



*Capacity Building of BLUE Economy Stakeholders
to Effectively use CROWDFUNDING*

Risk & Mitigation Nuggets Factsheets

WP3 - TESTING

T1.4

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Technical references

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Executive Summary

BLUE CROWDFUNDING is an Interreg Project aiming at spreading information and knowledge about crowdfunding as such and as applied to blue economy, in order to make it more accessible to the stakeholders involved. To this end, raising visibility from both public and private sector across Europe is key, mostly among blue economy stakeholders.

In fact, notwithstanding the high potential that crowdfunding has to innovate many aspects and fields of the market¹, its real application is uneven among EU countries – mostly due to a limited culture about it. Such a lack of information and knowledge on its specifics brings about perceived risks and real challenges that prevent many users to apply alternative finance and benefit from it. This series of **Risk & Mitigation Nuggets Factsheets** (Deliverable D3.1.4) is intended as a portfolio of situations that might be perceived as difficult and tricky for the “average-user” – completed with the correlated mitigation strategies that can help solve the issue.

The collection of cases has been developed with the precise objective of addressing very specific obstacles and barriers, providing information and insights via a friendly and creative approach. This, in order for the reader to easily capture concepts and procedures even in case of unfamiliarity and inexperience in the field of finance and digital structures. Interestingly, these sheets are thought as to be possibly enriched with further materials and links to practical cases and examples, also integrated with best practices' catalogue resulting from D 3.1.3 – this, via a QR code that will be put on the finalized graphical version, embodying the specific case of reference.

These info-sheets will not only be used as compendium to the training materials foreseen as deliverable D3.1.1, but also as independent tool to be displayed, delivered and used as informative materials at the project partners' premises and at the transnational blue-crowdfunding cluster's info-points crowdfunding cluster with developed CF services for the blue economy stakeholders (WP5).

All in all, the ratio behind this deliverable is to make crowdfunding understandable and accessible by a large audience, not only as a financing tool, but as a mechanism for the enhancing of economic, technological and social virtuous cycles. All in all, they are meant to create awareness of crowdfunding and support the Blue Community in implementing mindful and successful crowdfunding campaigns.

This deliverable has been elaborated by P7 – ECN, starting from the source of data indicated in the project proposal, the “[4th European Alternative Finance Industry Report²](#)”, expanding the research to other papers, articles, sector studies and inquiries, as well as academic contributions. Practical experience of both, the PP responsible for the task and the other Consortium members, has been highly taken into account and treasured, contributing to frame the most complete and insightful scenario possible.

Focusing on this document's content, in the first section the methodological approach is outlined, followed by the presentation of the task implementation milestones. The central section is devoted to the resulting info-sheets, divided as per category of stakeholder: Sheets 1-4 introduction and general definitions; sheets 5-11 risks and mitigations regarding the Project Owner; sheets 12-14 challenges related to the crowd of Contributors; sheets 15-18 focus on the Public Authorities, while info-sheets 19-23 are dedicated to the Platform. The Annex includes some screenshots of the info-sheets' graphic rendering.

¹ A. Delivorias for the European Parliamentary Research Service (ERPS), “Crowdfunding in Europe. Introduction and state of play”, 2017 – https://eurocrowd.org/2017/01/26/european-parliament-publishes-a-study-on-the-state-of-play-of-crowdfunding/?utm_content=buffer13517 or [https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595882/EPRS_BRI\(2017\)595882_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595882/EPRS_BRI(2017)595882_EN.pdf) and European Commission, “Crowdfunding: Mapping EU markets and events study – Executive Summary” – 2015, https://ec.europa.eu/info/sites/info/files/crowdfunding-study-executive-summary-30092015_en.pdf

² T. Ziegler et al., “SHIFTING PARADIGMS, “The 4th European Alternative Finance Benchmarking Report”, 2019 – https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-04-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf

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Methodological Approach: Limitations, Solutions and Milestones

The BLUE CROWDFUNDING project proposal stated that the aim of this task was to provide

“Risk mitigation nuggets. 20 one-pager fact sheets info of possible risks (Risks were exposed by the questionnaire of the 4th European Alternative finance industry report – specifically by Southeast Europe Stakeholders) and how to avoid it.”

In practical terms, the assignment required to build 20 fact-sheets from the results of an inquiry regarding crowdfunding platforms operating in South-Eastern European countries. The outcome of this survey is exposed in the following table:

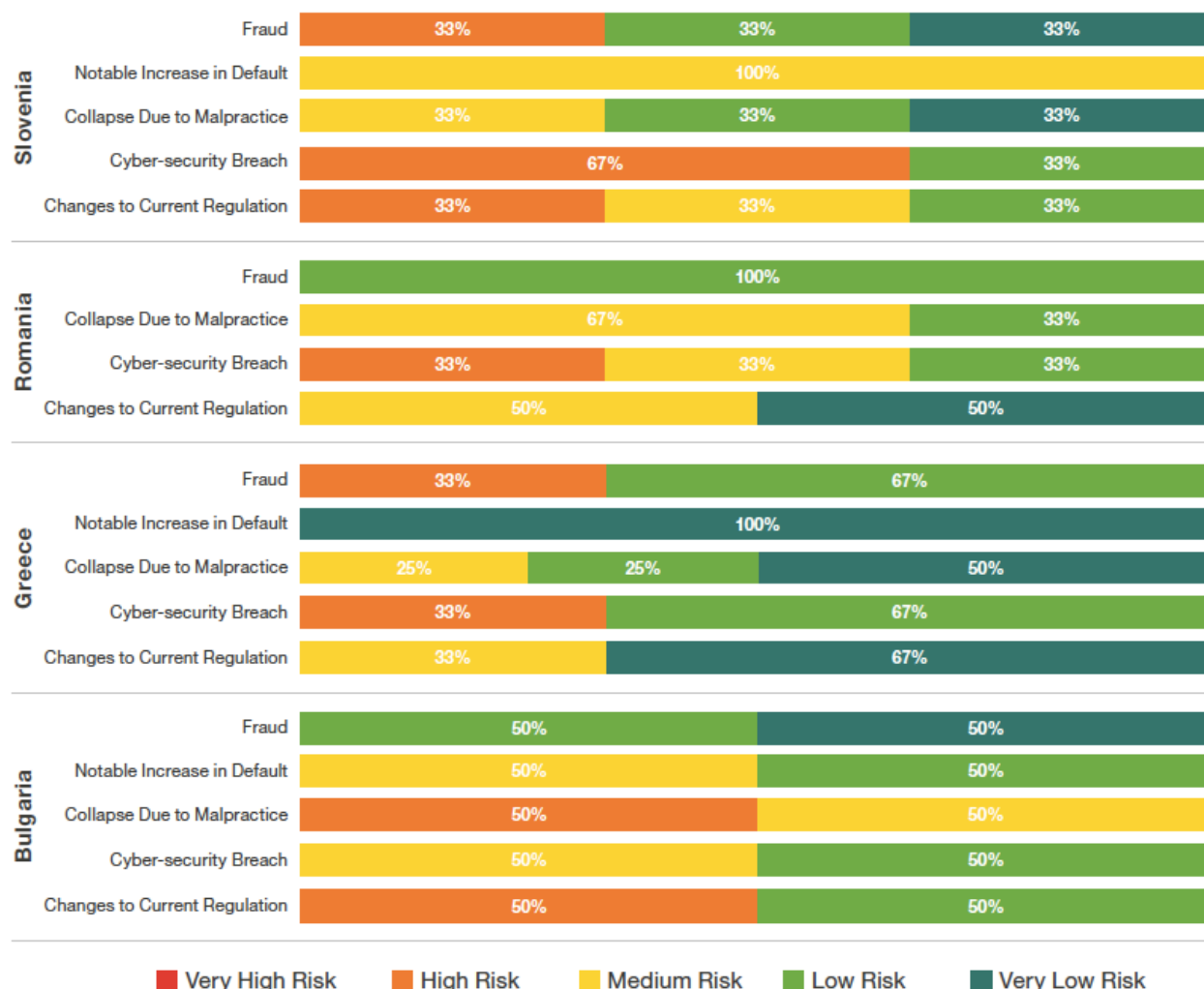


Figure 1 – Overall perceptions towards Risk Factors – South Eastern Europe³

Since the earliest reading, the assignment's indications presented some inherent limitations, summed-up here below:

- Only risks reported from the perspective of platforms
- Limited geographical scope: Slovenia, Romania, Greece and Bulgaria are the only countries in the research focus
- Selected and limited number of risks explored & no definition provided: Fraud; Notable Increase in Default; Collapse due to Malpractice; Cyber-security Breach; Changes in Current Regulations
- Very sector-specific risks, not useful for the new-entries in the crowdfunding market
- Only quantitative analysis, no qualitative reference

³ T. Ziegler et al., "SHIFTING PARADIGMS – The 4th European Alternative Finance Benchmarking Report.: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-04-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf - p. 137

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Therefore, contrarily to the task description, the focus has been broadened and deepened, applying the following criteria:

- Enlarge the perspective, including the 4 main crowdfunding stakeholders – namely, Project Owner, Supporter(s) and Platform (as per traditional literature on the topic), and the Public Authority, in order to deepen the 'civic' aspects of alternative finance
- No defined geographical scope
- Review of academic sources / literature to map all perceived/real risks – in this sense, the source has been expanded and many articles and reports have been included, as per Appendix
- Adoption of a language to be friendly and understandable by early-stage crowdfunding users'
- Descriptive approach

The task implementation has represented a true path of mutual learning and fact-testing, as it required both deep research and significant peer review to inform and validate the content. In practical terms, the making of the deliverable can be summed up like:

1. Literature Mapping & Screening
2. Collection of specific cases, per macro-category: general / financial / legal
3. Feedback from the Blue Crowdfunding Consortium
4. Combination of similar cases, in relation to context of happening and/or mitigation solution
5. Graphic rendering

The risks resulting from the screening and collecting activity are listed here-below, organized as per stakeholder of reference:

Project Owner

- #1 - Limited knowledge about alternative finance
- #2 - Underestimation of costs
- #3 - Unpredictable market factors
- #4 - Reputational damages due to unfulfillment
- #5 - Fluctuation of cash flows
- #6 - Intellectual Property / Copyright
- #7 - Uneven regulatory systems

Supporter:

- #8 - Limited knowledge about alternative finance
- #9 - Illiquidity, late returns & increase in default
- #10 - Uneven or unclear regulatory systems

Public Authority:

- #11 - Limited knowledge about alternative finance
- #12 - Decline of their institutional role
- #13 - Low engagement of stakeholders & community
- #14 - Regional / National diversified legislation

Platform:

- #15 - Lack of transparency & low accountability
- #16 - Inaccessibility for certain categories
- #17 - Cyber-security attacks & digital protection
- #18 - Uneven and unstable profit-making
- #19 - Diversified regulatory / legal framework

In the following pages, a more detailed and punctual presentation of the single cases will be offered.

Definitions

WHAT IS CROWDFUNDING:

"An open call for the collecting of resources (funds, money, tangible goods, time) from the population at large through an Internet platform. In return for their contributions, the crowd can receive a number of tangibles or intangibles, which depend on the type of crowdfunding"⁴

FOR WHOM ARE THESE FACTSHEETS?

>> PLAYERS AND ROLES:

> Project owner <

Anyone who has an entrepreneurial, innovative idea but lacks adequate capital to bring it into practice. The realization of this venture is subject to the contribution and support from a wider audience, via the crowdfunding campaign. The project owner is in charge of:

- ◆ the project identity
- ◆ business plan and choice of financing model
- ◆ relations with the supporters

> Supporter / Investor <

The financial participant and external contributor to the project. They can be individuals, companies, venture capitals or business angels, or public / financial institutions. They form the "crowd".

Their contributions vary from being very small, i.e. "micro-transactions" to the purchase of firm's shares and quota in the form of investments.

> Public Authority <

Particular actor who can activate and combine the funds from the crowd with public budget, also in line with a defined political agenda. Its participation or provision of co-funding generates the so-called "civic crowdfunding" and "match-funding" dynamics.

Its role varies:

- ◆ Sponsor
- ◆ Manager
- ◆ Curator
- ◆ Facilitator⁵

> Platform <

The internet-based intermediary that facilitates financial contributions between supporters and project owner.

It selects and supports the most promising initiatives to be upheld on its spaces for contributions. In this sense, it acts as "gatekeeper", filtering the projects per content, location, sector, objective.

Its profit derives from different fee structures, depending on the business model.

⁴ G.A. Gabison for JRC – IPTS, "Understanding Crowdfunding and its Regulations - How can Crowdfunding help ICT Innovation?", 2015 - <https://publications.jrc.ec.europa.eu/repository/bitstream/JRC92482/lbna26992enn.pdf>

⁵ ECN – "Triggering Participation: A Collection of Civic Crowdfunding and Match-funding Experiences in the EU", 2018 - https://eurocrowd.org/wp-content/blogs.dir/sites/85/2018/07/ECN_CF4ESIF_Report_Triggering-Participation_2018.pdf

Risks for the Project Owner

Actor at risk:

PROJECT OWNER

(Risk category: GENERAL)

> Limited knowledge on alternative finance <

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and budget structure. **Crowdfunding**, in particular, is not a homogeneous practice and the success of a campaign depends on the choice of the most appropriate **platform** and co-funding **type** (donation, reward, equity or lending). Making the wrong choice, in these terms, might lead to not reach the funding goal or can prevent from using this precious resource to its full potential.

Mitigation strategy

Awareness creation, training and **education** about crowdfunding and alternative finance is indispensable, as it prevents to be unprepared *via à vis* the specific funding dynamics. Such training can also empower with further and parallel **skills** that might be useful in the broader job-market, such as communication and managerial attitude, business planning etc.

Many specialized services and ad hoc coaching sessions are also offered by professional agencies or by the platforms themselves. Always trust service providers with proven reliability, experience and professionalism.

The choice of a platform suitable for the business model and product in question is essential. In case of fledging crowdfunding activity, it is always a good practice to opt for a platform that provides **support and help all along the process**.

- ♦ In case of multi-national platforms, make sure to have a **person or office of reference** in the country of activity, with the possibility of scheduling periodic meetings, chats and calls, in order to follow the development of the CF campaign. Administrative and procedural support - and the easiness to find the bureaucratic documents and processes on the platform is key to smooth the launch and the management of any CF campaign.
- ♦ In case of limited business experience, hiring a **risk management consultant** is a good investment for most companies. A consultant can analyze a business and determine which risks might be faced and which strategies to apply in order to avoid them or reduce their likelihood.

Actor at risk:

PROJECT OWNER

(Risk category: FINANCIAL)

> Underestimation of costs & fees <

Definition

A successful crowdfunding campaign requires **extra costs**, which are sometimes difficult to spot and calculate, or to take into appropriate account in the **business plan**.

In fact, in addition to fixed production costs related to raw materials, human resources and services providers, there are high costs of **overheads**, relating to investments in pre-campaign communication, campaign-maintenance, post-campaign activities. Among these, the **delivery-cost of rewards**, the social media campaign **fees** and sponsorships, the changes embodied in **small-scale production**...

Additionally, the **platform-related fees** largely impact on the final funds collected⁶. A poorly defined **market analysis** can lead to bad estimations as regards the demand of the product-subject of the crowdfunding campaign and its real value. If the product lacks of brand or identity, it is more exposed to face high competition, mostly towards the internet's broad and hidden market. Framing potential competitors is also key to better define the offer's success.

Furthermore, during the campaign, some **unforeseen and situations** can happen. Competing products might emerge from the market, the economy freezes, a national crisis occurs. "Murphy's law" and butterfly effects are difficult to predict and even less desired – still, these events might strongly affect the success of the campaign.

Mitigation strategy

It is indispensable to carefully prepare a thorough business plan -**budgeting and expenses forecasting**, considering every single phase and aspect of the campaign. To do so, a good support by the platform is useful and necessary, as their advice can better define the **business strategy** and **timing** of funding completion.

An accurate deep and complete **analysis of the market** and of the surrounding economic framework is among the first steps before putting a crowdfunding campaign into reality. It is key to understand the **competitors**, the **attractiveness** and **demand** of a certain product. This market analysis encompasses an accurate mapping of the territorial chances and gets hand in hand with a complete outlining of the **crowd** in terms of affiliation and motivation at the base of the engagement with the product/brand of reference.

A deep and complete screening of the firm's potential and **internal competencies** is also essential, in order to concretely frame the production abilities. It is to remember that "**Intention to produce ≠ Ability to produce**"! A solid internal structure and a stable collaborative attitude is also helpful in order to face contingent changes.

It is nonetheless suggested to not only rely on crowdfunding for the production or the fulfillment of an economic objective, envisaging other scenarios and funding options.

Focus on : The choice of the platform

Choosing for one platform or another can strongly make the difference in terms of final financial goal. The latter is impacted by platform's **affiliation fees** (flexible/fixed fee option) and shares on the funding (variable amount), the fees related to the **payment provider**, extra **services**...

It is also to consider which approach the platform chooses to **refund** the project owner of the collected money. It is to differentiate between an "**all or nothing**" or a "**keep it all**" approach. In the first case, reaching the total funding goal is binding for the transfer of all the collected money from the supporters, by the platform to the project owner. Such a solution is to be chosen in case of high investments linked to few activities - as it is, for example, with highly-specialized products, whose development implies very large investments in terms of manufacture or technology. The second method allows the project owner to directly get a certain and proportional amount per each and every contribution gathered from the crowd. This is particularly useful when even small amounts can make the project progress and develop.

⁶ For further information please see ECN, "Crowdfunding Guide – European Booklet for Entrepreneurs", 2017 – <https://eurocrowd.org/2016/04/03/crowdfunding-guide-european-booklet-entrepreneurs/>

Actor at risk:

PROJECT OWNER

(Risk category: GENERAL)

> Reputational damage due to unfulfillment <

Definition

There might be many reasons that prevent a campaign to be successful: limitations of technical nature, market- or business-unreadiness, unstable internal management. **Failing** to satisfy the initial promises might happen, but it is even worse if the crowd is not kept informed about the campaign development. This will make the entire firm look non-trustable and hinder the future business initiatives.

Mitigation strategy

Setting **realistic and reachable goals** (both in terms of requested amount, timing and production capacity) is essential for the implementation of a successful crowdfunding campaign. In parallel, **regular exchange information** and updates with the crowd about the project developments are key in order to build a trustworthy identity.

Always keep the crowd in the loop about the initiative's state of art, both on the social media and on the crowdfunding platform!

Focus on: Communication with the crowd

One of the main elements of a crowdfunding campaign are the supporters, the financial contributors to the product or initiative developments – also defined as “**crowd**”. Understanding who these supporters are, their degree of **affection** to the product / initiative and a careful **mapping** of their presence on the territory will make the strategy more precise in terms of communication, timing and location.

Such an identification allows for understanding their needs and drawing a product that is respondent to the market but also cohesive with the firm's identity! Additionally, it is also to remember that even the platform itself might have a crowd of reference and its network in which to create synergies and carry out ad hoc dissemination activities, in order to spread the voice about projects with high potential of success.

- ◆ Define the crowd, i.e. the target audience, stakeholders and market
- ◆ Benchmark the network of reference
- ◆ Frame the channels and tools to deploy for a fruitful communication and constant support
- ◆ Mainstreaming the presence and responsiveness ability on social media

The communication with followers enables to generate the **promo momentum** and builds up **trust** within the community of reference. Replying to questions, comments and suggestions from supporters does also count for confirmation of **reliability**. The possibility to organize **events** and offline / 'live' activities is also to be considered as to make the broader group of stakeholders know about the project and make **hands-on experience** of its strength points.

Actor at risk:

PROJECT OWNER

(Risk category: FINANCIAL)

> Exit strategy & fluctuation of cash flows <

Definition

The **exit strategy** is the moment in which a larger company, a venture capital or a “business angel” absorbs or buys the start-up out. This implies for the smaller firm to be included within a broader production, investment or market spectrum – and ensures the innovative product or idea higher chances to survive. This happening is not certain or predictable, even if sometimes awaited or presumed. In practical terms, though, the success of a business cannot be assured merely by external purchase.

Additionally, if and when the exit happens, the economic value of shares might have varied since the initial appraisal – shares and investments can worth differently along the crowdfunding campaign, mostly if it takes longer than few months. It is to consider, in fact, that an investment may take up to 4-5 years to return into the investor's pockets. During this time, the economy and the market change, resulting in a different appreciation of the capitals invested.

Mitigation strategy

It is very important to do an accurate **market risk assessment** and business valuation in order to **optimize profitability**, estimating the average return on investment that could be expected based on returns generated by the wider market – or in order to determine the economic value of a certain company unit and exit sale value, so to establish investors' rates of ownership and future taxation.

Estimating the average market return can help companies minimize total cost of capital, while providing the investors with a sense of real appreciation of the expected returns from their assets or shares, in comparison to the risk. At the moment of an exit, these calculations are particularly useful, as they permit to establish the liquidation value that investors will receive as their assets are liquidated and liabilities paid off.

It is highly suggested not to only rely on the happening of an exit/purchase. Being prepared for different scenarios and ready to embrace a “Plan B”, remembering that without an adequate business plan and support structure, even promising ventures can fail. In order to maintain a good and **reliable reputation** with the crowd of investors, it is good practice to envisage for them different options already in advance, in order to protect, guarantee and satisfy minor investors too – e.g. the so-called *tag-along* option.

Actor at risk:

PROJECT OWNER

(Risk category: LEGAL)

> Intellectual Property Right / Copyright infringement<

Definition

One of the key benefits of crowdfunding is that it enables highly-potential innovative projects and creative ideas to reach out and be supported by the wider public.

The internet, nonetheless, is not only a sea full of possible new backers and investors, but also of *little sharks*, competitors and spies, who might **imitate** the particular features of any given new product, **replicate** them and even put a **patent** on them.

If this happens within the frame of a larger-scale and more stable production activity, the short-term result will be the failure of the campaign, while among the long-term ones there might be the loss of market shares and future investors.

Another peculiar issue that links crowdfunding to copyright is the use of particular media materials during the campaign. In fact, copyright infringement could occur in the event that a video, image, soundtrack or digital content is deployed without the necessary permission or license from its owner/creator. This violation would lead to a shutdown of the campaign or even to a lawsuit.

Mitigation strategy

The golden rule concerning any un-patented product or idea is to only make available its basic and more general information, keeping the more particular details **secret** and discretionary. In this way, the key-features that make a project particularly treasurable and non-replicable will not be disclosed and the inventor will not risk to lose the paternity of long-developed innovative solutions. It might be **counterproductive** to go too much into details when reporting technology or highly-scientific innovations – if the project idea is too technical, it results difficult to understand by the public. In turn, this might lead the crowd to a lack of affection and support to the project itself. In other terms, the project idea needs to be **concrete, tangible** and **easily understandable as unique**.

You may consider **filing for patent/trademark protection** before launching the campaign in case of technology innovations in highly competitive markets. This option is costly and should be the result of a thorough costs-benefits analysis.

As far as third parties' media usage is concerned, always make sure to report the appropriate references to the source and creator of your supporting materials!

Actor at risk:

PROJECT OWNER

(Risk category: FISCAL / LEGAL)

> Uneven or unclear regulatory system <

Definition

Launching a project on a foreign platform might be attractive as it opens up to broader markets. Nonetheless, the lack of an international or EU-wide common crowdfunding regulation makes it unclear which law is to apply: the one of the SME's seat? Or does it depend on the platform? Or, even, on the supporter's location?

Same confusion might arise in relation to taxes. The latter, in fact, most of time depend on the national regulation, thus the **fiscal impact** or absorption of the investment may vary and not be clear in case of cross-border activity.

Lack of coordination between legislations in different countries and a scarce guidance on applicable fiscal regulation could result in market fragmentation and law-breach, even unintentionally.

Respecting the **platform's fundraising terms and conditions** is also key. Campaigns that run afoul of these rules may have their campaign suspended. Alternatively, they may face difficulties in accessing their funds, even if the campaign meets its targets. Either scenario represents a **monetary and reputational distress**.

Mitigation strategy

Before launching the campaign, it is key to ensure a deep and careful review of the business and legal plan against the chosen platform's rules. Opting for platforms that offer **clear and available legal information** and **contractual details and obligations** is highly suggested.

Having **legal framework, the authority of reference**⁷ and the **division of responsibilities** clearly displayed by the platform is not only an indicator of its reliability as it prevents future fiscal or legal issues, but also necessary for the fair development of the campaign towards supporters and firm: knowing the possible procedure for claims is essential to protect brand, product, money and crowd.

In order to better coordinate and make the diverse national legislation uniform, a new legislation has been proposed and is being adopted by the European highest institutions. It is the **European Crowdfunding Service Providers (ECSP) for Business Regulation** (COM(2018)0113 – C8 0103/2018 – 2018/0048(COD))⁸, which has the potential to make pan-European crowdfunding a reality.

Such regulation will harmonize the legal framework for the sector, offering a well-defined and structured legal skeleton for the activities of crowdfunding for business (lending and equity) all over Europe.

The main innovations⁹ will be :

- ◆ A single set of rules will apply to crowdfunding services in the EU, up to € 5 000 000
- ◆ Strict rules to protect investors from financial losses
- ◆ Member states responsible for authorizing and supervising crowdfunding providers

At the present, the regulation's details are still to be finetuned and technical work on the text is under way within the three institutions. The law is expected to come into effect in 2021 – still, this accomplishment will largely ease the crowdfunding process for all the involved actors, thus largely benefit European startups and SMEs and to European investors.

⁷ European Commission 2017, "Identifying market and regulatory obstacles to crossborder development of crowdfunding in the EU", 2017 – <https://eurocrowd.org/2018/01/31/cross-border-development-of-crowdfunding/>

⁸ European Commission, "Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European Crowdfunding Service Providers (ECSP) for Business", 2018 - <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018PC0113&from=EN>

⁹ ECN, "Agreed: Harmonised EU rules to boost European crowdfunding platforms", 2019 – article to be find at <https://eurocrowd.org/2019/12/19/agreed-harmonised-eu-rules-to-boost-european-crowdfunding-platforms/>

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Risks for the Supporters (Crowd)

Actor at risk:

SUPPORTER / INVESTOR

[Risk category: GENERAL]

> Limited knowledge on alternative finance <

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and budget structure. The crowdfunding world is extremely diverse and the process sometimes more complicated than it seems, as it requires a high degree of **self-assessment and selection of investment opportunities**. Choosing for the project to support might be tricky - timing, warranties and investment conditions, procedures...

Lack of experience might lead to invest money on unrealistic projects, resulting in **financial losses** or in **unsatisfaction**. In the same way, lack of economic literacy can result in risky financial behaviors - i.e. excessive and unconscionable investments, which overcome the real financial capacity.

Focus on: Digital inequality and illiteracy

As per definition, crowdfunding is a financial operation happening via an **internet-based platform**.

As a matter of fact, thus, supporters who are digitally illiterate or with limited access to the internet, can be deprived of the opportunity to participate, unless assisted by **intermediate agents**. This potential participant category might encompass a significant segment of middle-age and older citizens, especially in countries or territories where digital literacy has not well developed yet. Interestingly, these areas would be the ones in greater need for successful crowdfunding projects.

As a result, this citizen segment is cut-off from the benefits of crowdfunding both in economic and social-development terms. They are also the most-likely ones to fall victim of **malpractice** and **fraud** (either through incompetence or deceptive intention) by self-proclaimed intermediaries that volunteer to mediate between them and the crowdfunding platform.

Mitigation strategy

Get preliminary **training** on alternative finance instruments and procedures – attend local workshops and basic preparation. It is highly suggested to rely on experienced coaches and training centers – as well as on private financial accountants or bank analysts, in order to set the investment capacity.

In case of doubt concerning the product or initiative to support, always collect all the information on the project owner available on the internet and on the platform. It is also good practice to check the support of other **credible local organizations** to act as intermediaries. The engagement of an institutional actor might give the adequate level of accountability of a certain project and ensure the campaign accomplishment.

Generally speaking, furthermore, the choice of the crowdfunding project on which to place a certain amount is sometimes similar to choosing a restaurant: one might prefer the most packed one, instead of the one with the best menu and offer... Similarly, nonetheless, investing money in what “the mass” preferred, is not always a warranty for success and satisfaction. Avoiding the “*herd mentality*” and making a grounded and well considered decision is always the best way to face an investment.

Actor at risk:

SUPPORTER / INVESTOR

(Risk category: FINANCIAL)

> Illiquidity, late returns and increase in default <

Definition

In case of equity crowdfunding, future returns are expected from investments. However, it may take long to materialize *if at all*, in case of difficulty to scale the business. The chance that a company or individual will be **unable** to make the required payments on their debt obligation might happen to lenders and investors in virtually all forms of credit extensions. Market rules imply that higher levels of risk lead to higher required returns, and in turn, to higher interest rate. It is important to consider that, in the event of a **default**, investors may lose out on periodic interest payments and their investment in the bond.

Also due to value fluctuation, alternatively, assets may be subject to capital erosion over time.

The future of an investment, on the other hand, might also be represented by an **exit** option – which happens when a bigger and larger company, a venture capital or a “business angel” absorbs or buys the start-up out. The likelihood to accept this event is not to be declared, nor can it be forecasted at the moment of the investment.

This change on the horizon can surely require for adjustments and further tuning of the individual financial prospect and forecast.

Mitigation strategy

Diversifying the investments is a good practice to prevent losing large amounts or the risk of capital erosion. For lenders there is also the chance to opt for **fixed-income securities**, i.e. an investment providing a level stream of interest income over a period of time.

A deep financial measurement should also provide for a “leverage ration”, which is an estimation of the proportion between the capital coming in the form of debt in comparison to the total, also assessing the ability of a company to meet financial obligations.

Additionally, default risk can be detected using standard measurement tools, including FICO scores for consumer credit, and **credit ratings** for corporate and government debt issues. Credit ratings for debt issues are provided by NRSROs - nationally recognized statistical rating organizations¹⁰. An appropriate mitigation strategy might also be for lenders to charge rates of return that correspond the debtor's level of default risk.

In relation to the exit option, transparency and openness should be required from the investors on *when* and *how* they will be able to withdraw their initial investment, along with any associated gains and overhead. The project owners, on the other hand, should envisage the **tag-along** practice for their minority shareholder, i.e. giving them the right and option to join the transaction and sell their minority stake in the company when and if the majority shareholder sells his stake.

Focus on: The absence of a secondary market

For investors it would be relevant to have an early-stage equity secondary market as to be allowed to realize returns by **selling shares** in other companies or to reinvest in other firms, to either increase their share or buy into a round they may have otherwise missed out on.

Given that at the present time there are no secondary markets in place or only very few platforms have this option, it is necessary to consider having enough liquidity, as equity investments are blocked for 7-15 years and as no secondary markets are open to trade or sell shares/bonds.

Very experienced investors might consider adopting **BDLT** solutions. In fact, ledger technology (DLT) and blockchain offer the adequate infrastructure for secondary markets, enabling SMEs to exchange equity CF shares with security token to create liquidity. In other words, they eliminate the financial intermediary by providing an interface to connecting SMEs and investors.

¹⁰ J. Kagan for Investopedia, “Credit Rating”, 2020 - <https://www.investopedia.com/terms/c/creditrating.asp>

Actor at risk:

SUPPORTER / INVESTOR

(Risk category: FISCAL / LEGAL)

> Uneven or unclear regulatory system <

Definition

Supporting a project on a foreign platform might be an interesting option to broaden the individual portfolio of investments, as it opens up to larger markets. Nonetheless, the lack of an international or EU-wide common crowdfunding regulation makes it unclear which law is to apply: the one of the SME's seat? Or does it depend on the platform? Or, even, on the supporter's location?

Same confusion might arise in relation to taxes. The latter, in fact, most of time depends on the national regulation, thus the **fiscal impact** or absorption of the investment may vary and not be clear in case of cross-border activity. Lack of coordination between legislations in different countries and a scarce guidance on applicable fiscal regulation could result in market fragmentation and law-breach, even unintentionally.

Sometimes, furthermore, different countries impose different investment limitations to the individuals, thus legal issues might arise in relation to the **platform's fundraising terms and conditions**.

Mitigation strategy

Before transferring or investing money on any project, it is key to check and verify its legal and fiscal terms, as well as the ones concerning the platform. Opting for service providers that offer **clear and available legal information** and **contractual details and obligations** is highly suggested.

An open and understandable definition of the **legal framework of reference** and a transparent **division of responsibilities** is not only an indicator of the reliability of the service provider, but also a 'lifesaver' for the correct and fair development of the campaign towards the supporters.

Understanding beforehand which is the **authority of reference** and the possible procedure for claims is essential in order to protect your rights and your money. Require the platform to transparently express the specific country regulation applied, so that to avoid future fiscal or legal issues.

In order to better coordinate and make the diverse national legislation uniform, a new EU legislation has been proposed and is being adopted by the European highest institutions. It is the **European Crowdfunding Service Providers (ECSP) for Business Regulation** (COM(2018)0113 – C8 0103/2018 – 2018/0048(COD)¹¹), which has the potential to make pan-European crowdfunding a reality. Such regulation will harmonize the legal framework for the sector, offering a well-defined and structured legal skeleton for the activities of crowdfunding for business (lending and equity) all over Europe.

The main innovations¹² will be :

- ◆ A single set of rules will apply to crowdfunding services in the EU, up to € 5 000 000
- ◆ Strict rules to protect investors from financial losses
- ◆ Member states responsible for authorizing and supervising crowdfunding providers

At the present, the regulation's details are still to be finetuned and technical work on the text is under way within the three institutions. The law is expected to come into effect in 2021 – still, this accomplishment will largely ease the crowdfunding process for all the involved actors, thus largely benefit European startups and SMEs and to European investors.

¹¹ European Commission, "Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European Crowdfunding Service Providers (ECSP) for Business", 2018 - <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018PC0113&from=EN>

¹² ECN, "Agreed: Harmonised EU rules to boost European crowdfunding platforms", 2019 – article to be found at <https://eurocrowd.org/2019/12/19/agreed-harmonised-eu-rules-to-boost-european-crowdfunding-platforms/>

Risks for the Public Authority

Actor at risk:

PUBLIC AUTHORITY

(Risk category: GENERAL)

> Limited knowledge on alternative finance <

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and budget structure. **Crowdfunding**, in particular, is a valid form of compensation to the limits of traditional finance. The combination of the two sources, intermediated by public managing authorities and institutions, gives birth to the so-called “**Civic crowdfunding**”¹³ that can help smooth the limits inherent to usual forms of financing. Still, the solutions resulting from this mix are poorly diffused or put in practice because of a generally-limited knowledge and experience. Preferring or limiting the sources to traditional finance might result in less development opportunities for promising or necessary activities.

Mitigation strategy

Mainstream knowledge on crowdfunding, by implementing trainings, workshops and dissemination events that can be delivered to different social groups and economic actors. Increasing and spreading the crowdfunding culture is particularly needed as to unlock the full potential of the **participation of public authorities** as actor in the scenario of alternative finance scheme – with the role of sponsor, manager, curator or facilitator. The activation of any public institution within this method of alternative funding brings about a finance-multiplying effect that is realistically accessible to any citizen, organization, or enterprise. Public authorities have to be seen as the “**trainers to train**”, very useful ally on the territory in order to boost the success of any (civic) crowdfunding campaign. In fact, their presence is perceived as a trustworthy warranty for the relevance and, thus, the success of any project.

Close dialogue and synergies have to be launched and implemented, in order to design specific funding schemes, that would thematically fall within the scope of **regional or local priorities** and be technically viable and admissible.

Focus on: Digital inequality and illiteracy

Being crowdfunding a financial operation happening via an **internet-based platform**, supporters who are digitally illiterate or with limited access to the internet, can be deprived of the opportunity to participate, unless assisted by **intermediate agents**. This potential participant category encompasses a significant segment of middle-age and older citizens, especially in countries or territories where **digital literacy** has not well developed yet. Interestingly, these areas would be the ones in greater need for successful crowdfunding projects.

- ♦ Anticipate accreditation processes for established and credible local organizations to act as **intermediaries** between the platform and digital illiterate citizens. The engagement of a public authority might serve as mitigation to create the adequate level of accountability of a certain project and toward alternative forms of financial in general.
- ♦ Organize **local workshops and preliminary training** on alternative finance instruments and procedures. Rely on experienced coaches and training centers, in combination with adequate support of objective financial accountants to set the investment capacity.
- ♦ Increase the local or regional digital literacy rate, especially in smaller or underdeveloped communities, combining the effort of different social stakeholders

¹³ For an insight into the applicability of Crowdfunding to civic matters please see ECN, “The European Dimension of Civic Crowdfunding”, 2017 – at <https://eurocrowd.org/2017/11/23/european-dimension-civic-crowdfunding-potential-crowdfunding-boosting-economic-social-effectiveness-european-structural-investment-funds/>

Actor at risk:

PUBLIC AUTHORITY

Risk category: **GENERAL**

> Decline of institutional role <

Definition

Civic crowdfunding is a very powerful and win-win option for the public authority and the community¹⁴. In fact, it normally allows for the establishment of local initiatives and activities that would not have occurred otherwise.

Nonetheless, it is still a limitedly-diffused practice and might be opposed or wrongly perceived by citizens. In practical terms, whereas the public authority is not able to get the necessary funding by the state or from traditional forms of financing, the adoption of crowdfunding might shed a negative light on the authority itself, making the alternative finance initiative be perceived as the “stopgap” whenever and whereas the municipality or the public institution has limited power.

In addition, societal stakeholders might question the adoption of crowdfunding (instead of public budget) in areas where the public institutions have responsibility.

Mitigation strategy

It is important to build a **positive narrative** around crowdfunding, depicting it as a mechanism to expand the range of **possible public-private partnerships** and financial engagements. In this sense, combining public funding with private investments in the form of crowdfunding contributions will strengthen the relationship between the government/ public authority and the community of reference. In fact, civic crowdfunding is to be seen as a financial synergy and a shared effort in the name of **common objectives**. In practical terms, it allows for an injection of private capitals into the public economy.

This is particularly true in the practice of “*match-funding*”, which takes shape when the public authority tops up the crowdfunded amount with their own resources at the achievement of a defined sum or at the activation of a certain number of backers/supporters – resulting in a multiplication or scalability of services and projects, both new or already established. This strategy might also be applied in combination and partnership with the crowdfunding platform itself, that sometimes can allocate its money when they consider the initiative is of particular interest for the public benefit.

All in all, the public authority has the delicate power to practically **make the difference** and change the economic or social balance of given contexts, simply by choosing to intervene and support for a campaign or another. It is very important, thus, that it makes use crowdfunding to promote and create incentives for marginalized areas and its community. In addition, it can either promote the establishment of (local) crowdfunding platforms that respond to defined **civic criteria** or rely on platforms that explicitly privilege projects from underserved communities, in order to keep up with the “public good”. In this sense, the preference of a platform over another is to be considered as an ethic choice, which implies defined and clear market and social positioning. When making this decision, the public authority acts in its power of project “curator”, i.e. it selects initiatives that reflect their agenda, priorities and non-monetary aims among the ones proposed by an existing crowdfunding platform.

¹⁴ More insights in ECN, 2018 – “Triggering Participation: A Collection of Civic Crowdfunding and Match-funding Experiences in the EU”, 2018 - https://eurocrowd.org/wp-content/blogs.dir/sites/85/2018/07/ECN_CF4ESIF_Report_Triggering-Participation_2018.pdf and H. Griffiths for Future Cities Catapult, “Civic Crowdfunding - A guidebook for local authorities”, 2017 – <https://futurecities.catapult.org.uk/resource/civic-crowdfunding-guidebook-local-authorities/>

Actor at risk:

PUBLIC AUTHORITY

Risk category: **GENERAL**

> Low engagement of stakeholders & community <

Definition

When running a civic crowdfunding campaign, the level of involvement of the community is fundamental in order to increase the perceived feeling of **ownership, responsibility** and overall **civic participation** towards, for and in the initiative. The result of the project, in fact, is specifically defined as *common good* for the whole Community of reference¹⁵.

Nonetheless, a limited culture on crowdfunding, wrong communication strategies and timing, other managerial mistakes can lead to a low engagement of organizations, citizens and other stakeholders – making the public authority the sole or main project's supporter. This situation on the one hand represents an inconsistent and unbalanced investment for the municipality, while, on the other hand, embodies more limited chances for the project or the initiative to survive in the longer run.

Mitigation strategy

It is important that the Public Authority builds a strong **Consortium** of various actors around the initiative, engaging in external partnerships with local enterprises and organizations. External business stakeholders can be convinced showing the benefits of such partnership:

- ♦ playing a prominent role in the crowdfunding campaign, they can not only have a decision-making power within the project itself, but also increase their **social impact**, being perceived as change-makers and pioneers in the care and proactive socio-economic effort for the sake of the Community;
- ♦ offering side support to the campaign, they can boost their social added value and **corporate social responsibility** (CSR), promoting their activities to the crowd, understanding and meeting the needs of the local community and eventually result in an opportunity to increase **sales** by attracting customers.

These partnerships might lead to the introduction of reward-based participation systems, made up -for example- of shopping bonuses, reductions and facilitations or free services for those citizens who take part in the venture.

As far as the **community** is concerned, it is always good practice to involve them since the inception of the initiative, starting from the analysis of their needs and wishes, defining with them the campaign phases and objectives, in order to increase the sense of ownership towards the process.

In the same way, the public authority, in partnership with the crowdfunding platform, can organize **calls for tenders** and **contests** in order to collect ideas and bottom-up projects to be supported. In this way, the community of reference will not only feel a stronger linkage and ownership vis-à-vis the initiative, but will also be more likely to support it.

Actor at risk:

Risk category: **LEGAL**

¹⁵ More insights in ECN – “Triggering Participation: A Collection of Civic Crowdfunding and Match-funding Experiences in the EU”, 2018 - https://eurocrowd.org/wp-content/blogs.dir/sites/85/2018/07/ECN_CF4ESIF_Report_Triggering-Participation_2018.pdf

PUBLIC AUTHORITY

> Regional / National restrictive legislation <

Definition

Alternative finance lacks of a unique and robust set of laws and rulings of reference.

For instance, national or regional legislation may not allow public bodies (such as Regions/municipalities) to manage private funding – including those resources deriving from crowdfunding. Alternatively, in some countries these private funding may be considered as donation to the public sector. Consequently, these may be regulated by restrictive legal ruling and in some cases cumbersome provisions to ensure **transparency** of the actions. Such a fragmented and local-specific regulation makes it very difficult and even risky to embrace crowdfunding, as it might be perceived and defined as contrary to the law.

The introduction of financial models of crowdfunding in the partnership might prove more **challenging** for public authorities, as procedures and timing highly different between traditional institutional finance and the alternative one. Public administrations face stringent limitations to the way **public budget** is managed, allocated, and reported, and even more so when innovative ways of combining own and private resources must phase-out of the pilot action and move towards a full integration into public budgets.

Mitigation strategy

The knowledge and narrative of crowdfunding cannot set legal authorities and regulations aside. Civic crowdfunding must be seen as a tool to combine different sources of funding in the name of a common goal. This is particularly true in case of **limited budget availability** and if the aim is at increasing **civic engagement**, channeling funds into initiatives that are perceived as priorities by stakeholders in their territories.

Crowdfunding platforms and public/managing authorities have to strengthen their collaboration and work together in order to identify **areas** in which a pilot program can be carried out, as to implement innovative matching schemes that can reach a higher investment impact, and to design specific funding scheme, that would thematically fall within the scope of regional or local priorities and be technically viable and admissible.

Priority areas as those identified in regional Smart Specialization Strategies might be a solid starting point for the design of the matching scheme, since the listed sectors have already been identified as key in the economic territorial development and provide a long-term framework in which pilots can be tested.

In other words, it is to expand the scope of public partnerships with crowdfunding – designing secure and transparent ways in which to **scale up the match-funding mechanism** as to also include lending and equity crowdfunding.

In addition, combinations have to be explored with **European Structural Investment Funds** (ESIF) and the specific thematic priorities and resources, in order to find common strategies and application fields. This process would also enlarge the number of projects that could receive funding without increasing the amount allocated from public budget. Such partnership would also grant increased visibility to the **EU and cohesion policy**, while allowing managing authorities to be more responsive, better equipped and efficient when investing in territorial and citizens' needs¹⁶.

¹⁶ ECN – “Triggering Participation: A Collection of Civic Crowdfunding and Match-funding Experiences in the EU”, 2018 - https://eurocrowd.org/wp-content/blogs.dir/sites/85/2018/07/ECN_CF4ESIF_Report_Triggering-Participation_2018.pdf

Risks for the Platform

Actor at risk:

PLATFORM

Risk category: GENERAL

> Lack of transparency and low accountability <

Definition

The role and objective of a crowdfunding platform is to **support** and **enhance** the creation of integrated financial dynamics to collect resources from the crowd and institutional donors. These funds are in the name of the innovative project's activities and initiatives, in line with specific demands or needs. In this sense, any malpractice or perceived lack of transparency and accountability can result in the **stakeholders' disaffection**, that mines the success of any proposed crowdfunding campaign.

A platform's reliability and trustworthiness result by mixing clear expressions of transparency and a considerable campaigns' **completion rate**. In other terms, promoting unfortunate or failing initiatives can also negatively influence the perception on the platform's capacities and credibility. This is also true because investors and supporters do not always have a thorough understanding of alternative finance dynamics and make irrational choices, opting for more-widely-known platforms ("*herd mentality*").

Mitigation strategy

In principle, platforms should be transparent about their code of conduct. Apart from individual transparency, industry associations also suggest a set of rules or guiding principles that platforms should respect and follow¹⁷. The platform has to build its accountability taking two main aspects into account: the creation of a **transparent profile**, and a **fair management** of campaigns and projects.

For the first purpose, it should declare and openly publish **its legal information, contractual obligations** and details of the implementing/managing **bodies of reference** (board, person of reference, etc.).

In the same way, transparency can be guaranteed by issuing **public calls** for the submission of new actions, as well as the **rating/references** by the crowd. An additional indicator of its reliability consists in selecting projects via specific **criteria** and publishing score and arguments.

In relation to the practical management of the initiatives, on a preliminary basis it would be good practice for the platform to **check on the project owner's capacity**, on the **project's suitability** for their space, and on the **users' readiness**. This would result in higher success chances for the proposed initiatives and, as a consequence, in a better reputation in overall terms. Along the campaign, the platform is expected to regularly **report** about the project's implementation with evidences (photos, videos, interviews, etc.) and supportive materials. At the end of the funding period or initiative, it is also good practice to present the action's results and foreseen developments.

Building and keeping on a **regular communication** and an **open relationship** with the community of reference and crowd is fundamental to the extents of an accountable profile. In the medium to long term, in fact, contractual clarity and transparency contribute to maintain a reliable and trustworthy profile also in the context of negative contingencies. This might reduce the impact that a certain number of failed projects can have on the reputation of the platform itself.

¹⁷ In these respects see, for example, the Code of Conduct suggested by the European Crowdfunding Network <https://eurocrowd.org/membership/code-of-conduct/>

Actor at risk:

PLATFORM

[Risk category: GENERAL]

> Inaccessibility for certain categories <

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and budget structure. **Crowdfunding**, specifically, has been proven being poorly known and limitedly used by a large part of the population. This is mostly due to a general **digital unpreparedness** and a scarce **culture** about alternative finance.

In such a context, possibly-interested parties are simply not informed about crowdfunding initiatives, and, thus, unable to access and support the campaigns on the platform.

Particularly significant is the case of people from **disadvantaged contexts**, with disabilities or/and digitally illiterate such as elderly people. The sum of these contingencies results in a **lack of potential users** and, thus, in a more limited success of the projects hosted.

This, in turn, on the one side hinders **development chances** for the territory and the community; on the other side, it is high-potentially influencing the **fruition, reputation and profit** of the platform itself.

Mitigation strategy

Among the platform's powers and capacities, it is to acknowledge the chance to **organize training and workshops, webinars, coaching and support-sessions** for users and *ad hoc* events to spread the crowdfunding word. Assistance and backing-functions should be provided to its users *before, during and after* the campaign. Such an 'investment' in **capacity-building** will later result in a broader crowd and market community – and will, at the same time, confer to the platform a certain status as *point of reference*.

Particularly in case of small-to-medium size platforms, a dedicated focus on a specific territory is very welcome. Interestingly, in fact, the presence of formerly-funded initiatives and projects on a given area does play like a multiplier element for the perception of the crowdfunding benefits by the locals and the overall diffusion of such a culture and its dynamics.

In order to broaden the community of possible project owners, furthermore, dedicated and even **regular calls and contests** can be launched, as to make crowdfunding a more visible and tangible funding option to make their dreams and initiatives come true.

Practical expedients like a more **user-friendly website**, easily-understandable **infographics** and clear visual elements on their **services** and on the projects offered (status, location, timeline, progress, project owner's details etc.) can also help mainstream the appeal of crowdfunding and make it be perceived as closer to the wider and less experienced public. The publication and **easy consultation** of legal and administrative information and documents is another very meaningful element that can shorten the distances between the digital service provider and the audience.

Actor at risk:

PLATFORM

[Risk category: GENERAL / LEGAL]

> Cyber-security attacks and digital protection <

Definition

As per definition, crowdfunding is a financial dynamic happening through the anonymous internet space. In this sense, **hackers** are the pirates of the digital 'galaxy', able to attack and break into seemingly inviolable data repositories to steal credit card details and other personal data. These **cyber-criminals** are a danger both, for the crowdfunding platform itself and for its users, as they can imperil the very financial transaction as much as the **identity** of the two stakeholders.

Given the unknown profile of many users on the internet, furthermore, economic transaction over platforms might be perceived as possibly hindering illicit activities of money laundering or terrorist financing (**ML / TF Risks**).

The perception of the risk to incur in potentially insecure financial transactions via the platform can prevent public donation and support, resulting in a loss of income for project managers and owners, and in a general failure of the campaign.

Mitigation strategy

One of the major elements of care for the platform has to be the **digital protection** of its users' data and personal information. Being up-to-date with the latest **technology** is not only a matter of easier transactions, but a legal and financial **warranty** towards both, the project owners and the supporters. Among the possible solutions:

- ◆ Create a **secure system** to access to the crowdfunding platform and adopt users' and customers' verification (i.e. installation of **SSL** certificate for secure data transfer);
- ◆ Opt for **end-user security education and awareness training** (i.e. drawing customers' practitioner experience and empowering them through user-centric solutions). Similarly, systems to deliver threat awareness and alerts for risky behaviors is highly recommended;
- ◆ Enable transactions through established and **accredited financial institutions** and channels.
- ◆ Harden the **cookies system** hanging the platform configuration in order to prevent client-side impersonation;
- ◆ Ensure compliance with **GDPR**, Implementation of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons against the processing of personal data and the free movement of such data;
- ◆ **Regulation** has to specifically address this issue and make clear division of **responsibility**, also in order to protect the platform from illicit fundraisers'/users' activities.

Actor at risk:

PLATFORM

[Risk category: GENERAL]

> Uneven and unstable profit-making <

Definition

The way how a platform actually makes money highly differs in reason of diverse considerations, concerning the nature of the supported projects, their scope and location, sector of activity etc. Most of times, nonetheless, the platform does not charge the supporters, rather takes money from the project owner(s). The choice of one or the other option highly impact on the regular inflow of money from any campaign.

The most common models are:

- a) what is known as **“success-fee” rate**, i.e. only charging the project owner in case of fundraising accomplishment. In other words, if the funding goal is *not* reached, the platform does not earn anything and all money is refunded to backers
- b) applying the so-called **“flat / flexible rate”**, meaning that the project owner gets to keep the money raised, regardless of whether the funding goal is reached within the defined timespan of campaign development. This is possible because the platform applies a fixed commission in terms of subscription or membership rate, which allows it to collect money independently as from the projects' real success.

In addition, usually, the platform also takes a percentage of the money raised all along the project in the form of credit card processing fee – normally upwards of 3% of each transaction, also in combination with a fixed amount per pledge.

Mitigation strategy

The considerations behind the adoption of one or the other of the two methods are diverse, as much as the consequences:

- a) Via the “success-fee” rate, the platform links its profits to the **quality** of the projects published and supported. This requires the campaign provider to be more attentive and **selective** when scrutinizing the project proposals. In practical terms, the platform will make sure that the project owner/firm is stable and ready to perform the crowdfunding campaign, that their business model is adequate and complete – and that the project as a whole is appealing and adequate to the market and sector of reference. The platform might, thus, allow for a lower quantity of projects to be published, but being estimated having a higher possibility of accomplishment. This is particularly true in case of small platforms, which also have to choose projects in terms of their management capacities.
- b) The second method brings the platform to the need of hosting a **larger number of projects** or having a higher amount of affiliated companies/project owners, who regularly provide for subscription fees. Consequently, the platform might perform a less accurate selection over the presented projects, which can vary in terms of topic, sector and size (i.e. financial goal). Nonetheless, it might at the same time propose a larger offer of initiatives and projects, thus attracting a larger quantity of creative entrepreneurs.

Taking these aspects and reasoning into adequate account is fundamental to the extents of a sound and regular financial activity in the medium to long term, ensuring internal profit and external accountability.

Actor at risk:

PLATFORM

[Risk category: FISCAL / LEGAL]

> Uneven regulatory system <

Definition

Crowdfunding can be of different types – donation, rewards, equity or lending. The first two dynamics do not embody a financial return vis-à-vis the initial investment and, normally, end with “thanks” and/or a minor material gift, gadget or sample.

Instead, the other two forms are monetary in their nature (based on investments and lending, respectively) and imply transfer of money and longer financial relations. Therefore, the users’ and supporters’ activity largely vary in function of the **national regulations** in terms of investment limitation and taxation. Diverging legislation across the EU makes operating on across-borders platforms and initiatives cumbersome, complicated and even not permitted.

Such restrictions hinder the possibility of **scalability** to the sustainable operation of a crowdfunding platform. In other words, limited activities imply that crowdfunding service providers (“CSPs”) must incur a meaningful level of capital expenditure and ongoing costs in order to build and maintain the legal, financial and technological infrastructure required to operate in a highly professional and compliant manner.

By this meaning, uneven regulatory measures undermine the health and viability of the crowdfunding market as a whole.

Mitigation strategy

In order to better coordinate and make the diverse national legislation uniform, a new legislation has been proposed and is being adopted by the European highest institutions. It is the **European Crowdfunding Service Providers (ECSP) for Business Regulation** (COM(2018)0113 – C8 0103/2018 – 2018/0048(COD)¹⁸), which has the potential to make pan-European crowdfunding a reality.

Such regulation will harmonize the legal framework for the sector, offering a well-defined and structured legal skeleton for the activities of crowdfunding for business (lending and equity) all over Europe.

The main innovations¹⁹ will be :

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- ◆ Strict rules to protect investors from financial losses
- ◆ Member states responsible for authorizing and supervising crowdfunding providers

At the present, the regulation’s details are still to be finetuned and technical work on the text is under way within the three institutions. The law will come into effect in 2021 – still, this accomplishment will largely ease the crowdfunding process for all the involved actors, thus largely benefit European startups and SMEs and to European investors.

¹⁸ European Commission, “Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European Crowdfunding Service Providers (ECSP) for Business”, 2018 - <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018PC0113&from=EN>

¹⁹ ECN, “Agreed: Harmonised EU rules to boost European crowdfunding platforms”, 2019 – article to be find at <https://eurocrowd.org/2019/12/19/agreed-harmonised-eu-rules-to-boost-european-crowdfunding-platforms/>

Annex

Interreg Mediterranean
BLUE CROWDFUNDING

Capacity Building of
BLUE Economy Stakeholders
to effectively use Crowdfunding

> RISK & MITIGATION
NUGGETS FACTSHEETS <

Project co-financed by the European
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What is Crowdfunding?

Crowdfunding is defined as an "open call for the collecting of resources (funds, money, tangible goods, time) from the population at large through an internet platform. In return for their contributions, the crowd can receive a number of tangibles or intangibles, which depend on the type of crowdfunding"

- G.A. Gabison (DRC), 2015 -

What is the purpose of these infosheets?

Crowdfunding is an innovative and alternative way of funding projects. Overall, this practice serves for market-related purposes and has several benefits concerning the democratization of finance. Still, knowledge about alternative finance and digitalization is not developed enough, mostly in the MED area. This impedes a complete implementation of its specific procedures and a full appreciation of its positive effects.

The intention of these infosheets is to provide for an overview over the perceived or potential risks associated with crowdfunding, as well as to suggest precautions and mitigation solutions. All in all, they are meant to create awareness and support the Blue Community in implementing mindful and successful crowdfunding campaigns.

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For whom are these infosheets?
- Players & Roles -

Project Owner

Anyone who has an entrepreneurial, innovative idea but lacks adequate capital to bring it into practice. The realization of this venture is subject to the contribution and support from a wider audience, via the crowdfunding campaign.

The project owner is in charge of:

- the project identity
- choice of financing/business model
- relations with the supporters

Supporter

The financial participant and external contributor to the project. They can be individuals, companies, venture capitalists or business angels, or public/financial institutions.

They form the "crowd". Their contributions vary from being very small, i.e. "micro-transactions" to the purchase of firm's shares and quota in the form of investments.

Public Authority

Particular actor who can activate and combine the funds from the crowd with public budget, also in line with a defined political agenda. Its participation or provision of a funding generates the so-called "civic crowdfunding" and "match funding" dynamics. Its role varies:

- Sponsor
- Manager
- Curator
- Facilitator

Platform

The internet-based intermediary that facilitates financial contributions between supporters and project owners. It selects and supports the most promising initiatives or to be explicit on its specific contributions, in this sense, it acts as "gatekeeper", filtering the projects per content, location, sector, objective. Its profit derives from different fee structures, depending on the business model.

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Project Owner

#1 - Limited knowledge on alternative finance

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and budget structure. Crowdfunding, in particular, is not a homogeneous practice and the success of a campaign depends on the choice of the most appropriate platform and co-funding tradition, reward, equity or lending. Making the wrong choice, in these terms, might lead to not reach the funding goal or can prevent from using this precious resource to its full potential.

Mitigation strategy

Awareness creation, training and education about CF and alternative finance is indispensable, as it prevents to be unprepared via a specific funding dynamics. Such training can also empower with further and practical skills that might enlighten the broader job-market, such as commercial and managerial abilities of business plans etc.

Many specialized services and/or coaching sessions are also offered by professional agencies or by the platforms themselves. Acting trust service providers with proven reliability, experience and professionalism. The choice of a platform offering for the business model and product or question is essential. In order of finding crowdfunding activity, it is always a good practice to opt for a platform that provides support and help all along the process.

In case of multi-actor platforms, make sure to have a process or office of reference in the society or industry, with the possibility of scheduling periodic meetings, chats and calls in order to foster the entrepreneurial support and the premises on the platform may be accessible to launch the management of any CF campaign.

In case of direct business experience, hiring a risk management consultant is a good investment for business and determine whether the rights the fund and what strategies to rely in order to avoid them, involve them throughout.

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Project Owner

#2 - Underestimation of costs

Definition

Crowdfunding differs from a normal production activity as it requires for diverse unusual extra costs, which are sometimes difficult to spot and calculate or to take into appropriate account in the budget.

In fact, in addition to fixed production costs related to raw materials, human resources and services providers, there are high costs of initial capital, in terms of investment in pre-campaign, campaign maintenance, post-campaign activities. Among these, the delivery cost of rewards, the social media campaign fees and sponsorships, the changes embodied in small-scale production. Additionally, the platform-related fees largely impact on the final funds collected.

Mitigation strategy

The careful preparation of a thorough business plan - budgeting and expenses forecasting, is indispensable considering every single phase and aspect of the campaign. A good support by the platform is useful and necessary, as their advice can better define the business strategy and timing of funding completion.

Focus on:

Platform's affiliation fees

Choosing for the platform can strongly make the difference in terms of final funds collected. In particular, due to the project of the platform, affiliation fees (fixed/variable capital) and on the share related to the platform provider are relevant.

It is also important to consider which approach the platform chooses to refund the project owner of the collected money. It is to differentiate between "full or no-refund" or a "keep it all" approach. In the first case, reaching the goal funding goal is leading to the transfer of all the collected money from the supporters, to the platform to the project owner. Such a solution is to be chosen for high investments related to few activities, as it is for example with highly specialized products, whose development implies very large investments in terms of materials, time or technology. The second method allows the project owner to directly get a certain and proportional amount per each and every contribution gathered from the crowd. This is particularly useful when even small amounts collect the project progress and develop.

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Deliverable 3.1.4

Risk & Mitigation Nuggets Factsheets

Project Owner Risk category: FINANCIAL

#3 - Unpredictable market factors

Definition

Crowdfunding can be adopted in order to reach different aims, among which gathering feedback on the product, testing the market and proving a brand concept. Nonetheless, it is not efficient only if anticipated and supported by a careful market analysis and positioning.

It is a practice also based on the crowd's emotional affection and attitude (which is not easy to predict). In the case of bad estimations concerning the demand, the appeal and the real value of the product to crowdfund, the campaign is a really missed chance!

In parallel, if the product lacks of brand or identity, it is more exposed to face high competition in the internet's broad and hidden market. Framing potential competitors is also key to better define the offer's success.

Furthermore, during the campaign, some unforeseen and situations can happen. Competing products might emerge, the economy freezes, a crisis occurs, "herd's law" and butterfly effects are difficult to predict and even less desired - still, unplanned events might strongly affect the campaign outcome.

Mitigation strategy

Deeply analyzing the market and the surrounding economic context helps frame the campaign, the attractiveness and demand of a given product. This involves a careful assessment of risks, competitors and competitors' behavior, with a complete outlining of the crowd in terms of attitudes and motivation towards the product/brand.

A careful assessment of the firm's potentials and internal competencies is also essential, in order to completely frame the production abilities. It is to remember that "Intention to produce ≠ Ability to produce".

A solid financial analysis, measuring other scenarios and building options.

It is nonetheless suggested to not only rely on crowdfunding for the production or the fulfillment of an economic objective, measuring other scenarios and building options.

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Project Owner Risk category: GENERAL

#4 - Reputational damages due to unfulfillment

Definition

There might be many reasons that prevent a campaign to be successful. Limitations of technical nature, market, or business unviability, unstable internal management.

Failing to satisfy the initial promises might happen, but it is even worse if the crowd of supporters is not kept informed about the campaign development. This will make the entire firm look non-transparent and hinder the future business initiatives.

Mitigation strategy

Setting realistic and reachable goals (in terms of requested amount, timing and production capacity) is essential for a successful crowdfunding campaign. In parallel, regular exchange information and updates with the crowd about the project developments are key in order to build a trustworthy identity.

Always keep the crowd on the loop about the initiative's state of art, both on the social media and on the crowdfunding platform.

Focus on Communication with the crowd

One of the main objectives of a crowdfunding campaign are the transparency, the clarity of the project or initiative, the communication, the information, the understanding, the "herd's law", the "herd's effect", the "herd's behavior". It is a key to success in the crowdfunding world. The crowd of supporters is not kept informed about the campaign development. This will make the entire firm look non-transparent and hinder the future business initiatives.

Such a communication exchange is fundamental to generate and maintain a trust in the project and its team. It is a key to success in the crowdfunding world. The crowd of supporters is not kept informed about the campaign development. This will make the entire firm look non-transparent and hinder the future business initiatives.

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Project Owner Risk category: FINANCIAL

#5 - Exit strategy & fluctuation of cash flows

Definition

The exit strategy is the moment in which a larger company, a venture capital or a "business angel" absorbs or buys the start-up out. This implies for the smaller firm to be included within a broader production, investment or capital spectrum - and ensures the innovative product or idea higher chances to survive. This happening is not certain or predictable, even if sometimes expected or presumed. In practical terms, though, the success of a business cannot be assured merely by external purchase.

Additionally, if and when the exit happens, the economic value of shares might have varied since the initial appraisal - share price fluctuations can occur differently along the crowdfunding campaign, mostly if it takes longer than few months. It is to consider, in fact, that an investment may take up to 4-5 years to return into the investor's pockets.

During this time, the economy and the market change, resulting in a different appreciation of the capital invested.

Mitigation strategy

An accurate market (risk assessment and business valuation) optimizes the project profitability and helps estimate the average return on investment that could be expected, based on returns generated by the wider market. It is necessary to determine the economic value of a certain company and its exit can value to establish a realistic rate of accounting and future taxation.

Estimating the average market return helps companies to understand the cost of capital and the return on investment with a sense of an appreciation of the market value of their assets or shares, in comparison to the market.

At the moment of exit, these companies should be able to liquidate their assets and return the investment to the investors. It is necessary to determine the economic value of a certain company and its exit can value to establish a realistic rate of accounting and future taxation.

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Project Owner Risk category: LEGAL

#6 - Intellectual Property Right & Copyright infringement

Definition

One of the key benefits of crowdfunding is that it enables highly potential innovative projects and creative ideas to reach out and be supported by the wider public.

The internet, nonetheless, is not only a sea full of opportunities for creators and investors, but also of risks, market, competition and spies, who might initiate the "herd's law" and butterfly effects, leading to a shutdown of the campaign or even to a lawsuit.

If this happens within the framework of a larger-scale and more status production activity, the short-term result will be the failure of the campaign while the long-term one might be a lawsuit and even a criminal case.

Another peculiar question is the crowdfunding to copyright in the use of intellectual media materials during the campaign, in case of copyright infringement could occur in the crowdfunding world. The use of intellectual media materials is a key to success in the crowdfunding world. The crowd of supporters is not kept informed about the campaign development. This will make the entire firm look non-transparent and hinder the future business initiatives.

Mitigation strategy

The golden rule concerning any unpatented product or idea is to only make available its basic and more general information, keeping the more particular details secret and discretionary. In this way, the key features that make a project particularly innovative and non-replicable will not be disclosed and the investor will not risk to lose the identity of long-developed innovative solutions. If the project is a highly innovative one, the project idea (especially in the case of highly innovative solutions) is not to be disclosed and the investor will not risk to lose the identity of long-developed innovative solutions. If the project is a highly innovative one, the project idea (especially in the case of highly innovative solutions) is not to be disclosed and the investor will not risk to lose the identity of long-developed innovative solutions.

You may consider filing for patent/trademark/protection before launching the campaign in case of technology innovations in highly competitive markets. The project idea (especially in the case of highly innovative solutions) is not to be disclosed and the investor will not risk to lose the identity of long-developed innovative solutions.

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Project Owner Risk category: LEGAL

#7 - Uneven or unclear regulatory system

Definition

Launching a project on a foreign platform might be attractive as it opens up to broader markets. Nonetheless, the lack of an international or EU-wide common crowdfunding regulation makes it unclear which step to follow and which rules to apply. Or does it depend on the platform? Or even on the supporter's location?

Some countries might offer in relation to the law. The latter, in fact, must be clear in the national legislation, that the final result of the campaign or the investment may vary and not be clear in case of cross-border activity.

Lack of coordination between legislations in different countries and a scarce guidance on applicable fiscal regulation could result in market fragmentation and law breach, even unintentionally.

Respecting the platform's fundraising terms and conditions is also key. Campaigns that run about of these rules may face difficulties in accessing their funds even if the campaign meets its targets. Either scenario represents a monetary and reputational disaster.

Mitigation strategy

Ensuring a deep and careful review of the business and legal plan against the chosen platform's rules is essential before launching any campaign. Make sure the platform displays:

- legal framework
- the authority of reference
- division of responsibilities
- contractual details / obligations

Such information are an indicator of reliability, as they prevent future fiscal or legal issues, ensuring a fair campaign development towards supporters and firm is essential to protect brand, product, money and crowd.

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Supporter / Investor Risk category: GENERAL

#8 - Limited knowledge on alternative finance

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and funding flows. The crowdfunding world is extremely diverse and the economic dynamics are complex and not linear. It is necessary to determine the economic value of a certain company and its exit can value to establish a realistic rate of accounting and future taxation.

Lack of experience might lead to invest funds in unattractive projects, resulting in financial losses or in a loss of time and resources. The crowdfunding world is extremely diverse and the economic dynamics are complex and not linear. It is necessary to determine the economic value of a certain company and its exit can value to establish a realistic rate of accounting and future taxation.

Mitigation strategy

Get preliminary training on alternative finance tools and procedures - attend local workshops and basic preparation, relying on experienced coaches and training centers, as well as on private financial accounts or bank analysis, to set the investment capacity.

In case of doubt about the product or initiative to support, always collect all the information on the project owner available on the internet and on the platform.

In general terms, make personal grounded and well considered decisions when choosing on which project to place a certain amount of money. Do not rely on what "the mass" or "the herd" is doing, as it is not always a certainty for success and satisfaction. Instead of being supportive of the "herd mentality", check the support of other credible local organizations or public authorities. The engagement of an institutional actor might give the adequate level of accountability of a certain project and ensure the campaign accomplishment.

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Deliverable 3.1.4

Risk & Mitigation Nuggets Factsheets

Supporter / Investor

Risk category: GENERAL

#9 - Illiquidity of capitals, late returns & increase in default

Definition

In case of equity crowdfunding, future returns are expected from investments. However, it may take long to materialize if all or most of the investors are not satisfied. The chance that a company or individual will be unable to make the payments or return the invested capital is called the risk of default. Investors in equity crowdfunding are not entitled to interest, and in the event of a default, investors may lose out on periodic interest payments and their investment to the fund.

The future of an investment, on the other hand, might also be represented by an exit option, which requires either a target and larger company's venture capital or a business angel. In this case, the exit option is not to be diluted, nor can it be transferred to the investor of the company. The success or failure of the investment is subject to the success and failure of the company.

Mitigation strategy

Diversifying the investments is a good practice to prevent losing large amounts or the risk of capital erosion.

Before investing it would be necessary to do an appropriate financial measurement to estimate the riskiness of the debt operation, also assessing the ability of a company to meet financial obligations.

Default risk can be detected using standard measurement tools including RCD scores for consumer credit, and credit ratings for corporate and government debt issues, provided by nationally recognized statistical rating organizations (NRSOs).

In case of lending, it might be considered to charge rates of return that correspond to the debtors level of default risk or to opt for fixed income securities, i.e. an investment providing a level stream of interest income over a period of time.

In relation to the exit option, the investors should require transparency and openness on when and how they will be able to withdraw their initial investment, along with any associated gains and overhead on the "tag along" practice.

The idea of a security market

For investors, it would be necessary to have an early stage security market, which is a market where investors can buy and sell securities. This market would be necessary to provide liquidity to investors and to provide a platform for the company to raise capital.

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Supporter / Investor

Risk category: GENERAL

#10 - Uneven or unclear regulatory system

Definition

Supporting a project on a foreign platform might be an interesting option to the individual portfolio of investments, as it opens up to larger markets. However, the lack of an international or EU-wide common crowdfunding regulation makes it unclear which law is to be applied in the case of a dispute. Or does it depend on the platform? Or even, on the investor's location?

Some confusion might arise in relation to taxes. The latter, in fact, most of time depends on the national legislation. Thus, the investor or the platform of the investment may vary and not be clear in case of cross-border activity. Lack of coordination between regulators in different countries, and a scarce guidance on applicable fiscal regulation could result in market fragmentation and law breach, even unintentionally.

Sometimes, furthermore, different countries impose different investment limitations to the individuals, thus legal issues might arise in relation to the platform's fundraising terms and conditions.

Mitigation strategy

Before transferring or raising money in any project, it is best to check and verify in legal and fiscal terms, as well as the one concerning the platform. Make sure the platform displays:

- Legal framework
- The authority of reference
- Division of responsibilities
- Contractual details / obligations

Such information are an indicator of reliability, as they present future legal or fiscal issues. Require the platform to transparently express the local / country regulation applied, so that to avoid future fiscal issues or legal misinterpretations.

Focus on the European Crowdfunding Service Providers (ESCP)

ESCPs are the only entities that can provide crowdfunding services in the EU. They are subject to a set of rules that ensure the integrity and security of the crowdfunding market.

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Public Authority

Risk category: GENERAL

#11 - Limited knowledge on alternative finance

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different timing and budget structure. Crowdfunding, in particular, is a form of compensation to the limits of traditional finance. The combination of the two sources, intermediated by public managing authorities and institutions, gives birth to the so-called "Civic crowdfunding", that can help smooth the limits inherent to usual forms of financing. Still, the solutions resulting from this mix are poorly diffused or put in practice because of a generally limited knowledge and experience. Preferring or limiting the sources to traditional finance might result in less development opportunities for promising or necessary activities.

Mitigation strategy

Mainstream knowledge on crowdfunding by implementing training, workshops and demonstration events that can be delivered to different social groups and economic actors, increasing and spreading the crowdfunding culture is particularly needed as to unlock the full potential of the participation of public authorities as actors in the scenario of alternative finance scheme - with the role of sponsor, manager, curator or facilitator. The activation of any public institution within the method of alternative funding brings about a finance multiplying effect that is relatively insensitive to any crisis, organization, or enterprise. Public authorities have to be seen as the "backbone to train" territorial ally that help boost the success of any civic crowdfunding campaign. In fact, their presence is perceived as a trustworthy warranty for the relevance and that the success of any project.

Clear dialogue and synergies have to be launched and implemented in order to design specific funding schemes, that would thematically fall within the scope of regional or local priorities and be technically viable and admissible.

Focus on Digital Inequality and Illiteracy

Digital inequality and illiteracy are major challenges for the development of the digital economy. Public authorities should focus on these issues to ensure that all citizens have access to digital services and opportunities.

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Public Authority

Risk category: GENERAL

#12 - Decline of its institutional role

Definition

Civic crowdfunding is a very powerful and with growing impact on the economy and the community. In fact, it normally allows for the realization of projects that would not have occurred otherwise.

However, it is still a relatively diffuse practice and many public authorities, especially in the case of small municipalities, are not aware of its potential. This lack of awareness might lead to a decline in the institutional role of public authorities, as they might not be able to provide the necessary support and resources for the development of civic crowdfunding.

Public authorities should therefore focus on promoting civic crowdfunding and ensuring that they have the necessary resources and expertise to support it.

Mitigation strategy

It is important to build a positive narrative around crowdfunding, depicting it as a mechanism to expand the range of possible public-private partnerships and financial engagements. In this sense, crowdfunding platforms should be strengthened in the form of crowdfunding contributions will strengthen the relationship between the government/public authorities and the community of reference. In fact, state crowdfunding is to be seen as a financial synergy and a shared effort in the name of common objectives.

In practical terms, it allows for an injection of private capital into the public economy. This is particularly true in the case of "match-funding", which leads to the public authority topping up the crowdfunding amount with their own resources as the counterpart of a defined sum of the activation of a certain number of backers' supporters, resulting in a multiplication of the number of services and projects, both new or already existing. The strategy might also be applied in combination and partnership with the crowdfunding platform itself, thus facilitating the allocation of money when they consider the initiative is of particular interest for the public benefit.

All in all, the public authority has the delicate task to practically make the difference and change the economic or social balance of power contexts, simply by choosing to intervene and support for a campaign or another. It is very important, thus, that it makes use of crowdfunding to promote and create incentives for marginalized areas and communities.

The role of PUBLIC AUTHORITIES

Public authorities play a crucial role in supporting civic crowdfunding. They can provide financial support, expertise, and resources to help projects get off the ground.

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Public Authority

Risk category: GENERAL

#13 - Low engagement of stakeholders & community

Definition

When running a civic crowdfunding campaign, the level of involvement of the community is fundamental. In order to increase the perceived legitimacy of the campaign, responsibility and overall social participation are key factors for the success of the initiative. The result of the project, in fact, is specifically defined as common good for the whole community of reference. Nonetheless, a limited culture on crowdfunding, together with communication strategies and timing, might lead to a low engagement of stakeholders, citizens and other stakeholders - making the public authority the sole or main driver of the initiative. This situation, on the one hand, represents an unbalanced and unsustainable model for the initiative, while, on the other hand, it might lead to a low engagement of stakeholders and citizens, which could result in a low impact of the initiative to survive in the longer run.

Mitigation strategy

It is important that the Public Authority builds a strong Consortium of various actors around the initiative, engaging in external partnerships with local enterprises and organizations. External business stakeholders can be convinced showing the benefits of such partnership:

- allowing a prominent role in the crowdfunding campaign; they can not only have a decision-making power within the project itself but also increase their social impact being perceived as change-makers and drivers in the area and practice social-economic efforts for the sake of the community;
- offering side support to the campaign; they can boost their social impact and corporate social responsibility (CSR), providing their expertise to the project and increasing its visibility and the needs of the local community and eventually result in an opportunity to increase sales by growing customers.

These partnerships might lead to the introduction of reward-based participation systems, made up, for example, of shopping bonuses, discounts, and facilities or free services for those citizens who take part in the venture.

As far as the community is concerned, it is always good practice to involve them from the inception of the initiative, starting from the analysis of their needs and wishes, listening to them the campaign phase and objectives, in order to increase the sense of ownership towards the project.

In the same way, the public authority, in partnership with the crowdfunding platform, can organize calls for tenders and contests in order to collect ideas and bottom-up projects to be supported. In this way, the community of reference will not only feel a stronger linkage and ownership to the initiative, but will also be more likely to support it.

Mitigation strategy

The mitigation strategy involves building a strong consortium of various actors around the initiative, engaging in external partnerships with local enterprises and organizations. This will help to increase the perceived legitimacy of the campaign and ensure that the project is sustainable in the long run.

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Public Authority

Risk category: LEGAL

#14 - Regional / National diversified legislation

Definition

Alternative finance risks of a unique and robust set of laws and ratings of reference. The absence of a common set of rules and standards may lead to a fragmented and unbalanced market, which could result in a low engagement of stakeholders and citizens, which could result in a low impact of the initiative to survive in the longer run.

Mitigation strategy

Crowdfunding platforms and public/managing authorities have to strengthen their collaboration, working together in order to identify areas in which a pilot program can be carried out, so to implement innovative matching schemes that can reach a higher investment impact, and to design specific funding schemes, that would thematically fall within the scope of regional or local priorities and be technically viable and admissible.

Priority areas as those addressed in regional Smart Specialization Strategies might be a solid starting point for the design of the matching schemes, since the latter sectors have already been identified as key in the economic territorial development to provide a long-term framework in which pilots can be tested.

In other words, it is to expand the scope of public partnership with crowdfunding - designing clear and transparent ways in which to scale up the match-funding mechanism as to also include lending and equity crowdfunding synergies.

In addition, combinations have to be explored with European Structural Investment Funds (ESF) and the specific thematic priorities and resources, in order to find common strategies and applications. This process would also enlarge the number of projects that could receive funding without increasing the amount allocated from public budget. Such partnership would also grant increased visibility to the EU and cohesion policy, while allowing managing authorities to be more responsive, better equipped and efficient when investing in territorial and citizens' needs.

Mitigation strategy

The mitigation strategy involves strengthening the collaboration between crowdfunding platforms and public/managing authorities. This will help to identify areas in which a pilot program can be carried out, so to implement innovative matching schemes that can reach a higher investment impact.

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Risk & Mitigation Nuggets Factsheets

Platform

Risk category: GENERAL

#15 - Lack of transparency & low accountability

Definition

The role and objective of a crowdfunding platform is to support and enhance the action and the financial dynamics between investors and crowdfunders and institutional donors. The platform is in the name of the innovative projects activities and initiatives, in line with specific demands or needs. In this sense, any malpractice or perceived lack of transparency and accountability can result in the stakeholders' dissatisfaction, that undermines the success of any proposed crowdfunding campaign.

A platform's reliability and trustworthiness result by making clear expressions of transparency and a considerable campaign completion rate. In other terms, promoting information and transparency can also negatively influence the perception on the platform's capacities and credibility. This is also true because investors and supporters need to have a thorough understanding of alternative finance agencies and make rational choices, opting for more widely-known platforms (herd mentality).

Mitigation strategy

The platform has to build its accountability taking two main aspects into account: the creation of a transparent profile and a fair management of campaigns and projects. For the first purpose, it should declare and openly publish its legal information, contractual obligations and details of the implementing managing bodies of reference (board, person of reference, etc.). In the same way, transparency can be guaranteed by issuing public calls for the submission of new actions, as well as the transparency by the crowd. An additional indicator of its reliability consists in selecting projects via specific criteria and publishing score and arguments.

In relation to the practical management of the initiative, on a preliminary basis, it would be good practice for the platform to check on the project owner's capacity on the project's suitability for their space and on the users' readiness. This would result in higher success chances for the proposed initiatives and, as a consequence, in a better reputation in overall terms.

Along the campaign, the platform is expected to regularly report about the project's implementation with evidence photos, videos, interviews, etc. and support materials. At the end of the funding period or initiative, it is also good practice to prevent the actions results and feedback developments.

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Platform

Risk category: GENERAL

#16 - Inaccessibility for certain categories

Definition

Alternative finance is an economic dynamic characterized by specific procedures, particular actors, different times and building structures. Particular crowdfunding has been growing being mostly used by a large part of the population. This is mostly due to its transparency and a scarce culture about alternative finance. In such a context, crowdfunding initiatives and their inability to access and support the categories on the platform.

Particularly significant is the case of people from disadvantaged territories with specific difficulties with elderly people. The current consequences result in a lack of potential users and thus in a more limited success of the project itself.

This is, in turn, on the one side hinders development chances for the territory and the community on the other side, it is high potentially influences the reputation and profit of the platform itself.

Mitigation strategy

The platform has the chance, power and duty to organize training and workshops, webinars, coaching and support sessions for users and all key events to spread the crowdfunding word. Assistance and backing functions should be provided to its users before, during and after the campaign. Such an "investment" in capacity building will later result in a broader crowd and market community, and will at the same time, confer to the platform a certain status as point of reference.

Particularly in case of small-to-medium size platforms, a dedicated focus on specific territories and areas is very welcome. In fact, the presence of formerly funded initiatives and projects on a given area plays a role like multiplier for the perception of crowdfunding benefits by the locals, boosting the diffusion of this dynamics.

In order to broaden the community of possible project owners, businesses, dedicated and even regular calls and contests can be launched, as to make crowdfunding a more visible and tangible funding option to make their dreams and initiatives come true.

Practical expedients like a more user-friendly website, easily understandable metaphors and clear visual elements on their services and on the projects offered (status, location, timeline, progress, project owner's details etc.) can also help mainstream the spread of crowdfunding and make it be perceived as closer to the wider and less-experienced public.

The publication and easy consultation of legal and administrative information and documents is another very meaningful element that can shorten the distances between the digital service provider and the audience.

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Platform

Risk category: GENERAL

#17 - Cyber-security attacks & digital protection

Definition

Cyber-attack is, per definition, a financial or economic supporting through the anonymous internet. As such, in the same, hackers are the pirates of the digital galaxy able to attack and break increasingly sensitive data, repositories to steal credit card details and other personal data. These cyber-attacks are a danger both for the crowdfunding platform itself and for its users, as they can impact the very financial transaction as much as the identity of the key stakeholders.

Given the unknown profile of many users on the internet, furthermore, economic transaction over platforms might be perceived as possibly hindering illicit activities of money laundering or terrorist financing (ML, TF Risks).

The potential of the risk to occur in potentially insecure financial transactions via the platform can prevent public donations and support, resulting in a loss of income for project managers and owners, and in a possible failure of the campaign.

Mitigation strategy

One of the major elements of care for the platform has to be the digital protection of its users' data and personal information. Being up-to-date with the latest technology is not only a matter of easier transactions but a legal and financial warranty towards both, the project owners and the supporters.

Among the possible solutions:

- Create a secure system to protect the crowdfunding platform and adopt user and customers' verification (ie. installation of SSL certificate for secure data transfer)
- Opt for end-user security education and awareness training (ie. drawing customer practitioner experience and empowering them through –see center solution). Similarly, systems to deliver threat awareness and alerts for risky behaviors is highly recommended.
- Enable transactions through established and accredited financial institutions and channels.
- Harden the system against the platform configuration in order to prevent client-side impersonation.
- Ensure compliance with GDPR implementation of Regulation EU 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons against the processing of personal data and the free movement of such data.
- Regulation has to specifically address this issue and make that notion of responsibility, also in order to protect the platform from illicit funders/users' activities.

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Platform

Risk category: FINANCIAL

#18 - Uneven and unstable profit-making

Definition

The way how a platform actually makes money highly differs in reason of diverse considerations, concerning the nature of the supported projects, their scope and location, sector of activity, etc. Most of times, nonetheless, the platform does not charge the supporters (crowd) but rather the project owner(s). The choice of one or the other option highly impacts on the regular inflow of money from any campaign. The most common models are:

a) the so-called "success fee" (also called charging the project owner in case of fundraising accomplishment, in other words, if the funding goal is not reached, the platform does not earn anything and all money is refunded to backers to ensuring the so-called "refund rate", ensuring that the project owner gets back the money raised, regardless of whether the funding goal is reached within the defined campaign development. This is possible, too, when the platform applies a fixed commission in terms of subscription or membership rate, which allows it to collect money independently as from the project's real success.

In addition, usually the platform also takes a percentage of the money raised along the project in the form of credit card processing fee - normally upwards of 3% of each transaction, also in combination with a fixed amount per pledge.

Mitigation strategy

In order to ensure an internal regular profit and an external sound accountability, it is fundamental to look at the diverse consequences of each of the two methods.

a) Via the "success fee" rate, the platform risks to profits to the quality of the projects published and supported. This requires the campaign provider to be more attentive and selective when scrutinizing the project proposals, in practice terms, the platform will make sure that the project owner/firm is stable and ready to perform the crowdfunding campaign, that their business model is adequate and complete - and that the project as a whole is appealing and in line with the market and sector of reference. The platform might, thus, opt for a lower quantity of projects to be published, but being estimated having a higher possibility of accomplishment. The platform's management capacities also include sort the quantity of projects to run.

b) In the second case, the platform needs to have a larger number of projects or to have a higher amount of platform commission/project owners, who represent specific subscription fees. Consequently, the platform will have the presented projects might be less appealing in terms of sector and size (ie. financial goals) but the platform's business enables the platform to propose a larger offer of initiatives and projects, thus attracting a larger quantity of entrepreneurs.

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Platform

Risk category: LEGAL

#19 - Diversified regulatory system & legal framework

Definition

Crowdfunding can be of different types - donation, rewards, equity or lending. The first two dynamics do not involve a financial transaction, but rather a simple investment and, normally, are with "thick" and/or a minor money amount. The latter two, however, are more complex, involving the flow of money and, in their nature (based on investments and lending, respectively) and easy transfer of money and, in their financial relations, therefore, the users' and support activity largely rely on the function of the national regulations in terms of investment limitation and taxation.

Dispersing regulatory limits, the EU member operating on across borders, and sometimes in transnational, complex and even not permitted.

Such restrictions, however, are a consequence of a liability to the sustainable operation of a crowdfunding platform, in other words, limited activities imply that crowdfunding service providers (CSFs) must incur a meaningful level of capital expenditure and ongoing costs in order to build and maintain the legal and technological infrastructure required to operate in a highly professional and compliant manner.

By this meaning, where regulatory measures undermine the health and viability of the crowdfunding market as a whole.

Mitigation strategy

In order to better coordinate and make the diverse national legislation systems, a new legislation has been proposed and is being adopted by the European highest institutions. It is the European Crowdfunding Service Providers (ECSP) for Business Regulation (COM(2013) 104), (a measure 2014/609/EU), which has the intention to make pan-European crowdfunding a reality.

Such regulation will harmonize the legal framework for the sector, offering a well defined and structured legal position for the activities of crowdfunding for business lending and equity/real estate Europe. The main innovations will be:

- A single set of rules will apply to crowdfunding services in the EU up to €5,000,000.
- Solid rules to prevent investors from financial losses.
- Member states responsible for authorizing and supervising crowdfunding providers.

At the present, the regulatory details are still to be discussed and technical working is required. It is only very within the three institutions, the law is expected to come into effect in 2022 - and this accomplishment will largely ease the crowdfunding process for all the involved actors, thus ensuring great benefits to European startups, SMEs and investors.

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