

**CROWDFUNDING:  
A PROMISING ALTERNATIVE TO TURN DREAMS INTO REALITY**

<sup>1\*</sup>Norhafiza Nordin, <sup>1</sup>Faizah Ismail, <sup>1</sup>Zaemah Zainuddin

School of Economics, Finance and Banking,  
College of Business,  
Universiti Utara Malaysia  
06010 UUM, Sintok  
Kedah Darul Aman, Malaysia

\*Corresponding author's email: norhafiza@uum.edu.my

*Submission date: 15 July 2017      Accepted date: 30 Sept 2017      Published date: 30 Nov 2017*

**Abstract**

Crowdfunding, an Internet based fundraising method is gaining popularity for its fast and simpler process. Despite its importance and rapid development, little scholarly literature exists to discuss about this topic. To address this gap, this paper reviews some issues in crowdfunding based on the information gathered from a desktop research. In particular, this paper discusses the crowdfunding's application, potentials and challenges. Focus is given on how crowdfunding platforms work and their implications both to the founders and funders. How these platforms help to solicit funds from the "crowd" in order to realize projects, which face difficulty to obtain bank loans or any other traditional financing. Using the platforms, an entrepreneur (founder) will be able to obtain external financing from a very large audience. Each individual (funder) will contribute a small amount to raise the targeted amount, enough to finance the project. This method of fundraising saves time and money. Although it offers great potentials and benefits, crowdfunding is not without risk. Since many founders involve start-ups, the risk is quite high. Therefore, rules and regulations must be further developed and implemented in order to protect the interests of both parties (founders and funders).

**Keywords:** crowdfunding; crowdsourcing; donation; entrepreneurial financing; fundraising;

## 1.0 INTRODUCTION

Crowdfunding refers to a tool of raising fund or collecting money from public through online portals to finance both commercial and social projects. These for-profit and non-profit projects vary widely in terms of goal and magnitude, ranging from small-scale projects to massive projects worth millions (Mollick, 2014). Basically, there are five types of crowdfunding, which are (i) donation (ii) reward (iii) crowdsourcing (iv) equity and (v) peer to peer lending. Sheehan (2010) defines crowdfunding as the ability to get a large group of people to support and to fund products development or projects. Crowdfunding has so much potential and more people are interested to be involved in its campaign nowadays due to its simpler and faster procedure than the traditional way of raising fund. Not only it can be a fast way to raise fund, it can also be a platform to get feedback and expert guidance on how to improve the projects. In other words, the entrepreneurs can get feedback, comments and more ideas from the crowd. An effective crowdfunding campaign also serves as a good way to market a product. It is free and can easily reach a large audience. Not only to the visitors of the platform, but the information can be shared and spread to their friends and families. A growing number of

entrepreneurs and start-ups have chosen this platform as an alternative especially when they face difficulty to get bank loans or traditional financing. The application of crowdfunding is not limited to certain sectors only. It caters various reasons and activities. Therefore, it is important to evaluate the quality and accuracy of the information disseminated through crowdfunding campaigns so that the funds are not used to endure projects that have no potential (Hossain & Kauranen, 2015). Issues regarding exploitation and fraud call for a more in-depth exploration and examination on crowdfunding's applications, implementation, advantages, disadvantages, challenges and monitoring procedures. Amongst the most important question posed on crowdfunding is whether the successful crowdfunding campaign leads to the productive development of goods and services. In crowdfunding, the fund is raised beforehand without any definitive legal obligation from the project creator to deliver the promised rewards. This definitely opens room for fraud. Not only to the funder, the founder also faces risk. One major drawback to the founder is if the product or the idea has not been patented or copyrighted, someone may steal the concept or idea and come out with similar product or project.

There are many crowdfunding platforms, which have proven their ability to provide funds to finance new projects. This mechanism has expanded, not only providing capital for businesses, but also for social projects. Examples of successful platform are MyMajorCompany, IndieGoGo and Kickstarter (Hemer, 2011). Launched in 2009, Kickstarter, a reward based platform has managed to help and provide financing supports to artists to finance their creative projects. There are many projects that have managed to raise funds through crowdfunding platforms. For example, the biggest campaign on IndieGoGo in 2015 was Flow Hive. It was a project that developed a new way to harvest honey without disturbing or getting stung by the bees. The campaign had managed to raise USD12 million. Another high profile campaign in 2015 was Pebble Time Smartwatch, launched on Kickstarter. It was a project that developed a smartwatch that managed calls and e-mails as well as tracks one's steps and sleep patterns. This campaign managed to raise more than USD20 million (Verhage, 2015). The purpose of this paper is to explore the current development, long term implications, potentials and challenges of this crowdfunding phenomenon. The rest of this paper is as follow: Section 2 explains how crowdfunding works. This includes the initial development of crowdfunding. Section 3 discusses its potentials and challenges, specifically its economic and social implications. Section 4 concludes this paper.

## 2.0 CROWDFUNDING: HISTORY AND CURRENT DEVELOPMENT

Not known as a new concept, crowdfunding has started long time ago. A classic example of crowdfunding is the funding for Statue of Liberty in 1884 when the American Committee was unable to get enough fund to build the statue. The initial cost of the statue was over USD300,000 while the American Committee only managed to generate USD50,000. Realizing how important the project was, Joseph Pulitzer, an American-Hungarian newspaper editor and publisher had initiated to do an open call to all Americans. The fund was raised through micro-donation platform, which presently known as crowdfunding (Pitts, 2010). In Malaysia, the history of crowdfunding began when an insurance agent named Peter Teo initiated a fund raising in order to have more "live" World Cup telecast. On June 14, 1982 he called The Malay Mail newspaper's "Hotline" suggesting Radio Televisyen Malaysia (RTM) to collect RM1 each from the public. The Malay Mail launched the People's Live Telecast Fund (PLTF) on June 19, 1982 after RTM agreed with the proposed idea. The campaign managed to collect enough money to pay for four 'live' World Cup 1982 telecasts. To date (as at end of March 2017), based on the fact given by *Capital Markets Malaysia* (CM2), a total of RM12.6 million of fund for various projects has been raised through crowdfunding.

In general, the crowdfunding campaign involves three parties:

1. The founder or the owner who proposes the idea or the project
2. The supporters or the funders who support the idea and the project and willing to give funds,

3. The platform, which brings the founder and the supporters (funders) together in order to achieve the objectives of the project. The platform plays a very significant role as it coordinates and monitors the fundraising activities.

Although each platform may have its own way of offering crowdfunding service, the general concept is the same across the board. First, a profile containing an introduction to the project, a list of rewards (returns) per donation (contribution), and some detailed particulars must be created. In addition to the product's information, the profile must also state the monetary goals and the timeline to reach the goals. The basic idea is to disseminate information, which can draw the attention of Internet community to financially support the projects. According to Ahlers et al. (2015), providing more detailed information about the project's risks can significantly influence the successfulness of the campaign. There is no participation fee imposed to raise fund through crowdfunding. Based on Siew (2016), the five types of crowdfunding are:

- (i) **Donation:** This is a campaign, which calls for public donation. The crowd will draw up monetary gifts (i.e. donations) towards a charity or public institution/organization for some good causes. An example of this type of crowdfunding was the donation collected for Mr. Mohamad Sahar Mhd Noor in 2016. Aged 57, when he went to London to attend his daughter's graduation. Unfortunately, he suffered a massive stroke 20 minutes after the flight landed at Heathrow Airport. Rushed to the hospital, he underwent a treatment to release pressure on his brain and to allow the release of blood. The problem was he did not purchase any medical insurance prior to the departure and the medical bills had accumulated up to GBP46,000 or MYR250,000. In a desperate attempt to save his life, his daughter, Amirah Sahar started a fundraising campaign via website GoFundMe. Within two days, they managed to raise GBP25,000 (Othman, 2016).
- (ii) **Reward:** It is called a reward-based crowdfunding because those who participate will receive some kind of incentives or rewards. Specifically, a campaign to fund the project is drawn, and in return, the funders are promised to be rewarded with the products or the limited edition version of the products or any other appropriate gifts. For example, funders who contribute certain amount of money or more will get the new product when the targeted amount of fund is achieved. According to Gerber and Hui (2013), the desire to collect rewards is one of the motivations that motivate the funders to support a project. One major advantage of raising fund through rewards-based crowdfunding is the founders do not have to give up equity or accumulate any debt. Another advantage is it offers great potential to promote the next innovative project. Once the founders already established a strong foundation and network, the enthusiastic and loyal previous supporters will continue to support the new projects. In other words, once they have good experience, they will not become hesitated to get involved next time as well. Nevertheless, the founders must have a good plan and well executed project. It is because, if the project fails, the crowd funders' money vanishes all together. If this happens, the possibility to get support in the future will also vanish.
- (iii) **Crowdsourcing:** This refers to some start-up projects that may require collective ideas, skills and expertise to develop new products or project. These sources could come internally or externally, and a person who contributes most maybe given equity in the project.
- (iv) **Equity:** This type of crowdfunding offers the funders the ownership of the company. By funding the startups, they are promised the ordinary shares of the newly formed company. Ahlers et al. (2015) define equity crowdfunding as a method of raising fund by selling a specified amount of equity to a group of small investors through online platforms. These ordinary shares allow the funders equal right in the company, as any common shareholders would have. The drawback is that the shareholders will not be able to easily sell the stocks, as they are not traded in the open market.

Rules and guidelines on equity crowdfunding in Malaysia were introduced in 2015 (Cheah, 2015). Specifically, this act has been tabled through the amendments of the Capital Markets and Services Act 2007, to issue the requirements for the registration of equity crowdfunding platforms in order to provide good governance arrangement to the parties involved. In other words, the main objective for introducing the rules is to regulate equity crowdfunding activities and protect the interest of investors. Among the important rules are:

- (i) the qualified issuer/founder can raise maximum of RM3 million within a 12-month period.
- (ii) the investor/funder can only invest the maximum amount of RM5,000 for each issuer/founder.
- (iii) the maximum total investment amount an investor/funder can invest through equity crowdfunding is RM50,000 within a 12-month period.
- (iv) a 6-day cooling off period is provided for an investor/funder where, during this period, he or she may withdraw the full amount of the investment made.

As of 1<sup>st</sup> July 2015 Securities Commission has approved six equity crowdfunding platforms to carry out the stipulated activities (Siew, 2016; Cheah, 2015). They are Alix Global, Ata Plus, Crowdonomic, Eureeca, pitchIN and Propellar Crowd.

- (v) **Peer-to-Peer Lending (P2P):** This mechanism relates to the lending of money through IT platforms. The crowd invests in the startup of a project in return for interest payment. Collecting the money from the crowd who want to participate raises the amount needed. They are promised a return on the capital invested alongside with interest payment at maturity. One advantage to the funders is that the principal amount is guaranteed to be recovered. Yet, there is always a risk, for example, the bankruptcy or the failure of the founder (Reijman, 2017). Funding Societies is a Malaysian founded peer-to-peer crowdfunding platform aims to help small and medium enterprises (SMEs) to raise capital. Funding Societies offers SMEs and investors alternative financing and investment opportunities, which are fast and hassle-free procedure (Ee, 2017).

To recap, Figure 1 classifies the five-abovementioned crowdfunding types into two broad categories, (1) financial and (2) non-financial.

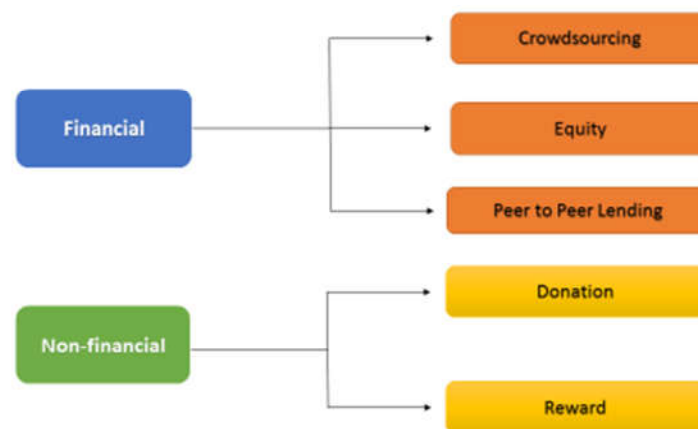


Figure 1 Types of Crowdfunding

### 3.0 CROWDFUNDING: POTENTIALS, CHALLENGES AND IMPLICATIONS

The key driver behind crowdfunding is the concept of open innovation. Consumers' feedbacks can be assimilated into commercialization activities through this crowdfunding activity (Kleemann et al., 2008). Making use of today's easy access to the Internet and social media like Facebook, Twitter and LinkedIn to disseminate the information about a new business, crowdfunding has emerged as an efficient way to attract investors. Pool of funds from a large number of individuals can be easily obtained to finance a project especially a new business venture. Financial crisis and recessions have made small businesses face difficulties in obtaining capital. Due to banks' reluctance to lend to small businesses, crowdfunding has served to be the next best alternative to obtain capital. This lack of bank financing has created a gap of opportunity that crowdfunding can fill. In other words, as banks are becoming more reluctant to give loans, the dynamic crowdfunding provides these businesses an opportunity to start their ventures. As the purposes of crowdfunding vary widely from simple to complex, the motivations of founders and funders also differ significantly based on the nature of the task. Gerber et al. (2012) state three main motivations for people to involve in crowdfunding. 1) monetary, 2) reward and 3) social interactions. Obviously, most founders launch their campaign with the hope to raise enough funds to develop their products. In contrast, the funders participate in order to get the rewards. Nevertheless, crowdfunding platforms are not only intermediaries of monetary transactions, but also platforms for social interactions and community connections (Gerber et al., 2012; Belleflamme et al., 2013). In other words, crowdfunding provides platforms for people to interact and share their thoughts and interests.

Crowdfunding is a promising alternative source of funding offered in addition to other sources of funding such as bank loans and venture capital. The most important element of crowdfunding is trust. This is because start-up financing is provided in the early phase where the risk of default is very high. In other words, the investors of crowdfunding are convinced and confident that the actual project will later be successfully implemented. To increase the probability of success, the founder must clearly signal or articulate their project's value to the potential investors (Ahlers et al., 2015). Crowdfunding is an open call, which pools funds from a large number of individuals in the form of donations or in exchange for some form of reward. Although crowdfunding has been in existence for quite a while, only recently it has gained popularity in line with the development and advancement of social network and its easy access. More businesses especially the start-ups have turned to crowdfunding to get support for their ideas. Crowdfunding creates a win-win situation where the investors are offered compelling rewards such as the chance to be the first owner to a new product in return for the capital invested.

Evidently, understanding crowdfunding is very crucial as slight contribution from individual funders to creators can lead to an establishment of new companies and the recognition of new professional identities that could have an impact on the economic and social function of a community. There are countless incentives awaiting the funders for their involvement. Unlike the traditional fundraising efforts such as securing funds from banks and venture capitalists in which the funders get a promised return for the capital provided, the funders on crowdfunding platforms are neither guaranteed a promised return, nor having assigned any shares in the planned project or the business model created. In return, the funders may receive alternative compensation in terms of tangible or in kinds. These types of compensation will open the prospect to interactively integrate resourceful sponsors in the value creation processes. The funders can also support the projects with feedback and idea generation for design, blueprint and branding. If a project is considered to be worth supporting, the crowd may provide funding for the project to be implemented despite being rejected by the financial institution. Therefore, crowdfunding is also a tool for promoting local projects that would have been unsuccessful due to the insufficient support of the traditional funding instruments.

Some general viewpoints have anticipated the funders' motivations to include the desire for knowledge, social standing, peer companionship, approval, and desire to improve society and to be autonomous. Weng and Fesenmaier (2003) have categorized the motivations of funders into five main

categories, which are instrumental, efficacy, quality assurance, status and expectancy. They provide examples for each category as such: first, instrumental motivations include seeking emotional support, finding peers, relationship buildings, group attachment, expressing identity, and expressing self-esteem, such as using Facebook to expand social network. Second, efficacy motivations in trying to satisfy other members' needs, being helpful to others, seeking or providing advice, and sharing enjoyment, such as engaging in an online forum. Third, quality assurance motivations include controlling products, service quality, and enforcing suggestions or evaluations, such as editing the Wikipedia to ensure correct and up to date information. Fourth, status motivations are such as trying to gain prestige and attain status in the community. Finally, expectancy motivations include seeking future exchange from anybody or someone who could provide help, such as waiting for a reply on a Twitter status. One of the biggest mistakes made by many projects or founders is to assume that launching crowdfunding campaign is as simple as hitting submit and waiting for it to go viral. Utilizing social media is not the only thing that one should do; it requires a decent amount of effort on the part of the project developer.

#### 4.0 CONCLUSION

Crowdfunding is an alternative fundraising mechanism. It is a tool for people to raise capital for a wide-variety of projects and reasons. Through crowdfunding, the founder of the projects can reach thousands or millions of potential investors who can see, evaluate, share and monitor the fundraising campaigns. Crowdfunding platform is also a good platform to test the potential of the new product. If people are interested to invest in the product, then it is a good sign that the product will be accepted in the market. This paper reviews the applications, potentials and challenges of crowdfunding. Popular crowdfunding sites such as IndieGoGo and Kickstarter have become an alternate route for fundraising. Crowdfunding is better to be used when there is an efficient and easy access to the internet. This issue has become the major constraint for people in the developing and third world countries as the system there is not fully developed yet. Undeniably, crowdfunding offers great potential as individuals and organizations may be able to gain from collective pool of knowledge by aggregating ideas, experiences and expertise from various groups of individuals. In addition, there is a great potential of introducing Islamic crowdfunding especially to the investors who look for Shariah compliant investments. While crowdfunding offers great potentials, it is worth noting that legal regulations for both the investors and the users need to be carefully considered and implemented as the risks to investors are high and the expectation of a return on the investment is also high. In conclusion, crowdfunding makes financing easier and possible. It is not only designed for small businesses and startups but also for community or social projects. Understanding crowdfunding is very important in order to ensure that the interest of all parties involved is well protected. The existence of crowdfunding platforms is important, as they are able to generate fund for the new products and projects. In other words, crowdfunding plays an important role to help the creators or founders turn their dreams into reality.

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