to the Digital Market Outlook, the crowdfunding segment in Spain is expected to grow to 445,45 M Euros in 2024 with average funding per loan 65.239,135 Euros. To compare, in France the average amount accounts for 50.877,39 Euros and in Italy – 252.267,96 Euros. Almost half of crowdfunding platforms in Spain consider government regulations as adequate and the environment – as user-friendly. On the CNMV (National Stock Market Commission) official website, there are more than 30 platforms officially registered as fundraising providers including the first Spanish government-run crowdfunding portal – Crowdfunding Bizkaia.

Regulation is good news for the crowdfunding industry in Spain, in fact, in the coming years we will see how the law will be applied and interpreted but the sector is already bullish on that new scenario.

In the nearer future, and partially thanks to this new regulation, the crowdfunding sector in Spain and as an asset class will become larger, stronger, more professional and more flexible due to some of the new measures regarding the access to information, the protection of investors rights and the regulation of conflict of interest, among others.

4. Conclusions:

This paper tried to discuss in brief, some of the alternative sources of financing small and medium enterprises other than conventional bank lending. Financial institutions tend to claim high interest on loans that may be challenged by the SMEs market, which does not always have enough funds to afford them. The sharing economy all over the world has been developing, therefore the authors put special attention to crowdfunding. According to them, it has the big potential to be even more popular in a few years.

However, crowdfunding struggles with a lack of clear policymaker's regulation. Crowdfunding platforms operated in the European Union have different rules as each country has its own legislation. The lack of consistent crowdfunding rules discourages the investor from putting their fund into this sector. The European Parliament approved new rules on crowdfunding in October 2020. Rules will come into force in one year following their publication in the Official Journal of the EU. It is a daunting challenge for policymakers to balance between over-regulation or over-regulation of the crowdfunding site. Hopefully, the investors will benefit from protection against poor investment as their decisions will be based on key investment details prepared by the project owner or at the platform level. And thanks to that, the SMEs will gain access to the much-needed financing.

There is no doubt that there is a place in the future for crowdfunding and that definitely there are a lot of options available for SMEs to grow and to reach their goals, not only in Spain, but in Europe.

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