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Alternative ways of financing SMEs

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SUSTAINABLE BANKING AND FINANCE

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ABSTRACT

In this paper the reader will be shown that the crowdlending market is currently not large compared to the amount of loans given by banks, but that the amount of loans through crowdlending is growing year by year. In 2020, there were already 8.4 billion dollars of loans via crowdlending outstanding in Europe and this would grow to over 10.5 billion dollars by 2026. Starting and running a crowdlending platform can be very lucrative, but is strictly controlled by the government on a national and European level.

The countries that are currently furthest advanced in terms of volume of loans and number of platforms are Spain and the Netherlands. For the SMEs themselves, peer-to-peer lending is also a very good solution because it allows for a more even distribution of funding, which in some countries doesn't happen through the traditional banking system. It is also a good solution for investors because they can lend money for a small amount to a company they believe in. In addition, the returns that are achieved are much more interesting than leaving money in a savings or current account.

RESUMEN

En este documento, se mostrará al lector que el mercado de crowdfunding actualmente no es grande en comparación con la cantidad de préstamos otorgados por los bancos, pero que la cantidad de préstamos a través de plataformas crowdfunding está creciendo año tras año. En 2020, ya había 8.400 millones de dólares en préstamos a través de crowdfunding pendientes en Europa y esto crecería a más de 10.500 millones de dólares para 2026. Comenzar y operar una plataforma de crowdfunding puede ser muy lucrativo, pero está estrictamente controlado por el gobierno a nivel nacional y europeo.

Los países que actualmente están más avanzados en cuanto a volumen de préstamos y número de plataformas son España y Holanda. Para las propias PYMES, los préstamos entre particulares también son una muy buena solución porque permiten una distribución más equitativa de la financiación, lo que en algunos países no ocurre a través del sistema bancario tradicional. También es una buena solución para los inversores porque pueden prestar dinero por una pequeña cantidad a una empresa en la que confían. Además, la rentabilidad que se consigue es mucho más interesante que dejar el dinero en una cuenta de ahorros o corriente.

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1. INTRODUCTION

This analysis has been carried out for the Blended Intensive Program: “Sustainable Banking and Finance” which took place in The Hague in March 2022.

This research offers a micro and macroeconomic view of the evolution, development and challenges of the growing appearance of alternative ways of financing for small and medium-sized companies, which are emerging thanks to technological evolution. Small and Medium Enterprises (SMEs) are those that have less than 250 employees and represent 99% of the business in the European Union, thus having a leading role in the behaviour of economies.

In order to grow, these companies often need external sources of financing, however, they have more difficult access to bank loans due to their size, and for the same reason going public is not an option in many cases. In addition, the recent Covid-19 crisis has made the conditions for obtaining financing in a traditional way quite difficult, banks have played a key role in the recovery of economies as state credit tools in some cases, however, the financing of other projects has been very restricted, especially if they were SMEs with little background. In this way, thanks to today's technological and business globalization, companies have found alternative ways to connect with potential customers and investors.

The main objective of this project is to analyse the financial structure of crowdfunding, specifically crowdlending variable, and its potential to face both traditional ways of financing and the challenges in the post Covid-19 economy.

In recent years, crowdfunding has become a very popular option to obtain financing through various investors. Even though the market size is still small compared to traditional banklending, crowdlending is rapidly gaining acceptance as a serious alternative to traditional forms of lending.

In order to illustrate our analysis, we have provided an example of a Spanish company financed through crowdfunding. This company is The Tropic Feel.

The methodology applied in this work will initially be based on going through a set of official and international articles and online resources that provide a clear basis on the added value of crowdlending market, making use of sources such as the European Commission Reports, the Data Platform Statista, bank research like the ones from BBVA

or official statements from National Governments. In addition, to know the impact on society of the new ways of financing and how our different countries have evolved, national decrees and regulations have been used.

Finally, the work will be structured as follows:

In part 1, an introduction of concepts will be made and it will be described mainly in a theoretical way what crowdlending is, how it works and what advantages it has over bank lending. In this part we will also explain the regulations and the main challenges.

Part 2 will delve into crowdlending market during the Covid-10 crisis, mentioning the support for SMEs and the different initiatives in Spain, and how was the impact of this crisis on this sector.

Part 3 will provide different examples of crowdfunding platforms and will explain in detail the example of the company mentioned, The Tropic Feel. Some features of this company will be also mentioned along the document.

2. CROWDFUNDING: DEFINITION, REGULATION AND CHALLENGES

2.1 CHARACTERISTICS OF CROWDLENDING

Crowdlending, also known as marketplace lending or peer-to-peer loans (P2P), offers alternative funding opportunities to businesses from individual or institutional investors without going through the traditional banking route. Companies can finance their projects with diverse sources of funding and investors can access large investments by co-financing projects by lending money in return for interest payments (finnovating, 2021). P2P lending platforms claim they can challenge traditional banks by providing a better (online) match of supply and demand of capital, and by operating with lower overhead - thus providing the service more cost efficiently than traditional financial institutions (finnovating, 2021).

In the crowdlending model, people lend small amounts of money to a company in exchange for a future financial return established in a loan contract. Nowadays, crowdlending is the most similar form of financing a bank can provide. Instead of a bank or financial entity, it is a private person or a company that decides to lend the company in question the money, with the conditions established by the parties. The money is returned including the interest, without the person who lends the money having access to the benefits of the project or, in principle, loses if the plan does not work as expected by its creators (truust.io, 2022).

Crowdlending is beneficial both for the investor and the borrower. Firstly, the lender can choose either a higher interest rate with a higher-risk project or a safer option with a lower interest rate. They can choose which matter to support following their own business knowledge or moral views. In other words, the investor has full freedom of choice (lendsecured.eu, 2021).

The main difference between crowdlending and peer-2-peer lending is that crowdlending is meant for investments in businesses where P2P is multiple individuals investing in 1 individual. Therefore, P2P is also referred to as the crowdfunding for the private sector.

The main risk to P2P lending is that the individual who has borrowed the money isn't able to pay back the investors. In order to help investors deal with this risk some platforms offer features such as a Provision fund. The fund will step in if a borrower misses a payment. The fund will only limit the risk for investors but cannot guarantee the investor that the investor will receive all the money back. It's still an investment after all.

One downside to the fund is that investors will receive a smaller amount of interest because the platform has to reserve some money to put into the fund. Provision funds are less common in crowdfunding platforms.

2.2 DIFFERENCE WITH TRADITIONAL LENDING

In the field of crowdfunding, there are several options, such as buying products, donating money, buying shares or providing loans. The most popular form is undoubtedly loans, as 89% of the amount raised through crowdfunding in the Netherlands in 2019 was raised in the form of loans. In Belgium, 91% of all crowdfunding money went to crowdlending at the same rate. Across Europe, the share of crowdlending in total crowdfunding is between 85% and 94% (goparity.com, 2022).

Moreover, setting up and running a crowdfunding/crowdlending platform is particularly lucrative as these platforms are much less risky than a conventional bank. The invested money is not theirs. The managers of a platform receive a fee for each new request for funding. This fee depends on the size of the sum that the SME wishes to receive. With this fee, they will pay their staff who process and analyse the file. Moreover, there are other platforms that, in addition to a small fee, also take a percentage of the interest paid to the investors.

For instance, Rabo&Crowd is an initiative of Rabobank and Nxchange. Through the Nxchange platform, investors can help companies to realize their plans and ambitions. Rabobank provides companies with a loan or credit. In addition, you can invest in bonds of these companies and help enterprising Netherlands forward.

With products like Rabo&Crowd, the distinction between crowdfunding and traditional loans may disappear somewhat, as banks open their options and also start providing loans above the amount raised through crowdfunding (zakelijklennen.nl, z.d.). But it is better to see the basic differences as follows.

The advantage for the investor is that the entrepreneur can test if there is enough demand or interest to start the project, and if not, all investors get their money back without any problems, while the entrepreneur or SME has to go back to the drawing board to improve the business plan and its elaboration. This does highlight one of the disadvantages, namely that the entrepreneur has to put in a lot of effort when using crowdfunding and if the goal is not achieved, it may have been for nothing. If a bank refuses the loan, the SME will still be nowhere to be found, but a lot more time will be lost in the case of refusal than when applying for a loan from a bank. SMEs also have a lot of administrative work to do, such as networking and following up with potential investors (wecapital.nl, 2022).

With traditional loans, SMEs can obtain the loan amount in a relatively short period of time, whereas with crowdfunding it can take several months. On average, it takes less than a month for a bank in Belgium to complete the credit approval process and the SME can receive the money within two months of approval. With a crowdlending platform, it takes up to 3 months of work before the project is posted on their website and then it can take another 2 to 3 months to raise the targeted amount of money. Loans from banks have their own disadvantages, such as strict application or approval requirements, which make it difficult or impossible for some companies or sectors to obtain a loan. This became clear during the Crown Pledge, when Belgian catering companies were unable to get new loans or such loans were very limited or restricted because the risk of bankruptcy in this sector suddenly became too great for the banks (HLN.be, z.d.). Moreover, there were bank loans where the money belonged to the entrepreneur himself and had to be repaid within a strictly defined time frame, paying interest, after which the SME would no longer have a relationship with the bank. This is different from crowdfunding, where the entrepreneur constantly must deal with investors and other third parties during and after the loan.

The main advantage of crowdfunding over bank loans is that relatively large amounts can be borrowed through crowdfunding, as the amount borrowed depends only on the number of people interested in the SME's services or products. The banks have a much larger amount of money than a crowdlending platform can raise but they are restricted by rules on how much money they can give to a type of project. It is all based on how much collateral the entrepreneur can give the bank. It is therefore clear that there are significant differences between a traditional bank loan and a crowdfunding campaign.

In short, a bank thinks too much in boxes when it comes to loans, but the entrepreneur does get his money faster, and with a crowdfunding campaign the SME can raise much more money if there is good publicity and interest, but will have to wait much longer for the collected money. In the following lines it is explained the different advantages that these platforms can provide both for companies and for investors.

Advantages for companies

Crowdlending has multiple advantages and disadvantages over the traditional fundraising options. An advantage for a company seeking to fund their business through crowdlending is that the interest rates are negotiable which usually means that a company has to pay less interest to an investor than the company would have if they had gone to a bank to finance the project. Crowdlending contracts are also more flexible since banks have more regulations and security systems in place to check for possible risks.

Another advantage for companies is that with crowdlending the investor will not receive any shares as part of the investment. This means the investor has no say in the daily operations of the company and cannot influence the strategy of the company through a voting right in contrast to the other forms of crowdfunding.

A disadvantage for companies is that ideas could be stolen if the idea hasn't been patented and/or trademarked. In the past it has happened that ideas have been stolen by other corporations because an idea was posted on an investment platform. This downside cannot be fought against on the platforms itself because platforms require businesses to share their data and information to potential investors.

Advantages for investors

Investors also have an advantage when using crowdlending. One such advantage is that the investor can meet face to face with the company they invest in. There is more communication, and the investor can see where the money is going towards. In contrast to putting money aside on a savings account or buying shares.

An advantage which is shared by both the investor and the company borrowing the money is that both parties can negotiate the terms of the investment. This advantage is also shared

by banks, but banks do not have the option to be as free in the negotiations as investors can when using crowdlending.

Investing via crowdlending has another great advantage for investors. Investors will not own shares but will receive an x amount of interest over their investment. The interest received is likely higher than an investor would generate if the investor would keep their money in a savings account (lendingcrowd, 2022).

For investors in The Tropic Feel there was another advantage for investing in this company. As it has already mentioned, this company contributes with the environment and global warming, thanks to the materials that they use to make their products. They can also get some discounts in the products, or other benefits.

As shown, crowdlending has many benefits, but at the same time, there are potential risks. Therefore, it is necessary to know how to regulate crowdlending and how it's currently regulated.

Business models of banks vs. platforms

On the other hand we can also compare the different business models. In this case, we are going to focus on one particular aspect which explains one of the differences among these two different options to get financed.

First of all, we have to take into account that banks have been existing for much longer than platforms. One of the reasons why platforms didn't exist 20 years ago is that access to technology wasn't as spread as it is now. Nowadays everyone can have access to the Internet and therefore these platforms take advantage of this to put in contact with different people having similar intentions in terms of funding (EUparlement, 2022).

The business model of banking companies is based on generating revenues through interests, financial advice and other transactional fees. They are like companies and can also be listed and take place in the stock market.

On the other hand, as it has already been mentioned, in the crowdlending model, people lend small amounts of money to a company in exchange for a future financial return established in a loan contract.

These platforms get their money from two different sources. The platform can decide which of them they would like to apply. The first option is as simple as charging a fee to fundraisers if the fundraising campaign is successful. The other option is taking a percentage of the investments made by each investor. For example: if an investor of an SME should receive an interest of 4% on his investment, the SME will in reality have to pay 5%, whereby 1% goes to the manager of the platform and 4% to the investor. In both cases the company raising money is paying for the service that the crowdfunding platform provides.

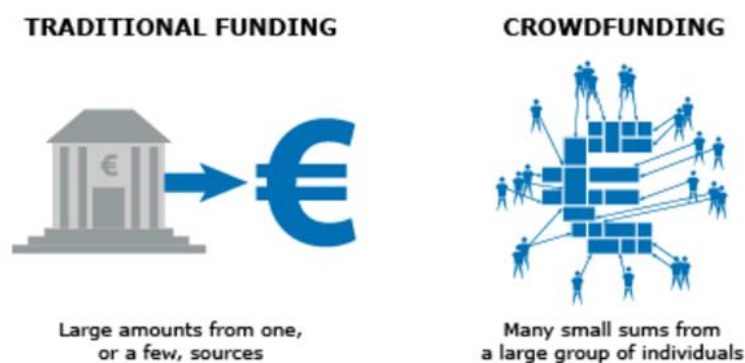


Figure 1. BUSINESS MODEL TRADITIONAL FUNDING VS. CROWDFUNDING

Some of the best known crowdfunding platforms are Free Funder, Indiegogo, or Kickstarter; and all of them get their revenues from different sources. In the first case, the platform fee is 0% although there is a payment processing which is 2.9% of the amount invested plus \$0.20. In the case of Indiegogo, they combine both, the platform fee is 5% on all funds raised and the payment processing is 3% + \$0.30. Lastly, Kickstarter has a payment fee if the campaign is successful 5%, and a payment processing of 3% + \$0.20 per pledge.

On the other hand, banks work more often with loans: they lend money and in exchange they receive a percentage until the loan is returned. This percentage is usually paid monthly (mostly in the case of individuals), but they could also be paid annually or on a quarterly basis. The money that banks lend comes from investors who lend their money in exchange of a return consisting of monthly interest for example. Part of the profits that banks obtain come from the difference between the interests that they receive and the ones that they pay.

Analysing both situations, we can observe that regarding the interest of investors, in terms of money, it is less risky to invest in a bank than in a crowdfunding platform, as we don't know if the project will be successful, if fundraisers will obtain all the money they need, if it will last for long... However, an investor might also have other interests such as helping to stop climate change or building schools in Africa, and for this reason they may prefer investing in these platforms rather than in a bank.

Another important aspect to consider is that in crowdfunding platforms you can easily diversify your investments among different projects, which in any case will be less risky than investing all your money in the same project.

Given that crowdfunding has emerged in recent years as a new business model based on technological progress, it escapes the current regulation that exists for platforms that perform similar functions such as donations. For this reason, as seen previously that its growth is exponential and successful in all countries, the paper will discuss in the chapter below how both the European Union and national governments have had to adapt their regulations to these new entities.

2.3 CROWDFUNDING REGULATION IN EUROPE AND SPAIN

Since 1st February 2017, crowdfunding platforms in different countries have been subject to special regulations introducing a recognised status for so-called "alternative finance platforms". Otherwise, there is (for the time being) no specific legislation for crowdfunding, but different financial legislations may apply, depending on the modalities of the crowdfunding initiative.

In addition, the European Parliament approved the final text of the Regulation on European Crowdfunding Service Providers for Businesses (the Crowdfunding Regulation) on the 5th of October 2020. Providers for business (Crowdfunding Regulation) was adopted, and were applied from November 10th 2021 across the EU. This regulation states the following three rules for crowdfunding platforms:

- 1: a project cannot raise over 5 million euros
- 2: platforms must have a permit to operate in the EU, this permit is handed out by the local government.
- 3: platforms must offer a knowledge test to starting investors

The new rules are expected to increase the availability of this innovative form of finance, which will help companies seeking alternatives to bank financing. Investors on crowdfunding platforms, meanwhile, will benefit from an aligned and enhanced investor protection framework, based on:

- Clear rules on information disclosures for project owners and crowdfunding platform
- Rules on governance and risk management for crowdfunding platforms
- Strong and harmonized supervisory powers for national authorities overseeing the functioning of crowdfunding platforms

Since many individual countries in the European Union do not have clear legislation on crowdfunding, this document can be a role model for drafting crowdfunding law.

The mentioned document was drawn up by the European Parliament and the Council, in addition the document is being corrected by the European Central Bank and the European Economic and Social Committee.

Currently, different rules apply in the European member states, which makes investors reluctant to invest via crowdfunding platforms from other member states. The new regulation aims to encourage EU residents to also fund innovative companies and start-ups across borders.

In particular, start-ups will be able to seek funding through platforms and investors based anywhere in the EU, without being limited to their national markets – which in many cases remain underdeveloped. It becomes evident that the introduction of the Crowdfunding Regulation can have positive effects to all three basic players (Crowdfunding Service Providers, project owners and investors) of a crowdfunding project (internationaltaxreview, 2020) (EU, 2021) (loyensloeff.com, 2022).

Focusing in the particular case of Spain, since a few years ago, these platforms have been under the supervision of the CNMV and the Bank of Spain. Crowdfunding firms have to comply with some administrative and financial requirements in order to be allowed to operate as crowdfunding platforms. Apart from those, this law limits the range of services that can be offered in them: they cannot offer counselling in aspects related to investments nor process payments.

It is compulsory to offer public information about the people involved and the project, although it is not checked whether it's true or not.

Spanish regulation classifies investors in two different groups: those accredited, which are defined by the SEC (Securities and Exchange Commission) as “either person or entity, that are allowed to invest in securities that are not registered with the Securities and Exchange Commission, have no limits, and those “not accredited” which can invest a maximum of 3.000 euros per project and a total amount of 10.000 euros per year.

Besides, this law also sets a limit in the amount for which entrepreneurs can ask for,

which is 2 million euros for projects open to everyone and 5 million for those aimed at accredited.

In order to understand the situation of Spain in the banking sector these years, we are going briefly analyze the situation of banks in our country and in Europe from the impact of the big financial crisis.

In 2008, the burst of the financial bubble led to a worldwide economic crisis. From that moment, people started to distrust banks and financial corporations. In consequence, the number of banks has continuously decreased while mergers in the banking sector increased. In 2020, there were 4348 banks in the Eurozone, a fall over the 30% compared with the beginning of the crisis.

In 2020, Poland is the second country with the most number of banks in the Eurozone (621) while Czech Republic only has 57 banks. The Eurozone average is 239 in 2009 and 161 banks in 2020 which implies a reduction of 48% which is almost half of the banks in only eleven years.

In Figure 2, a downward trend in the number of banks in the Eurozone can be seen in Spain as it is nearly following that Eurozone trend. The number of banks in both Poland and France are clearly above the rest during the whole period of study with the exception of France in 2009 and 2010. France and Netherlands are the only countries which had more than twice the number of banks from 2010 to 2011 compared to the rest of the countries being analyzed.

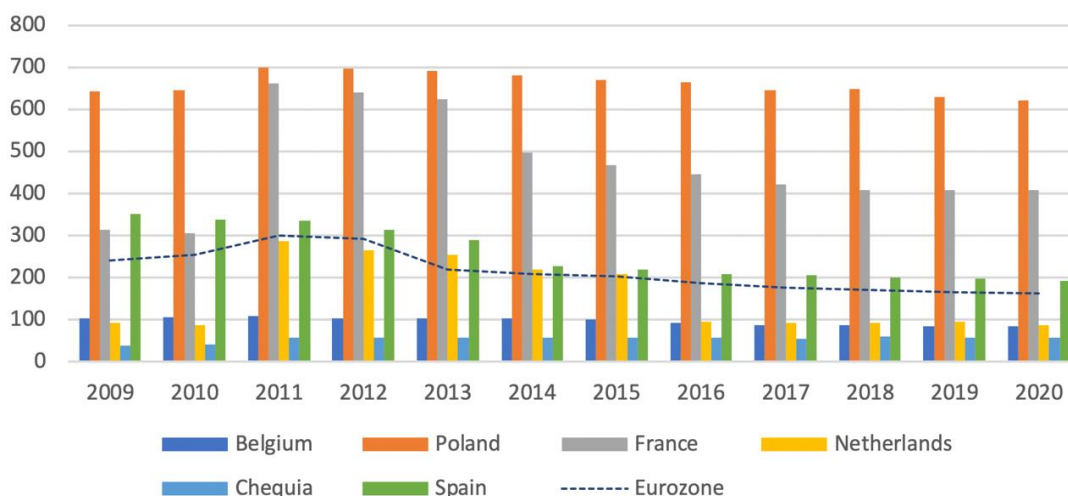


Figure 2. NUMBER OF BANKS 2009 - 2020

During the study period, French banks are, by far, the ones with the largest banking assets (more than 8000 million euros in 2009 and 6000 million in 2020). Both Spain and Netherlands have a big number of assets (around 2000 million euros) but much less than France as the number of banks in France is way bigger.

However, having a big number of banks doesn't imply a big number of assets. An example of that is Poland, whose number of banks is the greatest of all the countries studied but the number of assets it the second minor country, as shown on Figure 3.

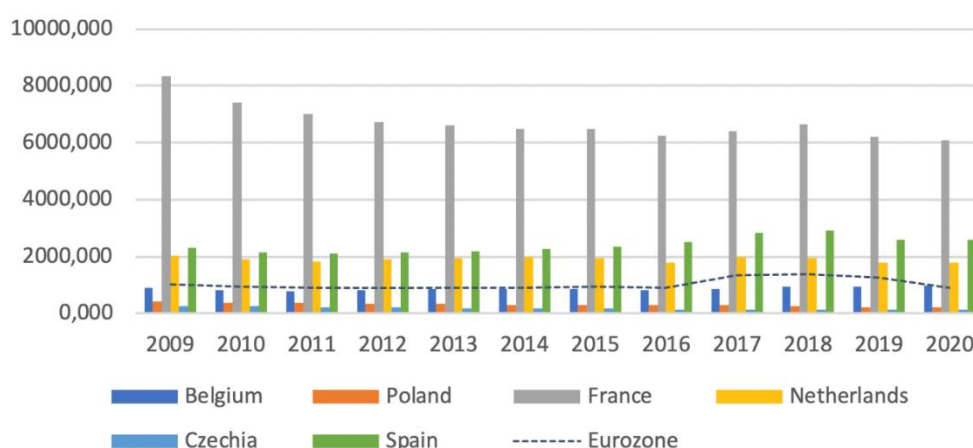


Figure 3. BANKS' ASSETS PER COUNTRY

Once we have observed how both banks and crowdlending platforms are being used to obtain funds, how the current situation of banks is in Spain, and the regulations in our country and in Europe; we are going to devote the next chapter to analyse how big the size of this new market is; and afterwards, we will compare the size of both markets.

2.4 THE SIZE OF THE MARKET

The literature on crowdlending (as opposed to crowdfunding more generally) is relatively small. With a few notable exceptions, there is a lack of EU-focused scholarship concerning the regulation of crowdlending (EU, 2021), however, the European crowdfunding market is growing rapidly, especially in continental Europe. At the same time, cross-border activities are still constrained. Fragmented markets, especially caused by differences in regulation, are an obstacle to growth of crowdfunding platforms (imarcgroup, 2022).

The European crowdlending market witnessed a transaction of USD 8,399.82 million in 2020. It is expected to reach USD 10,492.28 million by 2026. In contrast, the European crowd investing market witnessed a transaction of USD 2,089.41 million in 2020, and it is expected to reach USD 3,524.14 million by Vendors operating in the market studied have witnessed a significant slump in revenue during the 2020, which was due to the effect of the pandemic-induced lockdown, which forced businesses to close, thereby, resulting in low levels of investment in business expansion and other activities, diminishing the need for loans. According to the data published by marketplace Lender Prosper in May 2021, during the month of April 2021, the average loan size reached USD 13,000, and the average borrower income was at USD 107,000, which is a decrease of 2% month-over-month due to a higher mix of C-HR rated loans. Additionally, according to the data from Prosper, the weighted average borrower rate for April originations decreased by 12 bps over the prior month. Similar trends have impacted the market studied during the pandemic.

As can be seen from Figure 4, crowdlending has gained a lot of popularity in the European market over the period 2013 - 2020. In 2019, consumer lending value peaked at USD 4,183. And also, business lending value is increasing all the time (statista.com, 2022).

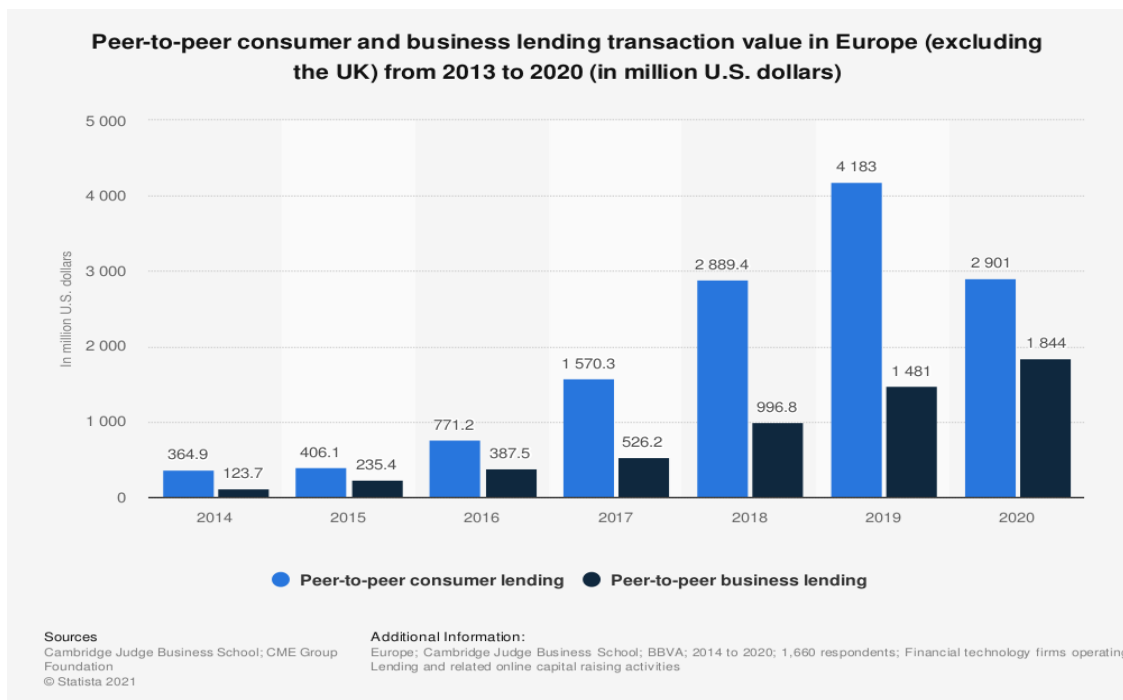


Figure 4. CONSUMER AND BUSINESS LENDING

This form of investment is much more attractive to consumers. It is probably associated with the ease of investing, low risk and not a large sum required to start. Despite this rapid growth, the current volume represents only a small fraction of the eventual potential market for P2P lending, and the Federal Reserve Bank of Cleveland notes that the market is poised for further growth. As these lenders become more mainstream and diversify into other asset classes, which many are just now beginning to consider, they will have the opportunity to reach vast new segments of untapped market potential.

Projections for the longer-term growth of the peer-to-peer market vary considerably, with one venture capitalist projecting volume as high as \$1 trillion by 2025.

A report by PWC estimates that perhaps it is possible to reach \$150 billion, but in this case peer-to-peer lending platforms would need to capture 10% of the \$800 billion in revolving consumer debt and 5% of the \$1.4 trillion of non-revolving consumer debt held by financial institutions.⁶ Although this would be a substantial undertaking for peer-to-peer lending platforms, it's a realistic scenario given their explosive growth rates. The International Organization of Securities Commissions estimates that global peer-to-peer originations could exceed \$70 billion within just the next five years, with the United States currently leading the way as the largest market (PWC, 2022)

2.5 FUTURE CHALLENGES FOR CROWDFUNDING PLATFORMS

There are different kinds of challenges for both crowdlending platforms and borrowers. The platforms face for example ever changing regulations regarding their business model. Platforms need to update their services in order to stay within what is acceptable by law. Changes in regulations could mean major investment for platforms because they might need to hire lawyers to update their policies. New regulations such as the regulations from 10/11/2021 by the EU could impact platforms who haven't received their permit yet and have to temporarily shut down their activities.

Another challenge for crowdfunding platforms is the growing number of crowdfunding platforms. This is also a challenge for companies seeking to finance their project via crowdfunding. When there are too many platforms investors won't be able to choose which platform they will use to invest their money. There are simply too many to choose from. For example, there are 80+ crowdfunding platforms in the Netherlands alone from which 38 offer a form of crowdlending.

Moreover, in some cases a platform or other investors can rate the project low. This rating will affect how many other potential investors want to invest in the company. Platforms try to filter out negative comments on projects when it's proven to be a fake review but this still affects the rating of a project.

Investors face the problem that not all projects are legitimate. A lot of pyramid schemes are started on crowdfunding platforms because it is an easy way to get money fast (lenderkit.com, 2022). Scams such as pyramid schemes are sometimes hard to detect and can look like actual projects. Platforms try to test and filter projects before they are allowed on the platform but there are platforms who do not control the projects well enough. This means that investors really have to rely on their own intelligence to spot fake projects (UScourtoflaw, 2020). One example of a major scheme from the USA is the

LLC and Larry B Brodman case who raised \$9,06 million dollars for private use while investors thought they invested in real estate.

Also, another challenge for crowdfunding platforms is the lack of commitment in some cases. Even though every platform is regulated and controlled, the delay in complying with the established obligations makes crowdfunding lose credibility. For example, non-payment of interest or failure to clearly establish investment objectives by borrowers creates distrust among investors. In order for the platforms to work properly, a collaborative effort is required from all the agents involved.

The maturity of the crowdfunding market is making the platforms evolve towards a role that is not limited to being the simple link between investors and borrowers. Now the promoters of the project go to the platforms for a global structuring of the project, which means that the platforms are expanding their activity towards professional consultants of the projects, finding here a new challenge. This is a new element that must be studied, advising promoters is not one of the competencies of a financing platform and could cause a loss of honesty.

Thanks to the new European regulation, investments can now be cross-border, benefiting both parties, investors will have a more specialized and diverse portfolio of projects and promoters will be able to diversify their sources of financing more easily. This will reduce concentration and therefore the risk, however, the trend towards the verticalization of crowdfunding platforms will cause new aspects to be regulated that escape the current regulation.

2.6 ADDED VALUE FOR SOCIETY OF HAVING AN ALTERNATIVE OF CROWDFUNDING

As explained above, crowdfunding has been growing exponentially worldwide as a new collaborative way of achieving common projects and leaving traditional financial intermediaries behind. However, crowdfunding is more than just another way to get financing. These platforms promote the creation of supportive communities and are also a tool for demand validation. For example, instead of needing vendors and marketers to create and promote demand forecasting, creators can talk directly with clients and funders to redefine certain aspects and measure market interest. Moreover, this close communication breaks the traditional quality rules for selecting a borrower. In traditional banking, the criteria followed to finance a project benefits certain profiles (trusted customer, purpose of the loan, job stability, savings capacity...) and disadvantages others (housewives, foreigners, inexperienced entrepreneurs...), being women 8% less likely to be financed by traditional banking (HBR.org, 2016). However, in crowdfunding it is the other way around, women are 13% (papers.ssrn, 2018) more likely to obtain financing due to the great variety of investors in the market who base their priorities on different criteria when investing compared to the fixed providers of traditional banking, and also due to the support among women, especially in the areas of technology and video games. Another aspect of crowdfunding that offers added value to society is the increased visibility of the cause. When borrowers request financing on international access platforms, the impact over potential members of the community is multiplied compared to obtaining resources locally, especially in charitable projects. Related to this, it must also be highlighted that crowdfunding makes room for projects of a social and sustainable nature, even if they do not provide as much profitability (eu.europa.eu, 2022).

We have already seen how crowdfunding has emerged and how it has affected its direct economic and social environment, however, we must analyse the role that it has played during one of the most important events recently: the Covid-19 crisis.

3. COVID-19

3.1 SUPPORT FOR SMEs DURING THE COVID CRISIS AND INITIATIVES IN SPAIN

More than ever, financial instruments such as venture capital and loan guarantees have proved to be a resource-efficient way of using cohesion policy funds during the crisis. The coronavirus pandemic hit SMEs particularly hard and many workers risked losing their jobs as companies struggled to survive. The financial instruments have played a crucial role in supporting the most affected SMEs and have thus helped to cushion the negative economic impact of the corona crisis on regions and cities of the EU. In particular, the financial instruments under the European Regional Development Fund have provided assistance in the form of financial products such as loans, guarantees and equity. 365 000 more SMEs than in 2019 received assistance through the financial instruments, i.e. about 1 000 more SMEs per day. In total, 478 000 SMEs received support in 2020. This for a total European support of €21.6 billion (of which €7 billion working capital) under the European structural and investment funds (ESIF).

But the European government is not the only government who has helped the SME's during the covid crisis.

In our country, in order to help those small and medium enterprises that have been affected by the Covid crisis, the Spanish government proposed some programs. On March 12 of 2020, the first plan of measures was approved to mobilize 18,000 million euros. The government initiatives were focused on families, the health system and the business sector to mitigate the impact of the crisis, however, focusing on SMEs, we highlight the following (mineco.gob.es, 2022):

- Tax payment deferrals for a period of six months with discounted interest rates.
- To cover the liquidity needs of companies and the self-employed, especially in the tourism sector (the Spanish economy is highly dependent on this sector) and for SMEs, a specific line of financing was approved from the Official Credit Institute for a value of 400 million euros.

- Companies that have received loans from the General Secretariat of Industry and SMEs are allowed to request the deferral of their reimbursement.
- Due to the importance of the tourism and hostelry sectors, Social Security bonuses were extended for discontinuous fixed contracts made between February and June in sectors related to these activities.

Five days later, on March 17th 2020, the second plan of measures was approved (200.000 million euros), this time to protect employment and reinforce companies' income decrease due to the reduction in their activity. Between those measure it can be found:

- Again, through the Official Credit Institute (ICO), the government offered around 100.000 million euros in loans for SMEs and self-employed in case they needed it to pay invoices and other concepts so they could continue functioning.
- The government opened a new insurance line on behalf of CESCE (Exporting Credit Agency of the Government) of 2.000 million euros for the financing of short-term liabilities.
- The suspension of public contracts is regulated in case their execution is affected by Covid-19.
- Temporary employment adjustment procedures (ERTE) are simplified to alleviate the cost burden on companies.
- An extraordinary benefit is approved for self-employed if their activity ceases.
- The Program called “Acelera” is also approved, endowed with 250 million euros, aimed to support SMEs in their adaptation to the digital and remote work environment.

One example are the financial guarantees offered by Cersa¹ in March 2021 which come from public entities (among other suppliers and clients). There are different types of help, from financial to technical or administrative: receiving grants in advance, faster administrative transactions, leases, provisional loans...

¹ Spanish Rebonding Company. The aim of these types of entities is to endorse companies.

To avoid future higher costs, in March 2021, the government carried out new helps to SME's, which consisted of financial aid to help them deal with fixed costs and debts with suppliers (7.000 million euros) and a fund of 1.000 million euros for recapitalization of the affected firms.

3.2 CROWDLENDING DURING THE COVID CRISIS

While the long-term SCCEffects of COVID-19 are yet to be determined, its immediate impact on crowdfunding is nonetheless significant.

Studies show that crowdfunding platforms are slowing down their development due to the coronavirus pandemic or limiting the attraction of borrowers from problem areas. The study results suggest a substantial difference in some categories between before and after the COVID-19 outbreak. While “dreams”, travel, or other topics are less likely to be funded before the COVID-19 outbreak, people began to make donations to these campaigns after the outbreak of COVID-19. People began to pay more attention to “medical, accident, and charity” (arxiv.org, 2021).

Platforms that specialize in government orders are holding up relatively well. Since such projects seem more reliable to investors, and the return of funds can be guaranteed to a greater extent than in private companies

The recent COVID-19 outbreak has shown a high demand for innovations that can be used in the fight against health hazards, specifically the pandemics. The crowdfunding platforms can provide these projects with financial support they may need within a fairly short time frame. In crowdfunding, donors motivated by getting something in return jointly finance start-up projects and make contributions to achieve a funding goal (pesquisa.bvsalud.org, 2019).

4. CROWDLENDING IN PRACTICE

4.1 SUCCESSFUL EXAMPLES OF CROWDLENDING PLATFORMS

As in the first edition of this paper we analysed different countries, in this chapter we are going to provide a brief description of some successful examples of crowdlending platforms in different countries in Europe, so that afterwards we can include an analyses comparing them and highlighting their similarities and differences. The countries that have been analysed are Spain, Netherlands, Belgium, Czech Republic and Poland.

Spain

MytripleA: MytripleA is a crowdlending and crowdfactoring platform in the Spanish market which was founded in 2013. It is the only crowdlending platform in Spain who has two licenses to operate in the market, the first is the Participatory Financing License supervised by the CNMV (National Commission of the Stock Market) and the second one is the Payment Entity License regulated by the Bank of Spain. This platform is focused on responding to the financing needs of Spanish companies through a marketplace where they can choose their appropriate financing product. It has 40 employees and offices in Madrid and Soria. MytripleA has achieved 141 million euros intermediated between investors and companies, 0% default for 2020, a volume of interest for investors of 2.5 million euros and an average return of 4.40% and 4.52% for loans and factoring respectively (mytriplea.com, 2021) (NIInvesteerd, 2022).

Netherlands

NLInvesteerd: this is the third biggest crowdfunding platform in the Netherlands but was the number one crowdfunding platform of 2021 because NLInvesteerd has raised over 125 million euros in 2021. This brings the total money raised for SME via crowdfunding by NLInvesteerd to 233 million euros. The other two biggest crowdfunding platforms were Collin Crowdfund (350 million) & Geldvoorelkaar (310 million). NLInvesteerd only allows crowdfunding for SME's on their platform. NLInvesteerd also gives both investors and businesses modern options to regulate their income flow and communicate

with (potential) investors. NLInvesteerd aims to have investors receive an interest rate between the 7 and 10% on a project depending on their investment (crowdfundingcijfers.nl, 2021).

Belgium

Winwinner is a Belgian crowd loan platform. It is one of the largest Belgian platforms and has already financed over 700 investments for more than 250 SMEs for a total amount of €23 million.

The platform was founded in 2016 with the aim of making young entrepreneurs aware of their financing needs through their own network, as this allowed investors to easily get in touch and invest in a tax-efficient way. Another Belgian platform is LOOK&FIN and its aim is to arrange real estate financing for SMEs by means of crowdlending.

Czech Republic

Kickstarter: Historically, the biggest Czech crowdfunding success belongs to the RPG game Kingdom Come: Deliverance from the developers from Warhorse Studios. In the beginning they wanted to raise 300,000 pounds, in the end they almost won four times.

As Kingdom Come leader David Vávra admitted, the campaign was key to the project. In the end, everything worked out, and the Czech work could thus rank among the most successful games on the Steam gaming platform (Kickstarter, 2021).

Poland

Sancus: The Sancus.pl platform was created to enable SME development thanks to money coming not from banks or loan companies, but from people who believe in their success. Anyone who would like to borrow money from a selected company, starting from PLN 100 (around 20 EUR), can register on Sancus.pl and collect it with a profit significantly exceeding the current interest rate on bank deposits - minimum 4% per year.

The company also invites entrepreneurs to register: small, local companies that will use the borrowed money to implement specific business plans. Sancus.pl is currently finalizing the qualification of the first projects that will be presented on the platform (sancus.pl, 2020).

Similarities

The similarities between the crowdfunding platforms in each country that they have successfully raised money for SMEs. This shows that in each country there is a market for crowdfunding. The platforms also demonstrate that more investors seek an alternative way to give their money purpose since all the markets are growing.

Differences

There are some key differences between the countries. As the numbers point out, the Netherlands is by far the biggest crowdfunding country. Whereas Poland and the Czech Republic have the lowest amounts of crowdfunding money raised. It's also noticeable that in the Netherlands there are over 80 platforms who all serve a different audience whereas in Poland there are only 6 small platforms who offer crowdlending.

4.2 BRIEF DESCRIPTION OF THE COMPANY AND THE PROJECT

The company The Tropic Feel S.L. is a Spanish company based in Barcelona which was founded in 2017 with the aim of distributing sneakers. It is a small firm with only between 11 and 25 employees. In 2020 the turnover was 8.4 million euros. (Touristear, 2022)

It has been operating for five years and its sneakers are for travelers committed with the environment, as part of the materials used to produce those shoes are recycled or organic. They also measure, assess and reduce the global impact of their products and materials together with the collaboration of BCOME.

As we can observe in the 5 principles of the company, the company focus their production process and the final product on respecting the environment and collaborating to reduce global warming:

1. Transparency is the first step to being sustainable
2. Don't cause unnecessary harm
3. Reduce your footprint and compensate for everything you cannot reduce
4. Durability is the key to sustainability
5. Activate the power of collaboration to challenge the status quo

This project first started selling 1.500 sneakers made in Vietnam and which were sold in pop-up stores. Due to the success, they decided to go further, and therefore look for investors in crowdfunding platforms.

Afterwards, as one of the founders had already been working in financing platforms for investors, they decided to try using a crowdfunding using the American corporation Kickstarter, which is a crowdfunding platform whose stated mission is to help bring creative projects to life.

For this first campaign they launched the Monsoon sneakers with the objective of obtaining 12.500€. In the end, they obtained 2 million.

The steps that need to be followed to start investing in Kickstarter's projects are explained below. First, you will have to create an account giving you personal details, and then, once you know the project you want to invest in, you will have to provide some information about the payment details.

1. Create an account
 - a. Full name
 - b. Email account
 - c. Password

Once you have completed your account and you log in, you are able to invest in the different projects that you can find in the website. There are different options of investment. Depending on the amount that you want to donate or invest, you may receive some kind of reward or not. The higher the amount you invest, the better the reward is supposed to be. You can also get some discounts for the product or some presents, however if the project is not successful, you may not obtain anything. There is a minimum amount from which you will obtain rewards, which is usually from 10€ or 15€, although you can donate a lower amount if you want to, without receiving anything in exchange.

As we have previously explained, once you have created your account and you know the project you want to invest in, regardless of the amount you want to invest or donate, you will have to provide the following information to the website in order to carry out the process:

2. Payment details
 - a. Full name of the owner of the credit card
 - b. Expiration Date
 - c. CVC
 - d. Postal Code
 - e. Agree that rewards may not be guaranteed by Kickstarter

Once you have provided the details mentioned, you can choose the type of investment that you want to make and the amount you are willing to pay.

This is an example of how the crowdfundering platform Kickstarter works, but for all them the steps to be followed are pretty similar.

CONCLUSIONS

Based on an extensive analysis on the European market of crowdlending, it can be stated that in recent years crowdfunding has become a very popular financing option for developing enterprises. Different types of crowdfunding and their associated risks were analysed, as well as comparisons with traditional banks.

It often happens that the definitions of crowdlending and crowdfunding are confused with each other, however, it should be remembered that crowdfunding is direct investment related to the acquisition of property (acquiring shares or stocks in companies), while crowdlending - sometimes called debt or loan crowdfunding - is indirect investment for by means of loans (no acquisition of property). Thanks to this form of investment financing, even people who do not have significant savings can invest their capital in profitable projects as a group. Thus, the usually high threshold of entering the real estate market is significantly lowered, and investors protect their capital against impairment. A characteristic feature of all the above models is that an unlimited number of funders can participate in the fundraising process, and its reach is global. In each crowdfunding model, apart from the initiator of the collection and the capital giver, there is the so-called crowdfunding platform, which is a specific market that aggregates the supply and demand for capital. This platform makes it possible to reach a wider group of interested parties on both sides, allows for the presentation of projects and the regulation of capital lending service processes; it can also oversee the issuing process.

It has been noticed that crowdlending as a form of financing in all analysed countries (the Netherlands, Belgium, the Czech Republic, Spain and Poland) is gaining popularity at a very different pace. Taking care of security, the European Union has established appropriate EU regulations regarding crowdlending all of the countries mentioned above. In Belgium, in particular, there are many additional regulations in addition, where in the Czech Republic or Poland there is not yet a comprehensive legal framework for social loans and also this method is just entering the financial market. The Netherlands and Spain are the undisputed leaders in terms of the number credit volume, the crowdlending platforms and the scale of growth. However, the role of crowdlending will increase

significantly in the coming years, as shown by statistical research conducted by specialists.

To sum up, the study deeply revealed the pros and cons of crowdlending, using the example of the countries of the European Union: Belgium, the Netherlands, the Czech Republic, Poland, Spain. In recent years, crowdfunding has become relevant and for some companies has become a worthy replacement for traditional bank loans. Therefore, the study compared traditional loans with crowdlending. Also, the impact of the Covid-19 pandemic has changed some of the direction of crowdlending, for example, start-ups related to medicine are being actively funded. In general, the work comprehensively covers the various specifics of crowdfunding.

5. APPENDIX

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