CHALMERS

Equity-based Crowdfunding Platforms

Competitive situation in an emerging industry and impact on the Swedish capital market

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Abstract

Background
Crowdfunding is a new way of funding companies and has the last few years experienced a rapid growth. On an internet-based marketplace, business ideas can easily reach potential investors that can provide the entrepreneurs with the capital that is required to make the idea come true. It is therefore a good complement to traditional ways of funding that do not use the capital and wisdom of the crowd. Furthermore, a funding gap in the Swedish market has been identified which primarily is facing small and medium sized enterprises which lack the opportunity to find funding. Crowdfunding could be argued to be a reaction to this problematic situation facing one of the most important forces in today's economy. However, one could crowdfund using several models which creates the need to delimit the scope to better suit the scope of this thesis. Therefore, the part of crowdfunding where entrepreneurs seek funding via equity, equity-based crowdfunding, will be the primary analysis object.

Purpose
The purpose of the thesis is to investigate how equity-based crowdfunding platforms work and how they relate to the Swedish capital market, in order to analyse the competitive situation of platforms and their capability to bridge the funding gap that SMEs are facing.

Theoretical Framework
In order to fulfill the purpose of this thesis a number of theoretical frameworks are used. Porter's five competitive forces model has been used to analyse the competitive situation in the industry of equity crowdfunding platforms, and Christensen's theories on disruptive innovations has been used to investigate the potential disruptiveness of crowdfunding towards the traditional actors on the Swedish capital market. Further, an adaptation of Osterwalder's Business Model Canvas for visualizing the business model of equity crowdfunding platforms is used.

Methodology
The study has been carried out with an inductive, qualitative method, due to its exploratory character of a new phenomenon where data is scarce. The study is primarily based on secondary data from articles, public institutional reports and academic papers. Up-to-date data on for example capital markets has been gathered from continuously updateable sources such as The Swedish Central Bank and the Swedish Agency for Economic and Regional Growth.

Conclusions
Equity-based crowdfunding has the potential to fill the funding gap SMEs are facing. The competitive situation for equity crowdfunding platforms is neither gentle nor fierce; the most prominent threat is the one from new entrants, while rivalry among firms at the moment is gentle. The latter force is however predicted to increase in the future. Furthermore, equity crowdfunding has the characteristics to potentially be disruptive towards traditional actors on the capital market, but must not necessarily be so if crowdfunding platforms and the traditional actors can learn to co-exist.

Sammanfattning

Bakgrund
Crowdfunding är en ny metod för finansiering av företag och har under de senaste åren upplevt en stark tillväxt. På en internetbaserad marknadsplats kan entreprenörer med nya affärsidéer på ett enkelt sätt nå potentiella investerare som kan bidra med det kapital som krävs för att få affärsidén att lyfta. Crowdfunding är därför ett bra komplement till traditionella finansieringsformer. Vidare har ett finansieringsgap på den svenska marknaden identifierats vilket främst små och medelstora företag med få finansieringsmöjligheter står inför. Crowdfunding kan ses som en reaktion på denna problematiska situation. Att använda crowdfunding för finansiering kan göras på flera sätt vilket skapar ett behov av att begränsa omfånget för att bättre passa uppsatsens storlek. Av den anledningen kommer den delen av crowdfunding där entreprenörer söker kapital genom att erbjuda delar av sitt företag, equity-based crowdfunding, att vara i fokus för analysen.

Syfte
Syftet med denna uppsats är att undersöka hur plattformar för equity-based crowdfunding fungerar och hur dessa relaterar till den svenska kapitalmarknaden, för att analysera plattformarnas konkurrenssituation och deras förmåga att överbrygga finansieringsgapet små och medelstora företag står inför.

Teoretiskt ramverk
För att uppfylla uppsatsens syfte används ett antal teoretiska ramverk. För att analysera plattformarnas konkurrenssituation har Porters femkraftsmodell använts, och för undersökningen av crowdfundings potentiella disruptivitet mot kapitalmarknadens traditionella aktörer har Christensens teorier om disruptiva innovationer använts. Vidare används en utveckling av Osterwalders Business Model Canvas för visualisering av crowdfundingplattformars affärsmodell.

Metod
Studien har på grund av sin undersökande karaktär genomförts med en induktiv, kvalitativ metod. Data är huvudsakligen inhämtad från sekundärkällor som artiklar, myndighetsrapporter och akademiska skrifter. Aktuell data för till exempel kapitalmarknaden har hämtats från kontinuerligt uppdaterade källor som Riksbanken och Tillväxtverket.

Slutsatser
Equity-based crowdfunding har potential att fylla finansieringsgapet små och medelstora företag står inför. Konkurrenssituationen för plattformar är varken lugn eller intensiv; den hårdaste kraften är konkurrens från nya aktörer, medan konkurrens mellan befintliga aktörer i nuläget är svag. Den senare förväntas dock öka i framtiden. Vidare har equity-based crowdfunding karaktärsdragen för att vara potentiellt disruptivt mot traditionella aktörer på kapitalmarknaden, men måste inte med nödvändighet vara det om plattformarna och de traditionella aktörerna kan lära sig samexistera.

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1. Introduction

In this first chapter, an introduction to this thesis is made and the phenomenon crowdfunding in particular is presented. The framework within which this study is carried out is set, which includes delimitations, purpose, questions to be answered and definitions.

1.1 Background

During the last decades, the digital revolution has in an extraordinary way developed how we communicate. Never before have so many people had the possibility to exchange thoughts and ideas with each other, regardless of the physical distance between them. Effective communication increases the speed of which information is spread. This leads to decision making as well as operational processes moving faster and hence accelerating business in many ways. One particular branch of business that has benefitted from the digital revolution is trade. Since information can be transferred to the counterparty in a transaction immediately, the time to a successful exchange is short. The time is shortened even more if the goods traded also can be transferred in the same way as the information about the goods. This is nowadays the case of money and financial instruments. However, even though speed is crucial, effectiveness is as important. When it comes to financial markets, effectiveness is about channeling capital in an effective way from those who have to those who need, i.e. in as few transactions as possible. Since money and financial instruments are heavily traded, trade patterns in the financial markets are complex, and tend to be more complex with the diffusion of digitalization. Many private investors are in a position where they do not know what their savings are used for, because of the increasing number of transactions between them and the counterparty. A reaction to the lack of transparency is crowdfunding, a new emerging phenomenon deriving from crowdsourcing, a method for engaging the crowd to solve a problem. Crowdfunding is a way to raise capital by asking the broad mass for funding, instead of only one party e.g. banks or institutional investors. What makes crowdfunding interesting is, firstly, that it competes with the traditional activities carried out by financial intermediaries. Secondly, crowdfunding is rapidly growing in size. According to Massolution (2015), global crowdfunding grew by 167 percent in 2014 reaching $16.2 billion and is further projected to double again in 2015. This is notable since the total amount crowdfunded back in 2011 was only $1.5 billion (Montini, 2011). Thus, the need to analyse this phenomenon is deriving from the combination of rapid growth and challenge against existing financial structures. However, the subject crowdfunding is wide and in order to better suit the scope of this thesis some delimitations are required.

1.2 Delimitations

Crowdfunding could be carried out in different ways which makes it hard to analyse as a single process. Since the different ways of doing crowdfunding attract different investors and companies as well as operate under different legal restrictions, a single analysis of

crowdfunding as a whole would be too comprehensive for this thesis. Therefore, a decomposition of the phenomenon is necessary.

Crowdfunding could be divided into two main models; donation and investment crowdfunding. The first model can be used to raise money for a good cause, for a creative project or for buying products and services before they are produced. The second model can be used to lend money with interest, or for buying equity and hence becoming a shareholder. The main difference between the two models is that investment based crowdfunding involves future yield requirements which are not present in donation crowdfunding where no real obligations are present. Even though donation crowdfunding is larger in the total amount of capital collected, the characteristics of investment crowdfunding makes it more interesting to observe since it could be a potential threat to some actors active on the financial market.

In theory, investment crowdfunding could be applied to any company no matter of size. In reality, some companies could potentially benefit more than others. A specific company segment, when considering size, is the small and medium sized enterprises (SME). SMEs are defined by the European Commission (2014) as companies with less than 250 employees and turnover smaller than €50 million or balance sheet total smaller than €43 million. These companies lack the opportunity to raise capital in the same way as large ones. Since many of these companies do not have a sufficient cash flow, it is hard to raise debt capital as it requires continuous yield payments. In these cases, capital raised by equity is a better solution. The problem explained is identified by the Swedish Agency for Economic and Regional Growth (Tillväxtverket, 2015) as the funding gap facing SMEs. Hence, crowdfunding would be more beneficial to SMEs if compared to large companies. Therefore, this thesis will focus on this problematic and thus restrict its scope to include equity crowdfunding towards SMEs. In addition, the geographical scope has also been delimited to only contain the Swedish crowdfunding market. This is due to the lack of previous work on this particular market and due to the variation in legal restriction between countries.

The delimitations can thus be summarized in one line. This thesis is delimited to investigate Swedish equity-based crowdfunding directed towards small and medium sized enterprises.

1.3 Purpose

The purpose of the thesis is to investigate how equity-based crowdfunding platforms work and how they relate to the Swedish capital market, in order to analyse the competitive situation of platforms and their capability to bridge the funding gap that SMEs are facing.

1.4 Questions

To fulfill the broader purpose of this report, three questions have been identified as crucial.

- What is equity-based crowdfunding, does it bridge the funding gap and how does it contribute to a sustainable development?

The intention of the first question is to lay the foundation upon which further analysis is built. This includes comprehensive analysis of the phenomenon in order to fully understand its character and dynamics.

- What level of profitability do existing and emerging Swedish crowdfunding platforms face?

The second question elaborates upon the first by adding a competitive focus. It also includes a more narrow perspective when the Swedish crowdfunding market is investigated.

- Is equity-based crowdfunding a disruptive innovation and hence a threat to current financial structures?

The third question also elaborates upon earlier questions. The goal of this question is to predict the future of equity crowdfunding by observing its dynamics and competitive status.

1.5 Definitions

Before an analysis of equity crowdfunding on the Swedish market can be conducted, one has to define what the Swedish crowdfunding market actually is. The Swedish crowdfunding market could be defined by looking at the buyer's side, i.e. those who have capital to invest. The definition could therefore be; transactions and exchanges related to crowdfunding where the buyer is a Swedish citizen or company, take place on the Swedish equity crowdfunding market. However, the difficulty defining the market by buyers is that it, in practice, is hard to categorize specific transactions. A company seeking capital could have investors with several different nationalities which thus would result in the firm acting on several markets at the same time. Hence, this definition is not viable for equity crowdfunding.

Since investment crowdfunding has a lot in common with the stock and debt market, it is natural to observe how the Swedish markets are defined. What is usually referred to as the Swedish stock market consists of five different marketplaces. On these marketplaces, both Swedish and foreign investors buy and sell stocks issued by Swedish and international firms. Even though many of the involved parties are not Swedish, the transactions are taking place in the Swedish market. The definition is in this case based on the location of the marketplace. Therefore, one potential definition of the Swedish crowdfunding market would be crowdfunding platforms registered in Sweden.

One could also define the Swedish crowdfunding market on the basis of suppliers i.e. those who seek capital. This states that firms registered in Sweden that are seeking capital would be accounted for as acting on the Swedish crowdfunding market. As the phenomenon is somewhat new, there is no clear established definition. It leaves this thesis the opportunity to define it to suit its purpose. Hereafter, the last definition will be used and Swedish crowdfunding market will therefore refer to Swedish SMEs seeking capital through crowdfunding.

It is also necessary to define the Swedish capital market since one part of the purpose of this thesis is to consider what implications crowdfunding has on the Swedish market. However, the majority of companies are active in more countries than only Sweden. This makes it hard to draw a distinct line between what is Swedish capital and what is international capital. In a report about the Swedish capital market issued by the Swedish Central Bank, (Riksbanken, 2014a), the definition is based on national statistics from Swedish financial legal entities. Since this thesis uses some of these statistics it is hence suitable to use the same definition.

1.6 Thesis Structure

This thesis consists of seven chapters, as visualized below (Figure 1), where the first chapter is this introduction. Chapter 2 presents the theoretical frameworks upon which the analyses have been built. Chapter 3 describes the methodology used in conducting the work of the thesis with an emphasis on how the data collection has been carried out. In chapter 4, an overview of the current Swedish landscape for funding of SMEs is presented in order to investigate the environment in which equity crowdfunding exists. Chapter 5 describes the phenomenon of crowdfunding in general and equity-based crowdfunding in particular. Furthermore, the legal status of equity-based crowdfunding is investigated and prominent actors on the Swedish market are presented. Together chapters 4 and 5 constitute the empirical part of the thesis. In chapter 6, analyses are performed based on the theoretical frameworks and empirics provided in earlier chapters. In the final chapter, conclusions are made based on the analysis in chapter 6 in order to answer the research questions presented in the introductory chapter.

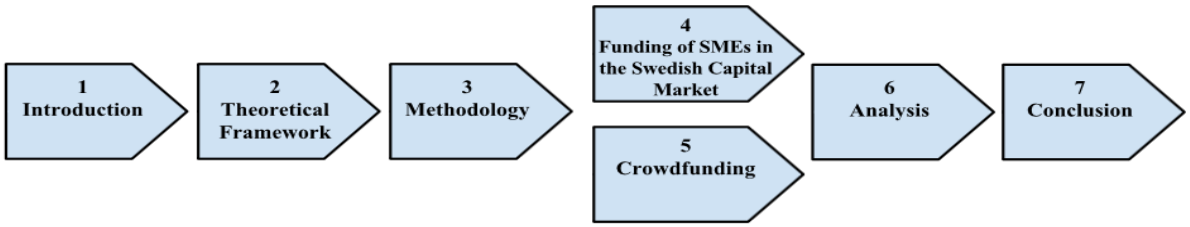

Figure 1: A visualization of the thesis structure.

2. Theoretical Framework

In this chapter the theoretical frameworks, which acts as the foundation upon which further analysis is built, are presented. Good understanding of these frameworks is needed in order to answer the crucial questions identified. To be more specific, the outlined frameworks are; Porter's Five Forces, Christensen's thoughts on disruptive innovation and Ladhe, Magnusson & Nilsson's Platform Business Model Canvas.

2.1 Porter's Five Forces

Managers tend to often define competition as actions among firms within an industry. The definition is, however, too narrow since it is not only what happens between competitors that affect the overall profitability of the industry. In an article in the March 1979 issue of the Harvard Business Review, Michael E. Porter (1979) introduced a framework to capture the external factors that affect industry profitability. He refers to the factors as forces that put the industry under pressure from different directions. The higher the pressure, the less opportunity firms have to attain high returns, and vice versa. In addition to the force Rivalry Among Firms, which is to be seen as the traditional factor affecting profitability, Porter present four additional forces; Bargaining Power of Suppliers, Bargaining Power of Buyers, Threat of New Entrants, and Threat of Substitutes. The framework is commonly known as Porter Five Force Analysis. The impacts of the five forces on an industry are visualized in Figure 2 below.

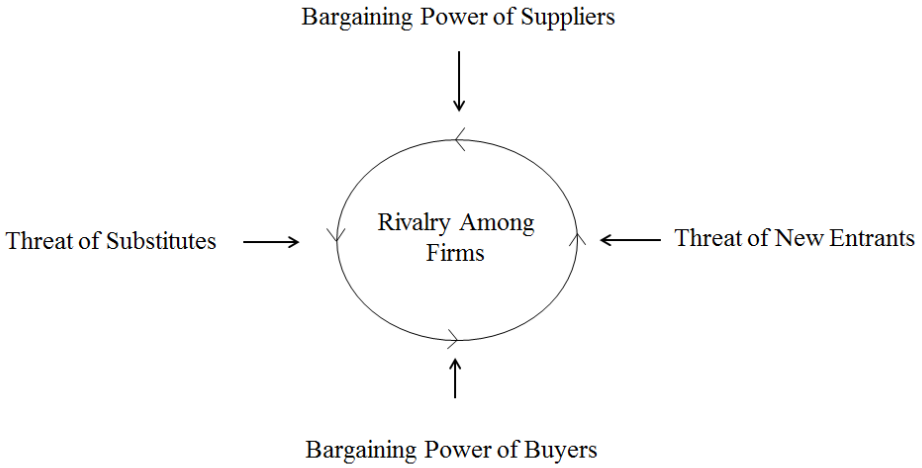

Figure 2: Visualization of Porter's Five Forces pushing industry profitability, showing one internal and four external forces. Adopted from Porter (2008).

The amplitude and presence of each force differ vastly among industries. Porter (2008) presents an illustrative example of this. The market for commercial aircraft has essentially two dominant producers, Boeing and Airbus. Although it looks like an oligopoly, these two producers are facing furious competition due to the strong bargaining power of their customers, the airlines. Thus, the industry profitability is hence decreasing even though other

forces such as threat of substitutes and threat of new entrants are minimal. The market for commercial aircrafts is then compared to the market of movie theatres. Here the threat of substitutes, such as Blu-Ray and Netflix, makes up for a major part of the overall pressure put on the industry. The case makes it clear that all forces have to be taken into consideration when examining an industry, but focus should be distributed equally to the relative size of the different forces. The characteristics of each force will be further discussed below.

2.1.1 Threat of Substitutes

A substitute is according to the Oxford Dictionary (2015a) "*A person or thing acting or serving in place of another*". A well-known example is e-mail acting as a substitute to traditional mail services. Substitutes can also be present indirectly. For the manufacturing firm producing manual screwdrivers, the advent of electrical, automated screwdrivers is a serious direct substitute. On the contrary, the increased demand of craftsmen in Sweden, due to the recent tax discount often referred to as ROT, reduces the need to do home improvements on your own. Thus, the general change in attitude towards home improvements acts as an indirect substitute to manual, as well as automatic, screwdriver manufacturers. The manufacturer's strategic response to this event could be changing customer focus from families to more demanding craftsmen, which in the end probably affect the characteristic of the product offering. This example highlights the need to understand the surrounding of the firm, and why the five force framework makes sense in a strategic perspective. It also highlights the fact that threat of substitutes easily could be overlooked since the indirect way it affects the firm sometimes is not evident.

In the article "The Five Competitive Forces That Shape Strategy", Porter (2008) emphasizes two factors that, if present, results in a high threat of substitute. The first factor is how well the substitute offers an attractive trade-off between price and performance. Again, e-mail offering a superior performance, i.e. almost removing delivery time, as well as reducing the marginal cost of sending information to nearly zero makes it a high threat to traditional mail services. The second factor that affects the level of threat to existing products and services are the costs associated with changing way of doing things, commonly known as switching costs. To send an e-mail you either need a computer or a smartphone, which you will have to purchase for an amount largely exceeding the cost of materials needs to write and send a letter. In addition to this monetary cost there could also be costs in terms of effort. It takes effort to learn how to use the computer, or smartphone for that matter, which reduces the threat towards mail services. This is obvious when studying the senior part of the population that normally has to put a higher amount of effort to learn how to deal with e-mails and therefore slow the transition from traditional mail to e-mail.

2.1.2 Rivalry Among Firms

To understand what amount of pressure the rivalry among firms within an industry put on the overall profitability, one has to examine the intensity of the rivalry and on what basis it acts. There are some criteria used to determine the intensity of the rivalry. Firstly, the intensity of rivalry is about decreasingly proportional to the number of other equally sized firms active in the industry. Secondly, intensity depends on industry growth. If an industry barely grows, stays the same or even decreases in size, firms will not compete for new customers. Hence, a

firm has to attract customers from another firm in order to grow, which results in lower profitability. Consequently, if the industry has a stable growth rate, firms compete for new customers which will keep the profitability at an acceptable level. Thirdly, exit barriers keeps unprofitable firms in the industry which will make changes in market share distribution slow, and eventually affect the profitability of healthy firms. Fourthly, there could be firms within the industry that have other reasons to operate than purely economic. Large firms could act in an industry to complement their product offering. In this case, the part of the firm operating in this industry might not be profitable, but will create value in other industries that the firm is involved in. Lastly, the intensity is affected by how well firms understand each other, and how competing firms react to specific events.

The combination of these criteria determines the intensity of rivalry. But for the overall degree of rivalry in an industry it counts for a smaller part than on what basis the firms compete. The basis could be seen with the concept of Generic Strategies Porter (1980) presents in his book "Competitive Strategy" in mind. He introduces three generic strategies as Cost Leadership, Differentiation and Focus. The first, cost leadership implicates that the firm mainly competes by offering low prices to all industry segments. The second, differentiation, implicates that the firm mainly competes by offering other attributes, e.g. high quality products or a large service network, to all industry segments. The third, focus, implicates that the firm mainly competes by either cost leadership or by differentiation but to selected industry segments. The basis mentioned earlier could directly be translated to strategic strategies. Thus, firms that compete with cost leadership form one basis. The cost leadership basis is by its character less profitable. Porter captures this as;

"Rivalry is especially destructive to profitability if it gravitates solely to price because price competition transfers profits directly from industry to its customers". (Porter 2008, s.9)

On the contrary, firms competing with differentiation do not erode profitability in the same way as those competing with price. The reason for this is by offering other attributes and differentiating from competitors, the firm creates products and services of higher value. Thus, price could be set to keep profitability high.

In summary, what affects rivalry among firms within an industry depends first on what basis they compete, and second on the intensity of rivalry on that particular basis.

2.1.3 Bargaining Power of Suppliers

Firms usually have many different suppliers to support them with products and services. Several suppliers could support the same goods as well as one supplier supporting a wide range of products (Jonsson & Mattsson, 2005). For this reason, it is no surprise that bargaining power differs vastly among groups of suppliers. The pressure on the industry's profitability depends on the relative power between the suppliers and the firms within the industry. Industries relying on one or a few suppliers face suppliers that will erode the industry's overall profitability, unless firms have the ability to pass high prices on towards buyers, this factor is further referred to as concentration. It is even higher pressure from suppliers if the industry represents a small part of the supplier's revenue. If, however, the dependency is the other way around i.e. suppliers depend on the industry, firms within the

industry could transfer profitability from their suppliers to themselves. This latter dependency is clear in the city of Gothenburg, Sweden. Gothenburg is home to two of the largest companies in Sweden, Volvo and SKF. Both companies have large numbers of suppliers situated in the local area. Some of these rely heavily on e.g. Volvo, in terms of revenue, and hence lack bargaining power. This could be devastating if Volvo chooses to change supplier strategy. Furthermore, switching costs and supply chain movements are important to take into consideration when studying the bargaining power of suppliers. Switching cost has been explained in the section outlining the threat of substitutes and thus needs no further presentation. Since supply chain movements are a matter of both suppliers and buyers, it can be analysed from both perspectives. This concept will be further explained in the upcoming section of bargaining power of buyers.

2.1.4 Bargaining Power of Buyers

If the bargaining power of suppliers could be represented as one side of a coin, bargaining power of buyers will represent the other side. It is a change of perspective and the pressure an industry is able to put on its suppliers could be equally put on the industry by its buyers, if conditions are similar. It is therefore important to analyse the same factors affecting buyers as it is when analysing suppliers. Actions that are possible both up and down the supply chain for industry incumbents are to, what in previous section is referred to as supply chain movements, threaten either suppliers or buyers to start operating in any of their industries. This action could successfully be used when, for example, suppliers operate in an industry with significantly higher profitability. Beer producers are known to threaten the can producers to enter their industry and hence remove a significant fraction of their sales. This would push profitability up the supply chain. When considering an industry the most important part of supply chain movements are to consider the fact that buyers and suppliers could do the same move by entering the industry.

However, a firm in an industry has to understand how price sensitivity differs among groups of buyers. If the buyer puts a small fraction of overall expenses in the industry, the buyer is likely not price sensitive. On the other hand, if the buyer puts a significant part of overall expenses in the industry it is more likely price sensitive. In addition, if the product has small effects on the buyer's product, price is often in focus. When it comes to bargaining power of buyers, one do not need to differ between buyers that are end users and buyers that refine the product and sell it to the next part in the supply chain, also known as intermediate customers. The dynamics of price sensitivity, for example, affects both cases equally. Nevertheless, intermediate customers gain improved bargaining power down the supply chain.

2.1.5 Threat of New Entrants

New entrants bring more resources and capacity into an industry to capture market share. This puts pressure on existing firms since more firms have to share the same industry revenue, unless the industry has a rapid growth. However, some industries require more effort from firms to enter than other. This phenomenon is known as Barriers to Entry. The threat of new entrants depends on the height of these barriers.

The definition of what an entry barrier "is" has taken many different shapes since the term was first introduced in the fifties. Preston McAfee, Mialon and Williams (2004, s.463), describe past definitions and how they relate to each other in order to present their own definition of Antitrust Entry Barriers as:

"Cost that delays entry and thereby reduces social welfare relative to immediate but equally costly entry".

Furthermore, they distinguish between antitrust barriers and economic barriers where the latters are defined as:

"Cost that must be incurred by a new entrant and that incumbents do not or have not had to incur" (ibid, 2004)

Consequently, all economic barriers are antitrust barrier, but not the other way around. Because of the, in some cases, vague difference between these types of barriers this thesis will hereafter use the broader and more common term entry barrier when referring to factors that prevent new entrants from entering an industry.

Further, Porter (2008) has through his work with refining his framework identified several major factors that affect industry entrance. These factors are; economies of scale, demand-side benefits of scale, customer switching costs, capital requirements, incumbency advantages independent of size, unequal access to distribution channels and government policy. Some of the factors are self-explained such as economies of scale, capital requirement, unequal access to distribution channels and government policy, and hence need no further explanation. Nevertheless, the means of demand-side benefit of scale might not be obvious. The benefit arises when the attractiveness of the product depends on the number of customers finding it attractive, commonly known as network effects. The barrier is clear in industries such as social media. Further, if firms within an industry are good at locking up customers in long-term contracts, changing vendor would be troublesome for customers and hence the attractiveness of new entrants falls if switching costs are high. There are, however, some advantages incumbents have over new entrants that normally stem from being early in the industry, and thus not depending on the size of the firm. One such advantage is the opportunity early entrants have to choose a suitable geographical location for their business. Brand identification is usually also a matter of time in the industry.

In conclusion, the magnitude of the threat of new entrants depends mostly on the industry structure and hence not on the entrants themselves. Firms within industries use this as an advantage by building barriers around its industry. Seven major factors have been identified as present at each and every industry. However, the magnitude of each factor differs vastly among industries.

2.1.6 Criticism and Extensions of Five Forces

Porter first published his framework in 1979 and more than 35 years later the framework is still useful, even though no changes have been made. Over the years, several extensions of the framework have challenged the basic five force model, usually by extending the number of forces.

2.1.6.1 The Sixth Force

The most common new sixth force has been either government or complementors. Government policies as well as complementary products and services affect the profit potential of an industry and should therefore be taken into consideration when conducting an industry analysis. According to Porter, the right way to account for these factors is by considering them just as factors and not as forces. The reason behind this distinction is that these factors could affect the overall profit potential either positively or negatively. Forces on the other hand are used to determine pure pressure on the profit potential, which is negative from the competing firms' point of view. Porter hence argues that factors affect one or many forces, in a positive or negative way, which in turn affects profitability. For example, a government's patent policy could, from a competing firm's point of view, be either positive or negative depending on what decision is being made. If the government extends the time period the inventor may withhold information from being public, entry barriers would rise and thus result in higher industry profitability. The effects would be reversed if the government instead would shorten this time period. However, this example shows that a particular decision affects a particular force and not directly the overall industry profitability.

Another example stresses that complements should be seen as a factor. This follows from the same logic that it could affect overall profitability either positively or negatively depending on which force you pay attention to. Entry barriers in the software application industry have continuously been lowered when more and more tools for writing new applications have been provided. The entrance of more firms in the computer hardware industry will furthermore push prices down and hence lower entrance barriers to developing software applications even more.

2.1.6.2 Inadequate Assumptions

Another criticism of Porter's five force model is about inadequate assumptions that have to be made in order to use the framework. Coyne and Subramaaniam (1996) highlights three such assumptions; (1) actors in the form of competing firms, buyers, sellers and substitutes are unrelated and clear distinctions can be drawn between each and every of them, (2) value comes from structural advantage i.e. from building entry barriers and (3) uncertainty is low which makes predictions of other actors strategic movements easy.

With the start of the IT-era, distance between people has drastically decreased. The same development holds true for firms. This has resulted in a new kind of industry structure emerging, *Co-dependent systems* or *Web structure*. The structure relies on a common architecture that all firms use and that creates positive network effects. The success of a single firm is therefore dependent on the firm's own actions within the web as well as the behaviour of the whole web. Thus, keeping the traditional arm length distance to competitors could be harmful and hence counterproductive. Another non-traditional industry structure is *Privileged relationship*, which basically implies that firms give other firms special treatment in order to receive financial benefits or other benefits in terms of trust, loyalty or friendship. The financial structure does have the characteristics of the web structure, making the assumption of clear distinctions between companies, buyers and sellers hanging. However, since the

purpose of this study has been restricted to treat SMEs on the Swedish equity crowdfunding market, it has also been possible to clearly define the different parts involved.

The second assumption about structural advantage being the ground on which to build profit is challenged by the fact that competitive advantages could be built on *Frontline execution* as well as *Insight/Foresight*. The first, Frontline execution, refers to firms in structural disadvantages who constantly outperform firms with structural advantages in day-to-day activities. The second, insight/foresight, refers to advantages that stem from having superior knowledge and hence better possibility to make correct decisions.

The last assumption mentioned as critical is that uncertainty is low. If the industry lies in the end of the uncertainty-spectrum where traditional microeconomic models hold true, then traditional frameworks such as Porter's five forces is applicable. In the other end of the spectrum, uncertainty has the character of multiple dimensions and a continuous scale along each dimension. Traditional frameworks are not suitable in this end. Instead, methods using game theory, latent demand analysis and evolutionary models are advocated (Coyne & Subramaaniam, 1996). Since the future is hard to predict, many industries tend to have a high amount of uncertainty and are hence in need of non-traditional analytical tools in order to do an adequate industry analysis. As a response to this, the future has always been hard to predict. The quote of Thomas Watson (Strohmeyer, 2008), President of IBM in 1943, makes this clear: "*I think there is a world market for maybe five computers."* Porter (2008, s.16) is aware of this and states that a common pitfall when conducting a five force analysis of an industry is to *"use static analyses that ignores industry trends"*. This means that the framework could be applied to an evolving industry, but that one has to account for market trends using other theory. The fact that the knowledge of overall dynamics is requested and that a complementary disruptive analysis will be conducted, makes Porter's framework motivated as a theoretical foundation for this thesis.

2.2 Disruptive Innovation

In 1997 Harvard Professor Clayton M. Christensen (1997) released the book "The Innovator's Dilemma" in which he describes a phenomenon he calls disruptive innovations. According to Christensen there are two types of innovations: sustaining and disruptive innovations. The characteristics of sustaining innovations are that they improve the performance of established products, meet the demands of mainstream customers in large markets and are mainly developed by established firms. On the contrary, disruptive innovations are developed by entrant firms, generally underperform established products in the mainstream markets, have new features that create new customer value and are cheaper, simpler, and more convenient to use. Disruptive innovations start at the low-end of the market, where it is not interesting for established firms, but over time the performance improves to a point where it can compete with the current dominating market offering. This is where the disruptive technology becomes competitive against the offering of established firms (see Figure 3 below).

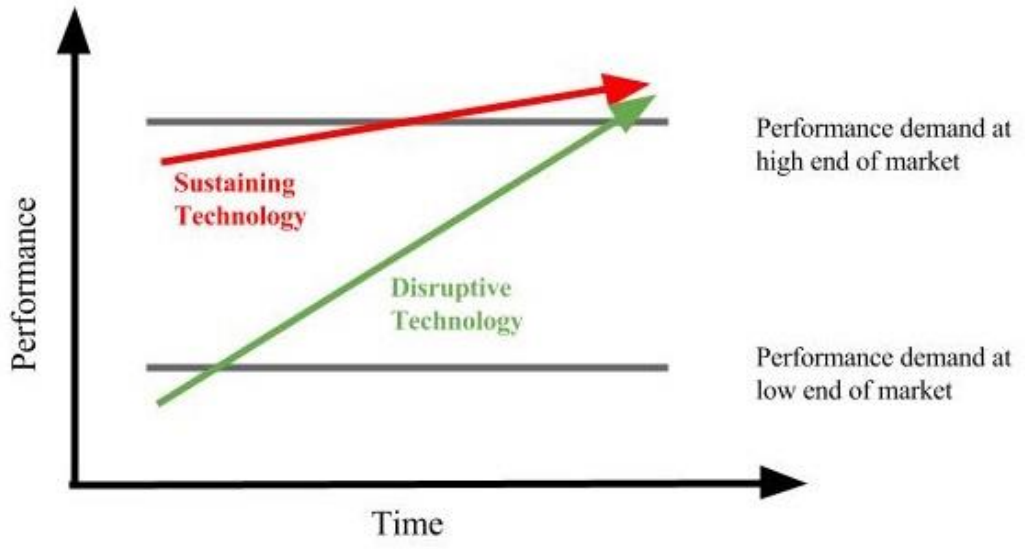

Figure 3: Disruptive and Sustaining Innovations. Adopted from Christensen (1997).

2.2.1 Managing Disruptive Technological Change

Christensen suggests a methodology and a way of thinking to handle disruptive technological change. Furthermore, a strategy for determining whether a technology can be considered to be potentially disruptive or not is presented.

From the point of view of the mainstream company, some important questions that need to be answered in order to determine if a technology is disruptive are according to Christensen: How much do we need to worry about the technology? Does it pose a legitimate disruptive threat to companies in the mainstream market? Does it have an opportunity for profitable growth?

To answer these questions, one method that Christensen provides is to study the trajectories of performance improvement supplied by the technology and compare it to market needs. In this, the first step is to define what the current mainstream markets' needs are and then to compare them with the current capacity of the technology. When doing this, the typical disruptive technology will be deficient in terms of functionality than what the mainstream market wants and compared to other technologies. But the technology can only be regarded as disruptive if it has the potential to be competitive in the mainstream market in the future. To assess this, it is necessary to draw the trajectories. If the performance improvement of the technology is faster than the increasing market needs, this means that the technology will be competitive in the future, and can be regarded as potentially disruptive. However, if the trajectories are parallel, the technology is unlikely to be competitive in the future.

Christensen further explains that it is not possible to use disruptive technologies in the mainstream market in the beginning of development, but as long as there is a market for the technology it has the possibility to evolve and move upmarket, resulting in it being competitive in mainstream markets in the future.

2.3 Business Models

In his book "Business Model Innovation Factory" Saul Kaplan (2012) discusses how executives and corporate employees often lack a complete understanding of their business model. It can however be useful to map out the business model since it helps to understand the essentials of a company such as who the targeted customer is, what needs are fulfilled and how revenues are generated. It may also be useful to analyze models of other companies since these can be used as analogies. A business model is defined by the Oxford Dictionary (2015b) as:

"A plan for the successful operations of a business, identifying sources of revenue, the intended customer base, products and details of financing"

Alexander Osterwalder has summarized the concept on a chart called the Business Model Canvas (Strategyzer, 2015) which consists of nine separate building blocks, each dealing with a specific aspect of the business model. The blocks are as visualized in Figure 4 customer segments, value proposition, customer relationships, channels, revenue streams, key activities, key resources, key partners and cost structure.

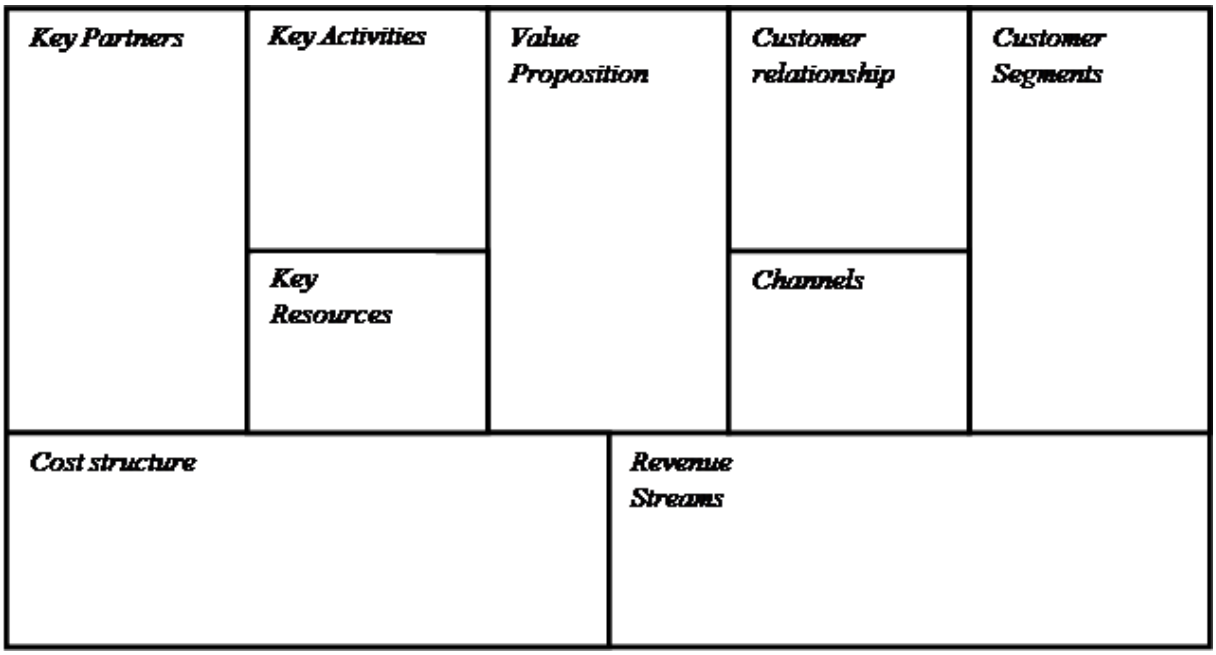

Figure 4: Business Model Canvas. Adopted from Strategyzer (2015).

The Business Model Canvas is built around the central value proposition which is the core of the business model. To the left there are key elements required in order to create the value proposition. Some of these are carried out together with suppliers. To the right of the central value proposition are element connected to the distribution of value. Similarly, these elements are involving customers. Below all segments are the cost structure and revenue stream which acts as the heart of the business by transferring money across the company.

The business model canvas was created in order to explain traditional companies' business models. However, in the last years new kinds of companies with different structures and business models have appeared. This requires new tools for analyzing business models. In the 2013 article "Introducing the Platform Business Model Canvas: Adapting an existing business

model conceptualization to challenging institutional logic" Ladhe, Magnusson & Nilsson (2013) argue that the business model conceptualization needs to be adapted in times of shifts in institutional logic. More specifically, they criticize Osterwalder's conceptualization for having substantial shortcomings when it comes to modeling business models for businesses using a platform strategy, where multi-sided markets and value co-creation between the actors is a vital part. The authors propose an adaptation of Osterwalder's Business Model Canvas, which is better suited for platform strategies, and calls it the Platform Business Model Canvas.

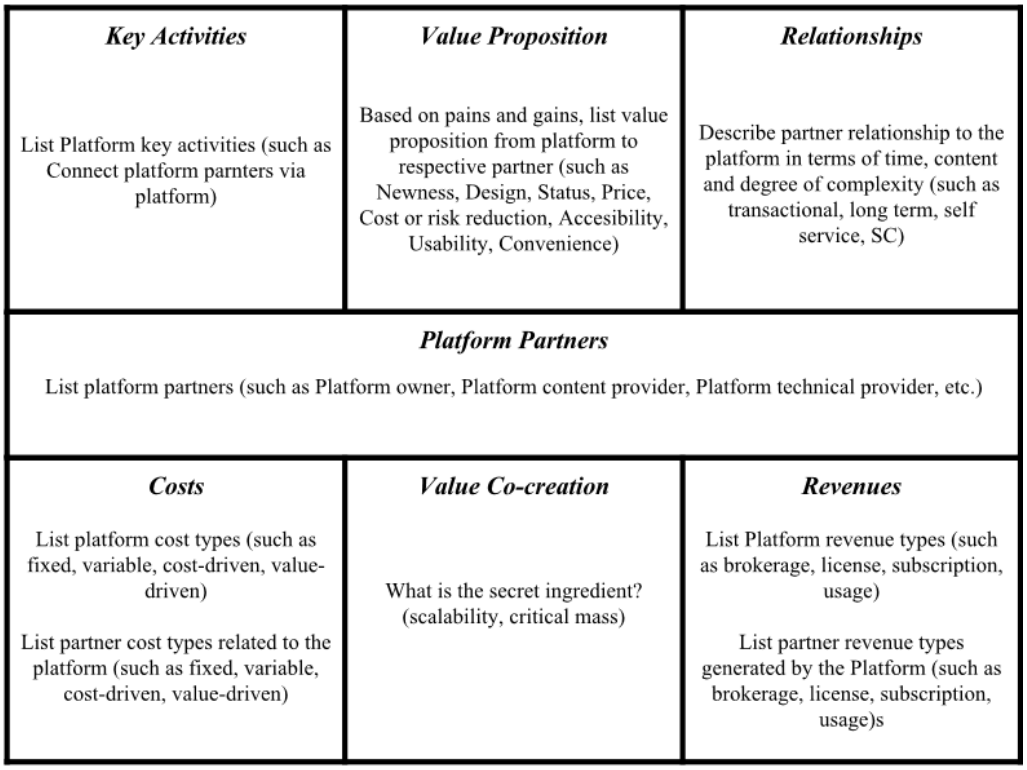

Figure 5: The Platform Business Model, re-modeled Business Model Canvas in order to better suit the business model of platforms. Adopted from Ladhe et al. (2013).

The object of analysis is changed from the firm to the platform, *Channels* is removed since the platform itself is the only channel, *Key resources* is removed because of the multi-actor perspective, *Customer segments* and *Key partners* is aggregated into Platform partners, Value co-creation is added to highlight that value is co-created on the platform, *Customer relationships* is changed into Relationships that are mediated via the platform, and finally, *Value proposition* now relates to value from platform to respective partner (Ladhe et al, 2013).

3. Methodology

In this chapter the methodology used in order to fulfill the purpose of the thesis is presented. It starts by outlining the research approach and the two-part purpose. Furthermore a literature review and the process behind the interview conducted are presented. The chapter ends with a section of self-reflection about the methodology used.

3.1 Research Approach

There are according to Wallén (1996) two main research approaches which consider the relation between theory and empiricism. These are induction and hypothetico-deductive. Simply put, induction means to make theoretical conclusions based on empirical data. This approach has been criticized because it only uses data collected from empiricism. When conducting a hypothetico-deductive study, a hypothesis is made based on theory. The hypothesis is then tried against empirical data to fortify its substance. There is an additional approach, abduction, which requires knowledge of the area and thus is less suitable when conducting a study of a new phenomenon.

The purpose of this thesis could be divided into two elements. The first is to investigate and outline the dynamics of existing equity crowdfunding platforms. The second is to analyze the competitive and disruptive situation of these platforms. This study could hence be divided into an explorative and an explanatory part. Both these parts have to be investigated according to economic theory because of equity crowdfunding's characteristics and contribution to the economy. However, some economic theories are not as strict and consistent as science-based theory. This is a result of using induction when economic events have been observed, as well as the fact that the use of assumptions is more common in economic theory. The most common assumption could be argued to be that all humans act rationally, which does not hold true in all cases. If the underlying events thus change, the theory also has to change accordingly. The problem is that humans, that are keystones of economic events, change more than physical phenomena, which are the foundation of science-based theory. Hence, the hypothetico-deductive approach would lack the stable theoretical basis if considering equity crowdfunding. Thus, the choice of using the inductive approach in this study is motivated. The choice is further motivated by Wallén (1996) who states that studies of exploratory character often have to use the inductive approach.

Furthermore, the study has to be classified as either quantitative or qualitative. Since equity crowdfunding is a relatively new phenomenon in an expanding phase, it is hard to find sufficient data to support a quantitative study. Even though some data is available, it is not enough to support the purpose of this study which needs another approach. Qualitative studies are needed if one only has access to a few cases, or if the characteristics of the object observed have to be set (Wallén, 1996). There is no strict definition of what is quantitative and what is qualitative and the line between these approaches is blurred. However, the criteria for where a qualitative approach is needed do better match the condition of equity

crowdfunding and the overall purpose of the study. Therefore, a qualitative approach would in this case be a better choice.

3.2 Literature Review

In general, the study this thesis presents is based on secondary data. The primary sources of information are articles, public institutional reports and academic papers. In addition, many web pages have contributed by offering up-to-date empirical information on the subject. This is especially true when it comes to equity crowdfunding platforms since not much has been previously written. In most of the research that has been done, the focus lies on the company that seeks funding or on the funder that looks to invest. However, it is not only equity crowdfunding that is evolving. Even the financial structure is continuously evolving making continuously updateable sources of data useful e.g. government agencies', such as The Swedish Central Bank and the Swedish Agency for Economic and Regional Growth, websites. All sources of data have been critically evaluated in order to strengthen the outcome of this thesis. Since some data easily gets out- or updated, different articles and reports have been compared to find the most accurate source of specific data. This has been done throughout the work of writing this thesis in order to find the most reliable sources of data to further maximize the credibility.

Information has mainly been gathered in order to answer the question about the characteristics of equity crowdfunding. Since equity crowdfunding is larger in other parts of the Western world than in Sweden, reviewed articles and publications do often refer to foreign markets. The choice to use this kind of data is motivated by the fact that the financial structures of the rest of the Western world are similar to the one of Sweden. However, one aspect that differs between Western countries is legal restrictions of equity crowdfunding. To accurately outline and understand which legal restrictions there are, an interview with Kajsa Liedén, who is an expert in equity crowdfunding at the law firm Jansson & Norin, has been conducted as a complement to the secondary information gathered.

The analysis of industry profitability has been carried out within the theoretical framework of Michael E. Porter which he refers to as five forces. Inspiration has mainly been gathered from the article "The Five Competitive Forces that Shape Strategy" published in the Harvard Business Review 2008. This article explains the framework Porter first presented in his book "Competitive Strategy" published in 1980. The article also includes his own comments on criticism of his model, which makes it a valuable data resource in combination with the original book. Complete references to these works could be found in the reference list of this report. The fact that a Harvard Business School researcher compiled a framework 30 years ago which is still taught to university students signalize its credibility.

The question about the disruptive character of equity crowdfunding is answered by using Clayton Christensen's thoughts on the subject of disruptive innovations. He presents some characteristics that are common among this kind of innovations. These characteristics are later compared to the ones of equity crowdfunding. Clayton Christensen is also connected to

Harvard Business School where he holds the title Kim B. Clark Professor of Business Administration. Furthermore, he coined the term "disruptive innovations" and is considered one of the world's top experts on innovation and growth.

3.3 Interview

The qualitative approach of this study does affect the characteristics of the interview and the questions asked. The questions have to be well-formulated in order to make it possible for the one being interviewed to describe and explain his or her thoughts and ideas of the subject (Wallén, 1996). As always, questions should not be directive to avoid the chance of obtaining misleading data. However, the questions used in this interview were low structured and held a low level of standardization. This is according to Patel and Davidson (2011) the right setup for a journalistic interview.

The interview conducted with Kajsa Liéden at Jansson & Norin was held in a relaxed atmosphere at her office in central Gothenburg, Sweden. It is suitable to use a place that has some kind of connection to the subject (Wallén, 1996). Liedén works as a business lawyer and has conducted a master thesis on the subject equity crowdfunding. The thesis has been analyzed with regard to the level of dependability that a master's thesis can provide. The thesis was built on regulations that cannot be questioned legally, but also personal reasoning that we have evaluated more diligently. Despite the fact that she graduated 2014, she is one of few lawyers in Sweden that has been involved in equity crowdfunding which is why she is a suitable interviewee. Hence, the focus of the interview was on legal restrictions facing equity crowdfunding in Sweden, which reflected the questions asked. However, Liedén does not want to be quoted and the interview should be seen as a discussion that served to strengthen the authors' confidence in legal matters.

3.4 Self-Reflection

When searching for data, about crowdfunding in general and equity crowdfunding in particular, it was realized that there is scarce official data, in the sense of statistics disseminated by national statistical systems. This has led to the usage of some unofficial data in order to at least illuminate some proportions. Since one part of the study has an exploratory character, which means that the main goal is to explain overall dynamics and trends, understanding the proportion of specific factors are crucial. However, this does not mean that explicit relations and connections should be neglected, but only that the focus is on the general picture.

Only having one interview could result in misleading or biased data, especially if the person interviewed could benefit from answering in a specific way. However, it is hard to find reasons why the interviewee would mislead this study. Anyway, to reduce the risk of this event, the number of interviews should preferably be higher than one, but not as high as if the study would have a quantitative approach. The problematic part is that the phenomenon is

new and that there are few sufficiently good interviewees, especially when regarding legal questions in Sweden. This is the main reason why no more interviews have been conducted. In other areas, such as equity crowdfunding dynamics, it is easier to find suitable interviewees. These might be individuals involved in equity crowdfunding platforms operations, preferably inside the company. The Swedish crowdfunding platform FundedByMe was proposed with a question for an interview that was turned down due to lack of time. A few smaller questions were though asked and answered via e-mail. This opportunity could, however, have been more used in order to obtain primary data, even though it is relatively easy to find secondary data in this area.

4. Funding of SMEs in the Swedish Capital Market

This chapter begins with an introduction to the capital markets main elements: the primary and secondary markets in which transactions are made and the financial intermediaries that make transactions in the capital market possible. Furthermore, different sources of funding are described and it is all carried out with a main focus on the Swedish capital market and SMEs.

4.1 The Capital Market

Capital markets are financial markets for the buying and selling of equity and debt securities. These markets channel capital between those who require additional funds and those who wish to invest their excess. Those who require additional funds are entrepreneurs or different institutions that sell securities to raise capital or to reallocate previous investments into new investments. Most companies are funded through a mixture of debt and equity capital. Those who wish to invest their excess funds are retail investors or institutional investors who buy securities in order to get a return on their capital. These funds usually come from savings or from return on previous investments. Originally, capital markets were physical places like coffee houses and later matured into purpose-built exchanges. Today, capital markets participants are located in different continents and conduct deals using advanced information technology (Chrisholm, 2009).

4.1.1 Primary and Secondary Markets

The capital market is divided into two different markets, a primary and a secondary market. The primary market deals with issuing new securities and the secondary market deals with trading these securities. On the primary market a security is only sold once and there is usually a time consuming process involved in issuing new securities due to regulations. The securities issued on a primary market are usually traded on a secondary market enabling investors to get in and out of investments whenever they see fit. Trading a security is usually a very quick process and there is no limit on how many times a security can be traded. In a secondary market the price of a security fluctuates with supply and demand (Chrisholm, 2009).

In both the primary and secondary markets, private investors and companies buy and sell securities with each other. In order for these transactions to take place a connection between the buyers and sellers has to be made. It is the financial intermediaries' task to make this connection as smooth as possible.

4.1.2 Financial Intermediaries

Financial intermediaries mitigate the cost of acquiring information and conducting transactions. Examples of intermediaries are banks and investment funds. They emerge to lower the costs of researching investments, managing risk, exerting corporate control and mobilizing savings. By providing these services to the economy, financial intermediaries

influence allocation decisions and savings that might change long-run growth rate. Economic theory provides a framework of how countries with well-functioning financial intermediaries, that are better at acquiring information, managing risk, exerting corporate control, and mobilizing savings, grow faster than countries with financial systems that are less developed. Countries with well-functioning financial intermediaries will therefore allocate savings to more efficient and productive fields (Salehi, 2008).

Another important role that financial intermediaries play on the capital market is to fill an information gap, which exists due to the inequality of information available between buyers and sellers. This asymmetric information makes it difficult to tell whether the terms of the transactions being held between two parties are mutually satisfying, and because of this it jeopardizes the stability of the market. This is one problem that financial intermediaries help solve. Because of their financial involvement in the process and with their expertise, they have the ability to remove potential risks and monitor the utilization of the loans that are provided (Salehi, 2008).

Furthermore, financial intermediaries are able to economize on the costs of acquiring information, and because of this, they have an advantage over non-specialized entities and individuals to interact between borrowers and lenders. In this way, they contribute to economic growth by monitoring the performance of companies, maintaining the exchange process, and improving the resource allocation in the financial market with their information acquisition capabilities (Salehi, 2008).

4.2 Funding in the Debt Market

In the debt market debt securities are traded which gives a fixed return in terms of an interest rate (Riksbanken, 2014a). It is common to divide the debt market in the money market and the bond market. The actors in the Swedish market are basically the same for both of these markets: mainly the government, mortgage lenders, banks and large investors such as insurance companies and pension funds, and to smaller extent non-financial companies.

According to Swedish Agency for Economic and Regional Growth (Tillväxtverket, 2015), companies in early stages at the Swedish market experience the ability to obtain funding in the debt market as a growth barrier compared to established companies. From an international perspective, there are fewer people in Sweden with enough savings of their own to start and run a private limited company compared to other countries. This has increased the need to find other forms of funding. However, loans from commercial banks (such as Nordea, SEB, Svenska Handelsbanken and Swedbank) is the most common form of external financing for young and small companies in Sweden and it is estimated that 14 percent of new companies finance their startup phase with bank loans. At the same time, the ability for companies to receive bank loans has decreased since the financial crash in 2008. This has caused problems in obtaining capital for small and new companies. For a startup company, the ability to acquire capital is an unavoidable factor for the creation of the company (Kontigo, 2011). Because of the risks involved with the creation of a new company, it might be hard to get the

necessary funding in the form of debt capital. The reason is that there is an information asymmetry, meaning that suppliers of debt capital would be exposed to opportunistic behavior and adverse selection. Furthermore, startup companies usually lack stable cash flow and thus lack the basic ability to pay an adequate return. It is also common that these kinds of companies lack sufficient assets to hold as collateral by the debt provider.

4.3 Funding in the Equity Market

Equity is provided by a company's shareholders, who are part owners of the business. The equity market exists to facilitate raising of equity capital by corporate issuers and transfer ownership interests in corporations among investors. In the equity market, all the essential mechanisms and necessary liquidity is provided to accomplish these key tasks. A key factor for corporate organizations is the limited liability of shareholders. This refers to the fact that if a company fails to meet its obligations and goes bankrupt, the shareholders are not held liable for the debt that the company has acquired. However, the ownership could either be private or public with a respective corresponding market. The private equity market and the public equity market are important to investigate separately (Schwartz & Francioni, 2004).

4.3.1 The Private Equity Market

The organized private equity market usually refers to professionally managed equity investments in unregistered securities. There is also a smaller unorganized private equity market including private investors. This professional management is provided by specialized intermediaries and, to a more limited extent, by institutional investors. Private equity managers acquire a large ownership stake in a company and are thereby able to take an active role monitoring and advising these companies. Funding in the private equity market is primarily directed to different kinds of SMEs including startup companies, companies in financial distress, and public companies seeking buyout financing. In Sweden, SMEs play an important role for the economy because these companies account for about 99 percent of all the companies in Sweden. SMEs also account for about 65 percent of the value added services in the economy (Tillväxtverket, 2015).

The actors on the private equity market are specialised in new ventures and investments that are related to early stages of companies, where companies expand from a development phase to start selling or expanding (Tillväxtverket, 2015). These companies are predicted to have high growth potential and high returns. The investors in these companies also contribute with non-financial values, such as professional management of the company board, recruitment of new staff and contacts with other investors that also might invest in the company. In some cases, the additional value added by the investor is more interesting for the entrepreneur than the capital itself. Some entrepreneurs are thus willing to pay extra for this feature which is not available in other forms of funding.

In the private equity market, shares of private limited companies are sold to a finite number of investors (Riksbanken, 2014a). In Sweden the requirement to become a private limited company is equity of 50,000 SEK. These types of shares are harder to trade than shares of

public limited companies for the investors since they are not listed on a public stock exchange. In Sweden, the equity issuance, adjusted for buybacks, of private limited companies is much larger than that of publicly listed companies. This can be seen in the amount of issued capital from private limited companies and publicly listed companies when compared year by year, see Figure 6.

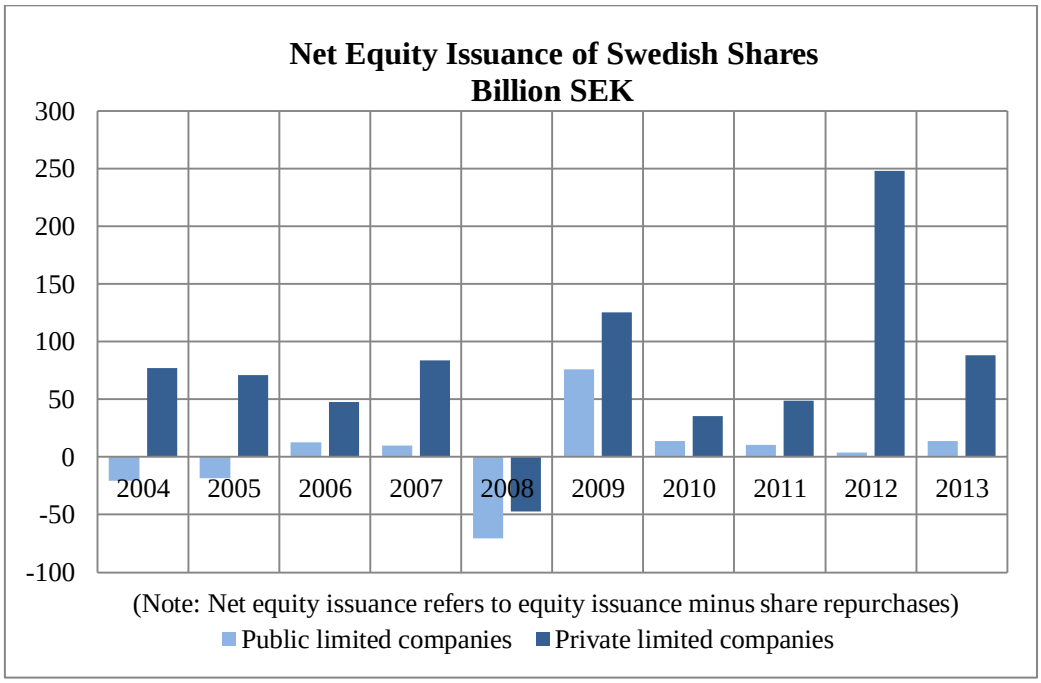

Figure 6: Net equity issuance of Swedish shares of publicly listed companies and privately held companies. Adopted from Riksbanken (2014a).

The private equity issuers, which are the parties seeking capital, vary in size and have different reasons for raising capital (Board of Governors of the Federal Reserve System, 1995). Issuers are generally companies that cannot raise financing in the debt or public equity markets, due to high costs and requirements, and therefore turn to the private equity market. They can be early-stage companies, still being in research and development stage or the earliest stages of commercialization, or they can be later-stage companies, that have several years of sales but still wish to grow rapidly.

4.3.1.1 Private Equity Firms

Private equity firms will, after obtaining the agreement of the controlling authorities, establish investment funds with the purpose of collecting capital from investors, which is illustrated in Figure 7. This capital is then used by these private equity firms to buy high-potential companies, which are called portfolio companies, and the eventual return is shared between the private equity firms and the investors (European Private Equity & Venture Capital Association, 2007). Examples of private equity firms in Sweden are Creandum and Northzone (Tillväxtverket, 2015).

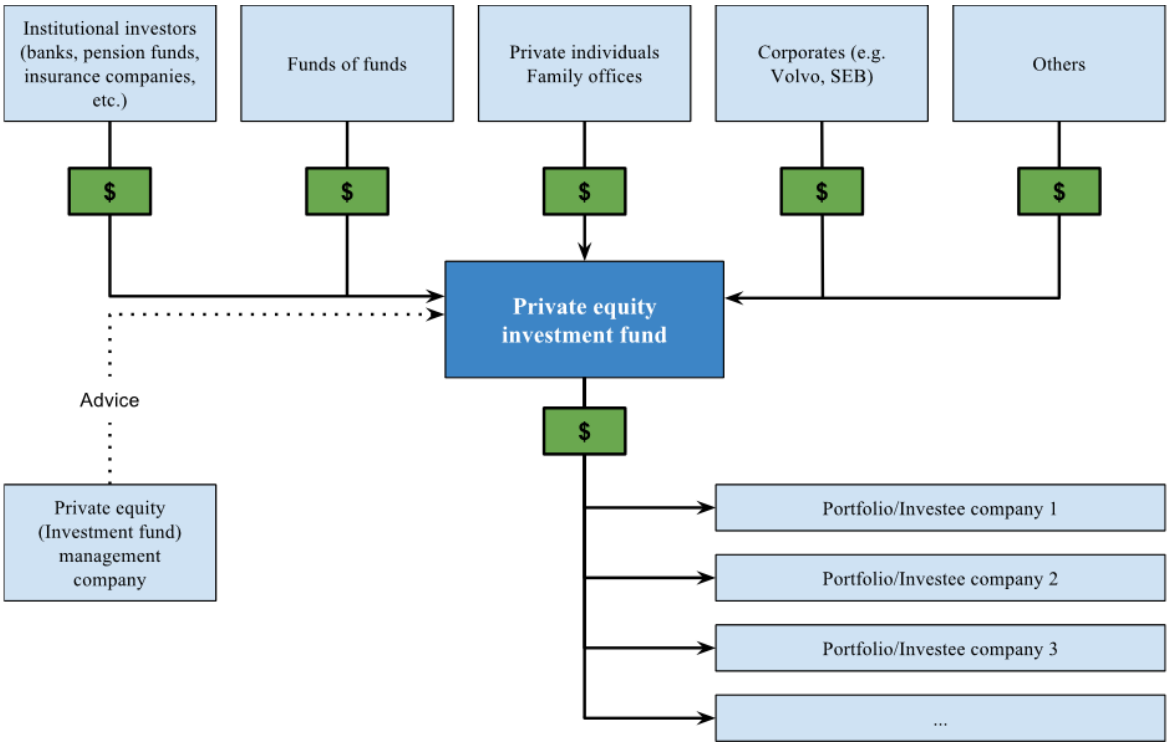

Figure 7: The private equity business model. Adopted from the European Private Equity & Venture Capital Association (2007).

The private equity fund managers invite individuals with significant assets or particular expertise and institutional investors, and these will subscribe to the investment fund for a certain amount of time (on average ten years). They will in turn take equity stakes in high-potential companies and this follows a clearly defined investment strategy. The investment strategy can be set from the sector in which the companies operate, their size, the stage of development and/or the geographical location. The fundraising period normally lasts for six months to one year (European Private Equity & Venture Capital Association, 2007).

The return on investment required for a private equity firm is normally very high, to justify the high risk projects that investments in SMEs typically are. The size of investments varies, but there is a lower limit in respect to how much a private equity firm will invest. This is because investing in a company requires significant resources in assisting and monitoring activities of the company being financed. This means that investments of small amounts will not be justifiable for the private equity firms (Caselli & Gatti, 2004).

In Sweden the first private equity firms were established in the late eighties. But the expansion of these firms has been rapid and in 2014 there were according to The Swedish Private Equity & Venture Capital Association 136 private equity firms together managing about 400 billion SEK (SVCA, 2014 see Tillväxtverket 2015). Venture capital corresponding to half a percent of Sweden's GDP is invested by these companies yearly. It is also common for subsidiaries of banks, insurance companies or industrial companies to invest in private equity on the behalf of the parent company. In Sweden some examples are Volvo Group Venture Capital and SEB Venture Capital (Tillväxtverket, 2015).

4.3.1.2 Self Financing

Another alternative to raising capital through the private market is private financing. This includes financing from the entrepreneurs themselves, friends, family or angel investors. This type of financing can be relatively easy and quick, but it is rarely a long-term solution for growth in a company.

Angel investors are private investors which are funding new companies with a high involvement of personal finance, and they are often experts in the sector in which they invest (Tillväxtverket, 2015). The companies angel investors invest in have particularly high risks, greater than the risks that private equity firms take since they are restricted by rules of risk management. As a result of this, the potential returns are also higher. The limit of this form of involvement is restricted to what the individuals are prepared to invest. The presence of angel investors is an important part for a well-functioning venture capital market and they play an important role in the financing of SMEs in Sweden.

For Swedish companies in general, the most important source of capital is self-financed capital, which is used in the startup phase. However, the access to external capital is important for companies that are looking to expand their business. It is estimated that between 60 and 80 percent of Swedish companies use self-financing for the startup phase and the total amount of money raised through self-financing is estimated to be between 3.5 and 4 billion SEK every year (Tillväxtverket, 2015).

4.3.1.3 Public Actors

In Sweden it is possible for public actors to invest in private equity. Examples are national or regional funds with public financing (from the government and/or the EU) that invest in companies, often with the purpose of encouraging regional growth or innovation. Almi Invest and Industrifonden are among the largest public actors in Sweden and in 2014 they invested roughly 750 and 500 million SEK respectively in startups and SMEs (Almi, 2015; Industrifonden, 2014). There are also other forms of subsidies, project funding and sources of finance for companies that are in the startup phase. Some are managed by Swedish government agencies such as Swedish Agency for Economic and Regional Growth, The Swedish Energy Agency and Vinnova (Tillväxtverket, 2015).

4.3.2 The Public Equity Market

In the public equity market companies can satisfy their capital needs by issuing new shares that are bought by different kinds of investors. This happens in a market where the investors then are able to trade shares with each other on a secondary market. The stock market therefore has an important role in turning savings into financing. The Swedish stock market is defined as the trade with shares and share-related instruments that are listed on Swedish marketplaces.

A large part of Swedish households' financial wealth is direct and indirect investments in stock markets. In 2013, Swedish households had a direct ownership in the Swedish stock market of about 514 billion SEK (Riksbanken, 2014a). During 2014, the Swedish households saved 153 billion SEK and in the beginning of 2015 had a fund-related fortune of 3,000 billion SEK, according to the Swedish Investment Fund Association (Fondbolagens förening,

2015). A large amount of the fund-related fortune is bound in different retirement programs and thus not able to withdraw due to legal restrictions. However, eight out of ten Swedish citizens do save in investment funds in addition to their retirement program. Even though it is difficult to estimate how much capital that could be withdrawn with little or no effort, one could realize that it is an amount largely exceeding the $5.1 billion that was raised by crowdfunding worldwide during 2013 (Barnett, 2014).

In Sweden there are five marketplaces for publicly traded companies, one dominating and four smaller ones. In the end of 2013 there were 513 publicly-traded companies in Sweden spread across these marketplaces. In relation to a total of 450,000 private limited companies in Sweden the publicly listed companies are a minority. Nasdaq OMX Stockholm (OMX) is the dominating marketplace with 256 listed companies and a market capitalization of 4,826 billion SEK, 99 percent of the total market capitalization (Riksbanken, 2014a).

In order to become a publicly listed company on a Swedish marketplace there is a requirement of at least 500,000 SEK in equity, a great enough number of shareholders, three years of accounting and financial resources for at least twelve months of future business. Being a publicly listed company also comes with increased requirements in accounting and communicating information to the public, e.g. increasingly detailed and more frequent financial statements. These requirements differ somewhat between marketplaces and are generally less for the smaller ones. These differences in requirements also make the listing costs different between marketplaces (Riksbanken, 2014a).

The most expensive market, OMX, has a listing fee of 700,000 SEK and an annual fee of a minimum of 199,000 SEK (Nasdaq, 2015). The least expensive, Aktietorget, has a listing fee of 50,000 SEK and an annual fee of 180,000 SEK (Aktietorget, 2015). It is important to note that these fees are only for becoming listed and remaining listed on the market, the issuing of new equity comes with additional cost in the form of e.g. legal advice.

Being a publicly listed company also comes with benefits, one benefit being that only publicly listed companies are allowed to issue shares to the public, whereas private stock companies only are allowed to issue shares to a limited amount of investors. Another benefit is that public equity investments gives a larger amount of liquidity to the company's shares, making it easy for investors to get in and out of an investment thus reducing risk for investors (Riksbanken, 2014a). These benefits usually do not outweigh the comparatively large costs of being a publicly listed company for SMEs.

4.4 Funding Problems in the Swedish Market

In 1998, a study was made in Sweden by Olofsson and Berggren concerning capital funding which concluded that financing was not a problem for companies (Olofsson & Berggren, 1998 see Tillväxtverket, 2015). But a later study made by Sweco Eurofutures identified a funding gap in the Swedish market concerning external capital between the seed phase and the next phase for companies (Tillväxtanalys, 2011). This shortage was assessed to be in the interval of investments in the range between 1 and 20 million SEK. The report also mentioned

it being more difficult for companies to obtain bank loans in smaller cities than in larger cities, which means that there are regional differences. Another report by the European Investment Fund (European Investment Bank Group, 2007) pointed out that there are market failures concerning banks' financing of SMEs and also that the equity market is undeveloped in certain regions in Sweden.

Therefore, observations concerning the funding market in Sweden points out that there are risks, particularly for small companies in the developing phase, whose business potential is hard to assess and who are operating in a geographical area with lower growth prospects of not getting access to external financing. Here new methods and procedures are needed in order to overcome the funding gap for SMEs. Equity is usually the best way a small company can raise capital because of their high business risk. The growing phenomenon of equity crowdfunding could thus be seen as a potential bridge builder by reducing the funding gap.

5. Crowdfunding

This chapter starts with a historical background and an introduction to the phenomenon of crowdfunding and crowdfunding platforms. It continues with a review of the Swedish market for equity-based crowdfunding and an investigation of the legal status of equity-based crowdfunding in important jurisdictions.

5.1 An Element of Crowdsourcing

Crowdfunding is a quite new phenomenon stemming from the wider concept crowdsourcing. This wider concept was first expressed in 2006 by Jeff Howe and Mark Robinson (2006) in Wired Magazine and is defined as to;

"Obtain (information or input into a particular task or project) by enlisting the services of a large number of people, either paid or unpaid, typically via the Internet." (Oxford Dictionaries, 2015c)

The idea of using the crowd can however be regarded as very old, Kevin Lawton argues in his book (The Crowdfunding Revolution, 2013) that wisdom and power of the crowd dates back to Athens in ancient Greece, where the statesman and poet Solon introduces the first ideas and reforms towards democracy (Nationalencyklopedin, 2015). Thus the key of crowdsourcing's success may lie in the fact that the crowd can be greater than the sum of its parts (The Crowdfunding Revolution, 2013).

Throughout the history we have seen many examples of when the crowd co-operates to achieve great things, but the Internet has revolutionized the conditions for co-operating crowds. The great span and connectivity of the Internet has enabled large groups of people with the same interest, commonly known as affinity groups, to overcome geographical boundaries that before had stopped them from reaching and finding each other. It started with the open source movement in the early nineties when tech enthusiasts created software with its source code free for anyone to modify. By the early twenties open source had become mainstream and paved the way for online crowdsourcing.

Another definition of Crowdsourcing provided 2008 by Kleemann, Voß and Rieder (2008) interprets crowdsourcing as a way to tap the crowd in order to obtain the best work from a large scope of individuals.

"Crowdsourcing takes place when a profit oriented firm outsources specific tasks essential for the making or sale of its product to the general public (the crowd) in the form of an open call over the Internet, with the intention of animating individuals to make a contribution to the firm's production process for free or for significantly less than that contribution is worth to the firm." (ibid, 2008)

As a result of this, online crowdsourcing has changed the rules in many industries. For example, Jeff Howe writes in his article The Rise of Crowdsourcing (Howe & Robinson, 2006), how crowdsourcing disrupted the business of professional photographers. Howe tells a story about a freelance photographer who loses a deal to the crowdsourcing site iStockphoto, a site that licensed out pictures taken by amateurs for around $1. Thus iStockphoto's pricing had undercut the freelance photographer's by over 99 percent and the buyer in the original deal ended up purchasing 56 images from iStockphoto for $56 instead of four pictures from the freelance photographer for $600. Due to iStockphoto's significantly different conditions, it's impossible for the freelance photographer to compete by lowering his prices. The photographer has to make enough money to pay for his living, in contrast to to the contributors at iStockphoto who just photographs as a hobby in their spare time. In 2000 the photographer made $69,000 from a portfolio of 100 pictures, but in the next year he generated less money, $59,000, from a portfolio of 1,000 pictures. This is an example of how crowds can clearly disrupt existing industries.

The definition of crowdsourcing and what elements define a crowdsourcing enterprise varies from researcher to researcher. Kleeman et al. (2008) would for example not define Wikipedia as crowdsourcing, while other researchers such as Buecheler, Sieg, Füchslin & Pfeifer (2010) would. Estelles-Arolas and González-Ladrón-de-Guevara (2012, s.9-10) identified this diversity and formulates a new definition based on common elements from existing definitions, in order to cover the basic characteristics of all different types of crowdsourcing.

"Crowdsourcing is a type of participative online activity in which an individual, an institution, a non-profit organization, or company proposes to a group of individuals of varying knowledge, heterogeneity, and number, via a flexible open call, the voluntary undertaking of a task. The undertaking of the task, of variable complexity and modularity, and in which the crowd should participate bringing their work, money, knowledge and/or experience, always entails mutual benefit. The user will receive the satisfaction of a given type of need, be it economic, social recognition, self-esteem, or the development of individual skills, while the crowdsourcer will obtain and utilize to their advantage what the user has brought to the venture, whose form will depend on the type of activity undertaken."

Many academics agree upon that crowdfunding is a part of crowdsourcing, as an example Belleflamme, Lambert & Schwienbacher (2013) express that crowdfunding can be viewed as an element of crowdsourcing.

5.2 Crowdfunding Definition

As an element of crowdsourcing, crowdfunding has undergone a similar development where web 2.0 has been an important enabler for crowdfunding's growth. The very basic idea of crowdfunding is for a person or organization to collect money from the crowd for a particular venture. Instead of getting financing from e.g. a bank or a venture capitalist, the goal is to obtain a small amount from many individuals, forming a crowd. The person or organization who seeks financing, in this thesis called collectors, can offer the particular individuals who

fund their venture, in this thesis called funders, something in return. These returns vary depending on what type of crowdfunding model the collector uses. Belleflamme et al (2013) provides a definition which captures the different crowdfunding models:

"Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes."

This definition is however criticised by Ethan Mollick (2013) for not covering the goal of the collector and the funders. Collectors might be seeking to raise a small amount of money for a one-time project or to find seed capital for a startup business. Furthermore, crowdfunding has been used by collectors to show a potential demand for their idea which can lead to increased funding from other traditional sources. Crowdfunding has also been used for marketing, to create interest for the project in an early stage (Ibid, 2013).

5.3 The Different Types of Crowdfunding

Crowdfunding is typically divided into sub-categories depending on what the collector offers the funders in return for their funding. In academic literature and media these categories are often donation-, reward-, lending- and equity-based. This thesis primarily focuses on equity-based crowdfunding, though all four models will be presented to give the reader a basic understanding of the crowdfunding phenomenon. The different types below are the most commonly used, but it is up to the owner of the crowdfunding platform to set the specific rules of the platform.

1. *Donation-based crowdfunding:* Donation-based crowdfunding, also known as crowd giving, can more or less be considered charity. The collector is not obliged to give anything in return to the funders. However it is common that the collector offers to give something to the funder as a token of appreciation, for example a thank you note or a mentioning in some movie scores (Bradford, 2012a). GoFundMe is a successful example of a platform operating this model, where funders can contribute to charitable causes.
2. *Reward-based crowdfunding:* In reward-based crowdfunding the collector is obliged to give the funder a pre-defined reward. In its most common form reward-based crowdfunding is known as pre-selling. The collector seeks financing to produce a certain product or service, like a music album, a movie, a painting, a new technical product, clothing etc., and the funder in return gets an early version of this product (Hemer, 2011). The line between crowd giving and crowd pre-selling is blurred. Platforms like Kickstarter, a reward-based platform, lets the collector select his or her own reward model, this often results in that the funders are offered some kind of gratitude token for small rewards (crowd giving) and the actual product for larger amounts (pre-selling).

3. *Lending-based crowdfunding:* In lending-based crowdfunding, or debt-based crowdfunding or crowd lending, the funders lend the collector money so that the collector can finance the venture. In return the funders get a monetary reward. The reward is, along with payback, interest on the amount pledged which is received at the end of the lending period. The interests can be fixed or predefined as a percentage of potential revenues.
4. *Equity-based crowdfunding:* In equity-based crowdfunding, or crowd equity, the collector offers the funders shares in the venture. It is basically venture capital financing, but with a large number of financers. This means that no single financer gets large influence over the company. The laws of different countries restrict in what countries financers can invest, in contrast to pre-selling where funders can invest in a project in literally any country. Equity crowdfunding has become a way for small, private limited companies to sell equity shares to large amounts of people.

Lending-based and equity-based crowdfunding are often referred to as investment crowdfunding, since they both have financial pay-backs, as opposed to donation- and reward-based models that often are grouped together as donation crowdfunding. In Table 1 below, adopted from a World Bank report on crowdfunding, this notation is used and pros and cons of the different models are presented.

Crowdfunding model	Business model	Pros	Cons
Donation	Donation-based	No risk.	Donors do not acquire security interest. Entrepreneurs have difficulty raising substantial capital.
	Reward-based	Low risk (primarily fulfillment and fraud risk). No real potential for financial return.	Potential return is small. No security is acquired, and there is no accountability mechanism. Most entrepreneurs may have difficulty raising substantial capital without a product with mass appeal to sell.
Investing	Lending-Based	Pre-determined rate of return agreed upon between lender and borrower. Debt holders are senior to equity holders in case of bankruptcy. Secured status may make it easier for entrepreneurs to raise capital.	May be subordinate to senior creditors. Start-ups' high-failure rate presents similar risk of loss as an equity investment, but with capped potential returns. Requires a business already generating cash flow. Existing/established, cash flow positive businesses may consider this option because they can offer a more structured exit opportunity than typical equity offerings.
	Equity-based	Potential to share in the profitability of the venture. Unlimited potential for financial gain. May attract relatively large numbers of investors.	Potential loss of investment. Equity holders are subordinate to creditors in the event of bankruptcy. Securities laws related to crowdfund investing may be complex.

Table 1: Different crowdfunding models. Adopted from The World Bank (2013).

So far, in the history of crowdfunding, the donation crowdfunding models have been the most successful in terms of both raised funds and media exposure. Kickstarter, GoFundMe and Indiegogo are examples of actors operating these models that have gained a lot of attention in recent years and are also the ones where the most funds have been raised (GoFundMe, 2015). However, the investing models are growing fast.

In the United Kingdom the growth of equity crowdfunding has been very strong in recent years, with strong actors such as Crowdcube and Seedrs. Between 2012 and 2014 equity crowdfunding in the U.K. has grown from €5 million to €111 million, while the rest of Europe has lagged behind with a growth from €18 million in 2012 to €83 million in 2014. In the Nordic countries, equity crowdfunding has grown from virtually nothing in 2012, to €4 million in 2014 (Wardrop, Zhang, Rau & Gray, 2015).

5.4 Crowdfunding Platforms

With the crowdfunding phenomenon explained, one might ask how collectors reach out to funders. Web 2.0 is the tool that enables communication and interaction between the two actors, but it is the crowdfunding platforms that connects collectors with funders, and thereby acts as intermediaries. A crowdfunding platform takes its form as a website where multiple collectors can upload their projects and funders can then browse and find these projects. Obviously the platform has to follow the laws of the country it operates in, but except that, the platform owner sets the rules for the platform. Typically there are rules on what types of ventures that are allowed and how they should be presented at the platform.

5.4.1 The Variation of Platforms

In the most recent years the number of crowdfunding platforms has grown rapidly, with many new niche platforms focusing on very specific ventures (Massolution, 2015). As an example, crowdbrewed.com is a platform focusing on financing microbreweries. Another one is sellaband.com where musicians seek financing for recording albums, and if the crowdfunding project succeeds the funders can get a copy of the album, merchandise or revenue shares depending on the initial deal. A crowdfunding project can be said to succeed if the collector reaches the monetary funding goal in a predefined timeframe. The rules for how to handle funding failures (the project does not reach its monetary goal) differ from platform to platform. Some let the collector get any amount collected even if the funding goal is not reached. But what seems to be the more popular model is all-or-nothing, where the collector gets nothing if the funding would fail (Hemer, 2011).

5.4.2 Business Model of Equity-Based Platforms

Since the main focus of this thesis is equity-based crowdfunding, the other types that has been briefly described above, are now put aside and the business model for equity-based platforms is described. A clear distinction between equity crowdfunding and other forms of crowdfunding is that the collector is always an entrepreneur of a limited company in the case of equity crowdfunding, as opposed to other forms where the collector might be anybody. Therefore, the collector of the equity crowdfunding activity will be referred to as the entrepreneur and the funder will be referred to as the investor, since it is now a real investment that is being done, instead of for example contributions for a good cause.

The basic idea of equity-based crowdfunding platforms is to connect entrepreneurs seeking funding in the form of equity capital with investors seeking to invest their capital in small, high-growth ventures. In practice, it basically works like this:

1. The entrepreneur creates a campaign, containing a description and financial information about the venture, and how big part of the venture that is offered to investors. The platform often provides guidance and help through the campaign creation.
2. After being reviewed and accepted by the platform, the campaign is launched on the platform, where it can be viewed by the registered users of the platform. Often a small pitch can be viewed by non-registered users, but full access to the campaign requires registration.
3. Registered users can browse between different campaigns, discuss in forums and ask questions to the entrepreneurs. The user has the choice to invest if he or she finds the campaign interesting.

The model for how the platform itself gets its revenue differs between different platforms. Common models are to charge a listing fee for campaigns, a percentage fee of collected funds or monthly subscription fees for entrepreneurs. It's also common to use a combination of these models.

The business models of different platforms obviously vary to some extent. However, they also have much in common. In Figure 8 below, the business model of a generic equity crowdfunding platform has been modeled in the form of a platform business model canvas (see section 2.3). The block of revenues has been slightly altered into Revenues/benefits to better capture what payback each actor gets.

<table>
<tr>
<td>Key Activities

In a comprehensive and efficient way connect entrepreneurs with investors.</td>
<td>Value Proposition

Owner: Revenue from platform activities.
Entrepreneur: Access to capital, and a wide investor base.
Investor: Access to a wide pool of exciting early-stage investment opportunities.</td>
<td>Relationships

Owner: Approves campaigns, performs maintenance
Entrepreneur:
Providing investing possibilities.
Investors:
Provides capital, crowd wisdom.</td>
</tr>
<tr>
<td colspan="3">Platform Partners
Owner: FundedByMe, Crowdcube, Invesdor etc.
Entrepreneurs seeking funding
Investors seeking investment possibilities</td>
</tr>
<tr>
<td>Costs

Owner fixed costs:
Servers/maintenance
Owner variable costs:
Approving of campaigns, support.
Entrepreneur costs:
Listing fee, creating campaign
Investor costs: Usually free</td>
<td>Value Co-creation

The platform is connecting a large community of investors seeking investment possibilities with entrepreneurs seeking capital.</td>
<td>Revenues/Benefits

Platform: Listing fee + percentage of total invested capital.
Entrepreneur: Equity capital, market response, broadened shareholder base.
Investor: Equity in potentially high-growth business, altruistic and social engagement.</td>
</tr>
</table>

Figure 8: The Platform Business Model Canvas applied to equity crowdfunding platforms.

The block of revenues and benefits describes both the pure monetary revenues and other value adding benefits. These other benefits are most present for entrepreneurs and investors since they have other incentives than just monetary ones when using crowd equity. For entrepreneurs the amount of capital a project raises from the crowd can be seen as an indicator of how well the market responds to the entrepreneur's idea (Schwienbacher & Larralde, 2010). Also investors can contribute with valuable knowledge and competence in the sector which the entrepreneur operates in. Investors can get motivated by personal identification with the subject and goal of a project and they can also feel satisfaction of being part of a particular community with the same priorities as themselves. Furthermore, investors can get the opportunity of contributing to a socially beneficent mission, and also feel enjoyment of being part of a new invention or being among pioneers of a new technology of business (Hemer, 2011).

The value co-creation increases with scale, because more investors leads to more potential funding for entrepreneurs and more entrepreneurs leads to more available projects for the investors to invest in. The platform can also be niched towards a certain area of interest, industry or community. Then value co-creation is also about connecting a special type of investors with a special type of entrepreneurs.

5.4.3 Platforms on the Swedish Market

The definition of the Swedish market was discussed in the introduction chapter, and it involves platforms open and viable to Swedish entrepreneurs seeking equity financing. Depending on the type of platform and the local jurisdiction under which it operates, Swedish registered as well as foreign platforms may be open to Swedish entrepreneurs. Whatever the nationality of the platform, the entrepreneur seeking finance operates under the law of his own country, why platforms that are open to foreign entrepreneurs often advice entrepreneurs to seek legal advice before starting a campaign.

American platforms, like crowdfunder.com and equitynet.com, have thus far often been open to international entrepreneurs (but only to accredited investors). However, this will change with the JOBS Act (further explained in 5.5.1), which will require entrepreneurs wanting to use crowdfunding in the U.S., to also be organized in the U.S. Thus these platforms are not deemed viable for Swedish entrepreneurs.

The most popular British platforms, like crowdcube.com, seedrs.com and fundingtree.com, are only open to U.K. limited companies. Similarly, Dutch symbid.com, one of the first equity crowdfunding platforms worldwide, is only open to Dutch limited companies.

In a recent report by EY and Cambridge University (Wardrop, Zhang, Rau & Gray, 2015) the percentage of cross-border transactions for European alternative finance platforms (also including platforms for P2P lending, reward- and donation-based crowdfunding etc.) was investigated, showing that a clear majority of funding goes to companies within the borders of the platform's country. With the difficulties of using non-Swedish platforms and the fact that the majority of funding stays within the platforms' country it is not odd that the majority of Swedish equity crowdfunding happens on Swedish or Nordic platforms. The most prominent Swedish platforms are fundedbyme.se and crowdcube.se that without question are the most

visible online. In the 2013 study of the Swedish crowdfunding landscape by Teigland and Ingram at Stockholm School of Economics these two are listed as the most prominent together with Finnish invesdor.com (Ingram & Teigland, 2013). Invesdor is however not as of yet open to Swedish entrepreneurs, and as good as all of the featured businesses are based in Finland. Fundedbyme and Crowdcube are therefore deemed the most viable equity crowdfunding platforms for Swedish entrepreneurs, and are further described below.

5.4.3.1 FundedByMe

The first Swedish platform for crowdfunding of entrepreneurial ventures was FundedByMe.se that was launched in March 2011. From the start it offered donation- and reward-based crowdfunding but since 2012 it also offers equity- and since early 2015 lending-based crowdfunding (Daboczy, 2012). Today, FundedByMe operates in the Nordic countries, the Baltic countries, Spain, Germany and Singapore. Equity crowdfunding is available to European investors and entrepreneurs from the countries mentioned. Entrepreneurs from other countries might, however, also be accepted after review of their national legislation[1]. The company is registered in Sweden as FundedByMe Crowdfunding Sweden Aktiebolag. For equity campaigns, FundedByMe charges a €500 listing fee to go live with the campaign and an 8 percent success fee on the total amount of money raised at the end of the campaign (FundedByMe, 2015b).

5.4.3.2 Crowdcube

Crowdcube.com, launched in 2010, is the world's first and Britain's largest equity crowdfunding platform (Ambani, 2014). In 2013, the company expanded into Sweden with the launch of crowdcube.se and the registration of Crowdcube North AB. To launch a campaign on crowdcube.se you need to be a Swedish citizen, which naturally makes Sweden-based companies the most common on the platform. Different from Fundedbyme, Crowdcube is a pure equity-based platform, i.e. they do not offer any other types of crowdfunding. Crowdcube charges a 25,000 SEK listing fee (12,500 SEK + 12,500 SEK if investment target is met) and a 5 percent success fee on total invested capital if investment target is met (Crowdcube, 2015).

5.5 Legal Status

The dominant part of crowdfunding has thus far been in the form of donation- or reward-based solutions. In recent years, however, the rise of debt- and equity-based crowdfunding has raised questions regarding the legality of such transactions. Investments in a company for promises of future economic return are regulated in nation-specific securities regulations, which pose a new problem to crowdfunders. This chapter aims to investigate these sets of ground rules in the United States and in the EU in general and in Sweden in particular.

5.5.1 Equity Crowdfunding in the United States

In the wake of the Wall Street crash of 1929, the Securities Act was introduced in 1933 to strengthen investor protection and reduce the risk of fraud. It brought with it regulations of the

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financial system and prohibited general solicitation, i.e. advertising the selling of securities to the general public, for private companies. From now on, all issuance of securities had to be registered with the Securities & Exchange Commission (SEC) and a vast amount of information on the company's financial status had to be provided. This made fundraising from the general public the exclusive domain of large stock exchange listed companies (Barnett, 2013).

However, the world has changed since 1933, and the rise of the Internet has radically increased the amount of information available to investors. This has left parts of the investor protection regulations outdated, which is why new regulation was passed through Congress in 2012.

"Enacted in 2012, the Jumpstart Our Business Startups Act, or JOBS Act, is intended, among other things, to reduce barriers to capital formation, particularly for smaller companies. The JOBS Act requires the SEC to adopt rules amending existing exemptions from registration under the Securities Act of 1933 and creating new exemptions that permit issuers of securities to raise capital without SEC registration." (Securities & Exchange Commission, 2013)

The JOBS Act is supposed to enable small, private companies to advertise and sell their securities to the public without registering with the SEC and thereby lower the cost of selling securities. However, all of it has not gone into effect yet, which is why it is hard to draw conclusions on its results. The first part of it affecting crowdfunding went into effect in September 2013, lifting the ban on general solicitation. However, only accredited investors (affluent individuals or corporations, banks etc.) are allowed to invest so far (Securities & Exchange Commission, 2013). The second and final part of the new legislation affecting crowdfunding is projected to go into effect as of October 2015. This will enable also non-accredited investors to take part in the funding activities.

The new regulation comes in the form of exemptions to the Securities Act of 1933 (DiLeo & Streaser, 2014). To pass under these exemptions, a list of requirements has to be fulfilled by the different actors. Some of the most important of these requirements are listed below (Bradford, 2012b):

1. The amount of money raised through crowdfunding is limited to $1 million per 12-month period.
2. Investor requirements:
    a) A limit on how much an investor may invest in crowdfunded offerings, depending on the investor's net worth and annual income.
    b) Investors must answer questions demonstrating an understanding of the risk of investments, i.e. an investor-education requirement.
3. Issuer requirements:
    a) Companies using crowdfunding to offer and sell their securities must be organized inside the United States. Public companies and investment companies are ineligble to use the crowdfunding exemption.

b) The issuers must disclose information regarding the company in general, its finances, ownership and capital structure as well as information about the offering itself.

4. Intermediary requirements:
    a) Intermediaries must register with the SEC to be allowed to use the exemption. "Funding Portal" is a new category of financial intermediaries that must stay neutral towards the securities offered and may not for example offer investment advice or manage investor funds.
    b) The intermediary is responsible for ensuring that investors review the investor-education requirement.
    c) To reduce the risk of fraud, intermediaries must perform background checks on the issuer's officers, directors, and large equity holders.
    d) The issuer must not receive the offering proceeds until the target offering amount has been reached.
5. Resale Restrictions: Securities purchased in a crowdfunding offering may not be resold for a year from the date of purchase. A few exceptions to this rule exists, including sales back to the issuer or sales to a member of the purchaser's family.

As can be seen, there are numerous requirements that has to be fulfilled in order to take part in equity crowdfunding activity. With this many requirements, some critics have argued that the cost of selling securities in small companies may still be too high, and that the whole purpose of the JOBS Act thereby gets lost (Bradford, 2012b).

5.5.2 Equity Crowdfunding in the European Union

A few of the European countries have issued new regulations that are specific to crowdfunding. In France, new regulation came into force in October 2014, forcing platforms to register under different designations depending on what type of crowdfunding model that is operated (Alois, 2014). In most other European countries where crowdfunding has been addressed by legislators, like the U.K. and Germany, measures have been taken to fit crowdfunding into the existing legal framework of capital investment and granted some exemptions like simplified prospectus (Torris, 2015). Even though no specific regulation exists in these countries, platforms are regulated and have to be authorised by the national financial regulatory body to improve investor protection (Financial Conduct Authority, 2015). In some cases, legal restrictions are considered the main barrier to entry for people wanting to start a platform (Groves, 2014).

Small steps towards harmonisation of European regulation have been taken with a recent release of an opinion on investment crowdfunding by the European Securities and Markets Authority (ESMA) (2014). Full such harmonisation within the 28 member states of the EU, however, still seems to be a long way off, with the emergence of disparate national regulations making it even harder (Torris, 2015).

5.5.3 Equity Crowdfunding in Sweden

There is, to date, no specific regulation of crowdfunding activities in Sweden, and no platforms are registered with the Financial Supervisory Authority (Finansinspektionen, 2015).

The regulation that exists is therefore general and was often formulated before crowdfunding existed as a phenomenon. That being said, investment crowdfunding in Sweden should not, however, be seen as unregulated (Tillväxtverket, 2013).

There are mixed opinions between different authors on how easy it is to run equity-based crowdfunding platforms within Swedish legislation: The Swedish Agency for Economic and Regional Growth claims it to be relatively easy and that no changes in legislation are presently needed (Tillväxtverket, 2013) while Liedén claims that there are big legal uncertainties that results in a lack of predictability to the actors on the market (Liedèn, 2014).

Equity crowdfunding is primarily regulated in The Companies Act (Aktiebolagslagen 2005:551) and The Financial Instruments Trading Act (Lagen om handel med finansiella instrument 1991:980). In the Companies Act there is a division between public limited companies and private limited companies. The most important issues to crowdfunders in the regulations are those of private limited companies' possibility to offer equity to the general public, and demands posed on the actor mediating the offering. (Tillväxtverket, 2013).

As cited below, the Companies Act says that private limited companies or shareholders of such companies cannot try to disseminate shares or various other forms of securities through advertisement.

"A private limited company or a shareholder in such a company may not through advertising try to disseminate shares or rights issues in the company or debentures or stock warrants that the company has issued" (Aktiebolagslagen 2005:551, translated)

However, there are exemptions to this rule that states that a company can approach an unlimited amount of people that has declared interest in advance, as long as a maximum of 200 shareholdings are issued. How such a declaration of interest should be performed is not clearly stated which is why there is room for interpretation. On the Swedish platform FundedByMe investors have to register as a user to see full financial information about offerings. The act of registration and clicking the button to see financial info could possibly be seen as such a declaration of interest. However, this has never been tested in a Swedish court why it is still uncertain whether this can be viewed as a sufficient declaration of interest (Liedén, 2014).

The law also says that securities from private limited companies cannot be part of organized trade, i.e. in the form of a stock exchange or "other organized marketplaces". What other forms of marketplaces are is also up to interpretation and it is not entirely clear if crowdfunding platforms should be viewed as such a marketplace. Since the deal and payment between investor and issuer often is made outside of the platform itself, the platform can probably be exempted (Liedén, 2014). FundedByMe puts it like this:

"For equity and loan-based campaigns a simple commitment is made through the system and all transactions happen offline between the entrepreneur and the investor." (FundedByMe, 2015a)

This is also the Financial Supervisory Authority view in these cases:

"Since the transaction is not made via the platform, but through an authorized investment company or directly between owner and investor, there is no requirement of authorization of the platform that thereby is not supervised." (Finansinspektionen, 2015, translated)

The Financial Instruments Trading Act provides further complications for companies wishing to take part in investment-based crowdfunding activities, since it demands the publishing of a prospectus when securities are offered to the public. However, there are exemptions for when the amount to be paid within EES by the investors within a period of twelve months is a maximum €2.5 million (Lagen om handel med finansiella instrument 1991:980). Consequently, €2.5 million per year can be viewed as a practical limit for how much small ventures can crowdfund in Sweden, since creating a prospectus is extensive and costly work why small limited companies often doesn't have the resources to do so (Liedén, 2014).

In summary, Swedish regulation of crowdfunding activities is still quite vague, yet some important things that is demanded to perform equity crowdfunding within the boundaries of the law can be laid out. Firstly, platforms do not have to register with the Financial Supervisory Authority as long as the transaction is not made via the platform. Secondly, shares in private companies cannot be traded on any second hand markets. Thirdly, investors have to declare an interest before being approached with the offering. Fourthly, a maximum of 200 shareholdings can be issued. Fifthly, a maximum €2.5 million can be raised within a 12-month period.

In a recent study from Ernst & Young and Cambridge University (Wardrop, Zhang, Rau & Gray, 2015) 38 percent of platform owners in the Nordic countries think that regulation is too strict while 32 percent deem it adequate and appropriate. This can be compared to the figures in France (where specific regulation exists), where 33 percent says regulation is too strict and 42 percent says it's appropriate.

5.5.3.1 Tax Relief

In December 2013 a tax relief, "investeraravdraget", roughly translated to "the investor deduction", was introduced in Sweden. This deduction makes it possible for investors in equity in small companies to deduct half of the investment, up to 1,300,000 SEK, from the taxable basis (Skatteverket, 2015). This tax relief applies to most equity crowdfunding ventures, since the companies most often are small and the amounts raised do not often reach the limit amount of 20,000,000 SEK a year.

6. Analysis

This chapter analyses equity crowdfunding in order to give answers to the initial questions in section 1.4. Each question is handled in separate subchapters. Porters five forces and Christensen's theories disruptive innovations presented in Chapter 2 are used to analyse the profitability of platforms and the potential disruptiveness of equity crowdfunding. In addition to the theoretical framework, explanations of the capital market and crowdfunding in Chapters 4 and 5 are used. A discussion on crowdfunding's contribution to sustainable development is also made.

6.1 Porter's Five Forces

All forces have been closely analysed and the level of effect a specific factor has on each force has been graded and displayed in graphs as low with value 1 and color green, intermediate with value 2 and color yellow or high with value 3 and color red. It is however important to fully understand the relation between cause and effect, because it could in some cases be a bit abstract. This is best illustrated by an example from the analysis. Consider the dependency investors have of equity crowdfunding. The dependency is low because there are a wide range of other options where to invest. The investor could therefore demand beneficial conditions in order to invest via crowdfunding. The low dependency thus increases the bargaining power of investors.

When speaking of suppliers and buyers on a crowdfunding platform it is first necessary to define who the buyers are and who the suppliers are. Porter's analysis is applicable when analysing an industry, but rather loose in its definition when it comes to understanding the nature of a phenomenon. If the industry focuses on financing SMEs, then the investors are the suppliers of capital and the entrepreneurs take on the role of being the buyers. This perspective could be confusing when it comes to donation-based services. On the contrary, the industry could also be focusing on providing products, in which case the customers become the buyers of the product and the entrepreneurs become the suppliers. This discussion depicts the geniality of this multi-sided market where all participants, including the platform providers, act as suppliers and at the same time make a profit. Regardless of the definition, both forces can be analyzed separately and for convenience henceforth the Goldman Sachs definition of investors as buyers and entrepreneurs as suppliers will be used (Goldman Sachs, 2015).

6.1.1 Threat of Substitutes

To be a substitute to an equity crowdfunding platform, the substitute must offer a channel on which financial securities could be exchanged. As been presented earlier, banks could be considered the main platform for such exchange in the modern world. The service both equity crowdfunding platforms and banks offer is to channel cash from those who have to those who need. It also contains some sort of backflow of returns towards the investor. To decide the

level of threat from substitutes, the two factors presented earlier will be examined; cost of switching and the attractiveness of the trade-off between price and performance.

Firstly, what switching cost does occur when the channel, in which a transaction is taking place changes? When considering investors, switching costs vary according to asset class as well as size of investment. Switching cost could also be present in the selling procedure of the old investment as well as in the acquisition of the new investment. A small private investor investing in an investment fund would usually not have any cost when selling the fund (in contrast to selling stocks where the investor usually has to pay brokerage). It has also been shown that a lot of capital easily could be withdrawn from e.g. pension funds. Hence, there are large amounts of capital that could be released with very small costs attached to it.

Capital could of course derive from other assets as well, but many of these entail costs when sold. These costs are usually a percentage of the capital and are basically in the lower end of the one digit range. The decreasing costs of buying and selling assets are one of many benefits that have followed the global trend of digitalization. In fact, many private investors are not aware of these costs or in some cases ignore them which mean they would not take them into consideration when changing channel.

In addition to the actual monetary cost associated with switching investment strategy there is the cost of effort. Since crowdfunding is a relatively new phenomenon, investors may recoil against it because of the human anxiety of new things. It would take time and effort to get enough knowledge to comfortably use this new way of channeling capital. This would prevent some of the passive investors as well as the investors that stay in old habits from starting to use crowdfunding. Trust is also an issue when small crowdfunding platforms start to compete with traditional banks. The fact that most interaction are made over the internet without direct contact with a physical person might scare both investors and entrepreneurs. Even though, for example, the Swedish bank SEB (2015) have 96 percent of their customer interactions over the internet, adopting a completely new way of investing could be problematic. The trust issue is therefore highly important to consider from both investors' and entrepreneurs' point of view because it raises the threat level of the substitute.

In addition, an additional benefit investors get from investing in SMEs via crowdfunding is the tax deduction it gives rise to. Investors can deduct half the amount invested, up to a specific amount, when a company is either started or when new equity are issued. This is not only applicable to crowdfunding, but since investors are offered a better opportunity to invest in this kind of companies when using equity crowdfunding, it could be argued that it will be more beneficial to them. The possibility to deduct some of the amount invested will decrease potential switching costs private investors face. If the investor's capital has increased in value since first acquired, there will in some cases be a tax effect if they decide to sell. This tax effect will be reduced if the investor choose to invest in a small company, e.g. via crowdfunding, within the same year. This is a good example of governmental factors affecting the dynamics of the threat of substitutes.

Unlike private investors, entrepreneurs tend to have higher switching costs. This could be traced back to the phenomenon of primary and secondary markets. Private investors face the

secondary market when trading their assets and are thus unlikely to be the first holder of a specific financial security. Financial securities are traded under the promise that the rights and obligations that the previous holder had will be transferred to the new one. However, firms could usually not repay a bond whenever they prefer to. Capital might be invested in fixed or current assets, or the condition of the bond states that it only can be repaid at a specific date, which is common. Thus, a firm cannot easily change structure of their liabilities once it has settled. For the first time seekers of capital crowdfunding offers a much cheaper way of acquiring capital in comparison to an IPO (Initial Public Offering), which is a more comprehensive action to take.

In conclusion, private investors have a higher level of mobility and more choices of where to invest than capital requesting companies which are bound to alter liability structure at specific points in time.

Secondly, do traditional financial intermediaries offer a price-performance trade-off that exceeds the offering of equity crowdfunding? We start by taking the perspective of lending. Interest rates have been falling for the last two decades, especially in Sweden, even though the journey has been volatile. The market rates have fallen even more in the last two years leaving many countries in Europe with negative rate of their government bonds. Since the price of capital has decreased, lenders are looking for other investment that yields more. This is however not easy. It has long been known that potential return has a strong correlation with risk (Riksbanken, 2014b). The correlation has not changed even though the market rates are at an exceptionally low level. Higher yield requires higher risk taken. The trend in the Swedish market, however, is that investors willingly take higher risk in order to receive higher yields on their investments. Lenders change of attitude has increased the attractiveness of the equity market in relation to the debt market (Riksbanken, 2014c). This has led to an overall high valuation of the equity market. With higher valuation comes lower attractiveness since the return (which has not increased at the same rate) decrease in relation to the investment. This leaves investors with two relatively unattractive markets.

Crowdfunding could therefore be an interesting way of achieving higher yields, if that is the main goal of the investor. Since companies requesting capital via crowdfunding in general are smaller than companies requesting capital in the traditional way, they have to pay a risk premium to the investor. The additional risk the investor takes when investing in SMEs with high operational risk have to pay off, which justifies a higher yield. Anyway, the relation between risk and return differs among companies using equity crowdfunding as their channel for capital. Therefore nothing can be told for sure if investors find equity crowdfunding better or worse than the traditional markets. It is all about how the investor perceives the trade-off by comparing the value of risk contra potential return. The perception is highly personal and could vary between different points in time. However, the trend seems to be that investors are willing to take more risk. Since equity crowdfunding, with the structure of today, have a potentially higher return than the debt and equity markets, investors could make a transition towards crowdfunding.

There are, in addition to the previously mentioned positive governmental factor, also legal restrictions that are not beneficial for crowdfunding. Trading shares of privately owned companies are restricted by law. This means investors investing in private companies, e.g. via crowdfunding, lock the capital invested. This reduces liquidity and increase risk even further because the investor does not have the ability to make an exit at a preferred time. The additional risk would impair the trade-off between price and performance. There is also a legal restriction of €2.5 million that is the maximum amount a company can raise. This delimits which companies that could be interested in crowdfunding. It is also a part of why this thesis has been delimited to mainly observe SMEs.

6.1.1.1 Conclusion Threat of Substitutes

The threat from current financial intermediaries, which is considered the main substitute, is intermediate with a mean value of two, see Figure 9.

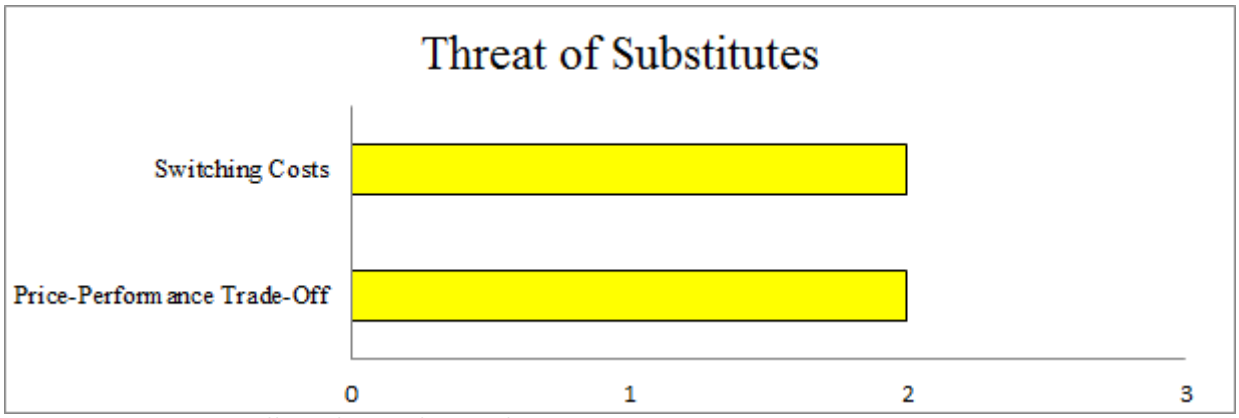

Figure 9: Describing the different factors of threat of substitutes, mean value 2.

Switching cost is low, at least monetary such from the investor's point of view. Both private investors and capital requesting companies have to put effort in switching way of exchanging capital. The present trust issue is one of the prominent factors that affect the threat of substitutes negative i.e. raising the level of threat. The price performance trade-off is not more attractive if one considers risk as price and return as performance. However, in absolute terms the return from investing in SMEs has the potential to exceed the return of the stock market. Note that this does not stem from equity crowdfunding itself, but from the opportunity to invest in the early stages of a company's growth.

6.1.2 Rivalry Among Firms

To analyse the industry rivalry using Porter's framework the market scene must be set. The equity crowdfunding market is very young, but has shown a significant growth rate during the latest years. The number of platforms is growing rapidly (European Securities of Market Authority, 2014). The Swedish market, however, only consists of a few actors. Mainly there are two substantial Swedish actors in equity crowdfunding and a few more Nordic ones.

6.1.2.1 Porter's Factors of Rivalry

Since there is a high industry growth, platforms mainly compete for new customers instead of existing ones. Classical Porter theory would suggest that this makes it easier for platforms to withhold an acceptable profitability compared with a case of non-existent growth rate, where platforms would have to compete for each other's customers. Although some companies will

use crowd equity more than once, the business transaction when a company seeks capital via crowd equity is commonly a one-time act. Also equity crowdfunding is most commonly used by startups, who by nature are new customers. So as long as startups are being the customer base for crowd equity, there will always be a substantial rivalry for new customers among platforms.

High exit barriers will keep unprofitable companies in the industry, which will make changes in market share distribution slow, and eventually affect the profitability of healthy firms. In the case of equity crowdfunding the exit barriers can be considered low. Platforms are in general not bound to fulfill any long-term contracts. They do not have large investments in fixed assets that are non-transferable.

Rivalry is great if it is hard for platforms to read each other's moves because of lack of familiarity, diverse approach to competing or differing goals. As explained more in detail further down, platforms are acting in the same way and should therefore be quite familiar to each other. They all have the same goal i.e. expansion by having more successful projects funded on their platforms. To achieve this they use similar strategies. Thus platforms' abilities to read each other's signals should be good and not a major force affecting the industry rivalry.

Platforms that have other reasons to operate than purely economic ones will intensify the rivalry in the industry, putting a lot of pressure on profit seeking firms. In the whole crowdfunding industry there are platforms that act out of other reasons than economical, but these platforms are not in the equity crowdfunding business. An example is the Swedish donation-based platform Crowdculture that collects capital for culture projects. Among the platforms in Sweden both Crowdcube and Fundedbyme have similar pricing models, where Crowdcube is slightly more advantageous for large investments and Fundedbyme for small. Thus no crowd equity platform on the Swedish market is yet competing with a differentiated pricing model. There are other pricing models, for example U.S-based Crowdfunder uses a monthly subscription fee instead of listing fees and a fixed percentage fee on successful projects as the platforms on the Swedish market does. Since the equity crowdfunding platforms are growing in numbers and expanding across borders, it is likely that in the future there will be platforms on the Swedish market competing with this type of pricing model.

6.1.2.2 The Importance of Scale

The European Securities and Markets Authority (ESMA) brings up the issue that there might not be enough entrepreneurs seeking to raise capital to match the intense growth rate in number of platforms. As stated before, the profitability of platforms depends on an inflow of new customers. This makes it seem reasonable that, just as the ESMA report points out, there will be a consolidation of platforms in the years to come where some will be failing and/or merging.

The future platforms will then be specialized niche players or have large benefits from economies of scale. Since there are no niche crowd equity platforms in Sweden, the rivalry among platforms is about obtaining economies of scale. In order to achieve large scale

benefits the current crowdfunding market in Sweden is not big enough and many platforms now operate across borders. Looking at the Swedish platforms, Fundedbyme is operating in multiple European countries and also in Singapore. Crowdcube is originally from Great Britain and has then expanded in the Nordics with a Swedish affiliation Crowdcube North AB. As in the example of Crowdcube, the across borders expansions of platforms means that, not only will Swedish platforms operate in other countries, but also there will be more foreign platforms operating on the Swedish market. An example is the Finnish crowd equity platform Invesdor, which will start operating on the Swedish market in the summer of 2015. The entrance of new platforms will intensify the rivalry for entrepreneurs and investors.

In order to analyze what platforms do to achieve scale, the meaning of scale for crowdfunding platforms needs to be set. Here it is defined as the total capital raised from all successful project on the specific platform. Thus, to increase scale a platform should increase its numbers of projects and the numbers of investors. As can be seen in Figure 8, investors receive value from entrepreneurs and vice versa. An increased number of investors enlarge the possibilities for entrepreneurs to succeed with their campaign, and on the other hand will an increased number of entrepreneurs give the investors more investment opportunities. Thus a large scale will not only increase platform's profitability, but also strengthen the co-creation of value. A platform which gets these scale benefits will much easier attract new entrepreneurs and investors since they in general can offer more value compared to platforms with less scale.

6.1.2.3 The Importance of Added Value

As getting scale benefits are of major importance for platforms, the rivalry should then be about attracting entrepreneurs and projects. Using Porter's generic strategies cost leadership would be a way to go, which in short means gaining market shares by having the lowest prices to value ratio. This is effective when quality and added value are unimportant and thus result in customers choosing the cheapest alternative. The platforms on the Swedish market do not, however, seem to be competing with aggressive pricing.

In equity crowdfunding the switching cost between platforms is low. For investors the usage of platforms is free and it is easy for the investors to switch between, or even use multiple, platforms. For entrepreneurs the switching costs are quite low as well. On the Swedish crowd equity market entrepreneurs are not bound to the initial platform they use, if they would like to go for a re-run. Low switching costs will diminish brand loyalty and increase the importance of price and added value. Thus platforms should either compete with low pricing or by value adding. Platform co-creation of value will come with increased scale, but platforms are also taking on other value added activities. Typically platforms are helping entrepreneurs to make their crowdfunding campaigns successful, by giving support in how to communicate through the platform with the potential investors. Today, no platform seems to be clearly outperforming the others in value adding activities.

6.1.2.4 Conclusion Rivalry Among Firms

The table below provides a comprehensive view of the different factors affecting overall rivalry. The mean value of all factors put together is 1.4, thus total intensity of rivalry among firms is low/intermediate, see Figure 10.

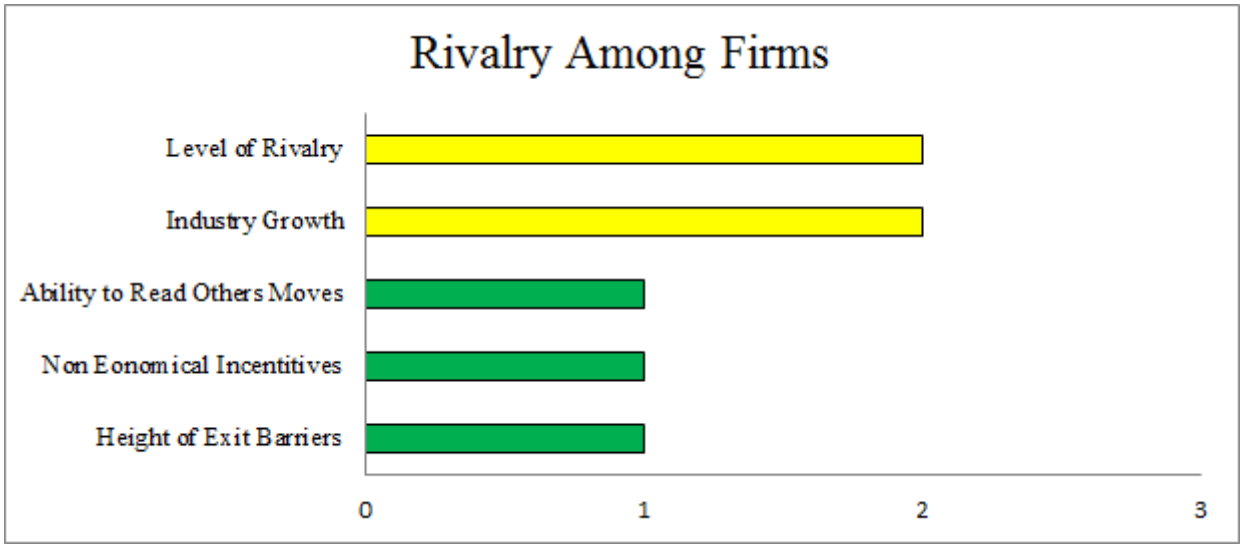

Figure 10: Describing the intensity of different factors of rivalry, the mean value is 1.4.

Porters measuring points would suggest that rivalry is low because the industry is growing rapidly, exit barriers are low, platforms can read each other's moves and there is no rivalry from platforms with non-economic agendas. By contrast, new platforms are entering the market, which will most likely result in a consolidation, where platforms with large scale or specialized focus will be the survivors. Thus, the level of rivalry ought to be high, but on the contrary no platform is aggressively using any competitive strategy. The somewhat diffuse rivalry that exists is that platforms compete about getting as much new investors and entrepreneurs as possible, and their method is rather differentiation and value adding than aggressive pricing. For now, the industry rivalry is deemed intermediate, but is predicted to be high in a not too distant future.

6.1.3 Bargaining Power of Investors

To estimate how much of an impact investors could have on the overall profitability of an industry one has to decide the bargaining power investors have relative to the industry. As mentioned earlier, it is a matter of industry structure more than individual firms. Since crowdfunding does not have the characteristics or industry structure of usual industries, such as the industries for textile or personal computers, some factors Porter have suggested observing in order to determine the bargaining power of investors are more present than others.

The supply chain of crowdfunding is quite short when compared to other industries. This is a result of having money as the product traded. Money could not be refined as for example iron. The only way to refine the product, i.e. increase the value of the money, is by offering it at the right time and place. The value adding process is thus trading money back and forth. This means the traditional picture of a supply chain as a one way flow is not representative for the

capital market. The capital market is more to be seen as closed system where capital is flowing back and forth. The result is that one has to observe a few specific transactions to analyse what Porter refers to as a supply chain. In the case of crowdfunding, investors could move up the supply chain, exclude the platform and contact the company themselves. The action is also known as "cutting out the middleman". However, the incentives for this kind of action from investors are considered low. Since private investors usually have to put a lot of time and effort finding interesting projects the platform containing such project would be welcomed. For some larger investor groups, taking contact with the company directly do not deter. Angel investors could for example be included in one of these groups. Anyway, for the broader mass, to overrun the crowdfunding platform would not be a viable option.

This leads to the question if investors are more concentrated than the industry incumbents? Once again we recall the fact that crowdfunding by its characteristics do not have a concentrated investor group. Thus, the industry incumbents are more concentrated compared to the investors. This reduces the bargaining power of the investors since they compete mutually. This also highlights crowdfunding platforms low dependency of specific investors. Since they do not rely heavily on some few actors, profit and marginal cutting is not necessarily in order to keep investors. However, it is important to keep in mind that investors have a lot of other options to where they would like to put their money. The bargaining power of the investor hence rises. Even though there are many investors, crowdfunding thus have to offer attractive services in order to keep them.

6.1.3.1 Conclusion Bargaining Power of Investors

Once again switching costs are interesting to observe, and once again we recall from the section threat of substitutes where this subject is treated. As pointed out, investor switching costs are low, both in relation to sellers switching costs as well as in absolute terms, see Figure 11. Thus, the conclusion is investor's switching costs have a great impact on the bargaining power of investors since they could threaten to leave equity crowdfunding if they do not find attractive offers.

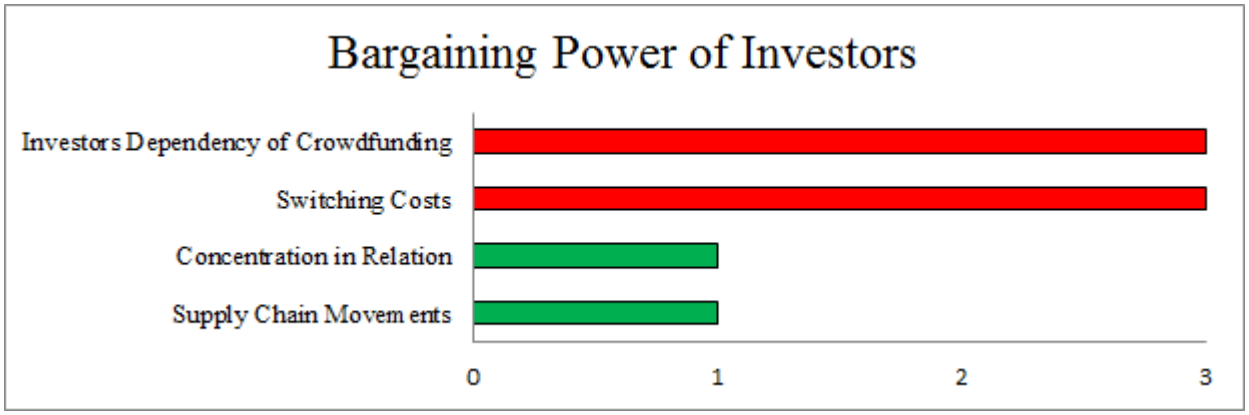

Figure 11: Describing the intensity of different factors of bargaining power of investors. The mean value is 2.

When summarizing the elements affecting the bargaining power of investors, one realizes the bargaining power is somewhat hard to define. On one hand, crowdfunding platforms' low dependency of specific investors, due to the low concentration of investors, and investors' lack of incentives to move up the supply chain puts the platform owners in a superior

bargaining position. On the other hand, the vast amount of investment opportunities investors face and the low switching costs associated with those investments makes the bargaining position more equal. Thus, the overall bargaining power of investors is categorized as intermediate.

6.1.4 Bargaining Power of Entrepreneurs

The bargaining power of entrepreneurs could be evaluated in more or less the same way as the bargaining power of investors, which means similar questions will be answered. To begin with, the concentration of entrepreneurs is smaller than the concentration of crowdfunding platforms, but larger than the concentration of investors. The concentration is in this case based on the number of actors in each group resulting in investors being the most numerous and also the less concentrated. Thus, the level of concentration is inversely proportional to the number of actors. If only considering the difference in concentration one could hence conclude that the bargaining power of entrepreneurs is stronger than the bargaining power of investors.

As in the case of investors, the external actors' dependency of the industry is at least as important to investigate in order to successfully define the bargaining power. Entrepreneurs tend to ask well-known actors first when it comes to raising capital for their startup. Banks and angel investors are among these more traditional providers of capital. If, for some reason, they decline to support the entrepreneurs with capital, the entrepreneurs have to look for other opportunities to raise capital. Crowdfunding is such an opportunity, which at current state has a lower priority among entrepreneurs. Each time an entrepreneur's request for capital is rejected, the entrepreneur becomes more and more desperate. Hence, the entrepreneur becomes vulnerable when he or she has to lower the expectation of the funding. Since many entrepreneurs requesting capital via crowdfunding are in this position, the bargaining power of this group is limited.

Furthermore, switching costs for entrepreneurs, as investigated in threat of substitutes, are at an intermediate level. It is argued that this is a result of entrepreneurs acting on a primary market where changing capital structure is somewhat tricky. If a company would commit to a specific way of raising capital it is not easily changed. The companies, or in this case entrepreneurs, are hence locked in to a specific capital structure which means their bargaining power is reduced by e.g. legal reasons.

There is a possibility for entrepreneurs to move up the supply chain, i.e. to go directly to investors and bypass the crowdfunding platform. This would entail seeking out larger investors, for example angel investors, or to try and contact a larger amount of investors. Although the latter is difficult for smaller companies, and would require a lot of marketing which is expensive. Since a crowdfunding platform offers the service of gathering the investors and promoting the projects, this solves the problems for smaller firms in order to raise funding from a larger amount of investors and is therefore welcomed. Also, the chance of finding funders is greater on a crowdfunding platform, compared to the general public. This is true since investors on the platform are interested in investing in crowdfunding projects. Hence, the capital seeking firm faces a higher hit rate if their campaign is promoted

on a platform. Contacting larger investors is usually a more expensive type of funding compared to getting funds from a larger amount of investors. There is also the need for networking and spending a lot of time finding the right type of investor that knows the business, since this investor will own a large part of the company. To summarize, it is possible for entrepreneurs to move up the supply chain but crowdfunding solves a lot of the problems connected with having to find funding yourself.

There are many substitutes to crowdfunding, for example to obtain a loan from the bank, finding angel investors or venture capitalists. But in many cases, crowdfunding is usually a funding method for SMEs that are not able to obtain a loan from the bank, or to find funding in other ways, so one could argue whether these actually are substitutes for crowdfunding. In some cases they might be, but in many cases they are not. As described by Swedish Agency for Economic and Regional Growth crowdfunding fills the funding gap in the capital market, meaning that small enterprises that could not get funding before now are able to. In these cases, there are few substitutes to crowdfunding.

6.1.4.1 Conclusion Bargaining Power of Entrepreneurs

The bargaining power of entrepreneurs is gentler than the bargaining power of investors, see Figure 12. Like in the case of investors, supply chain movements are unlikely and relatively low concentration puts the platform owner in a prior position.

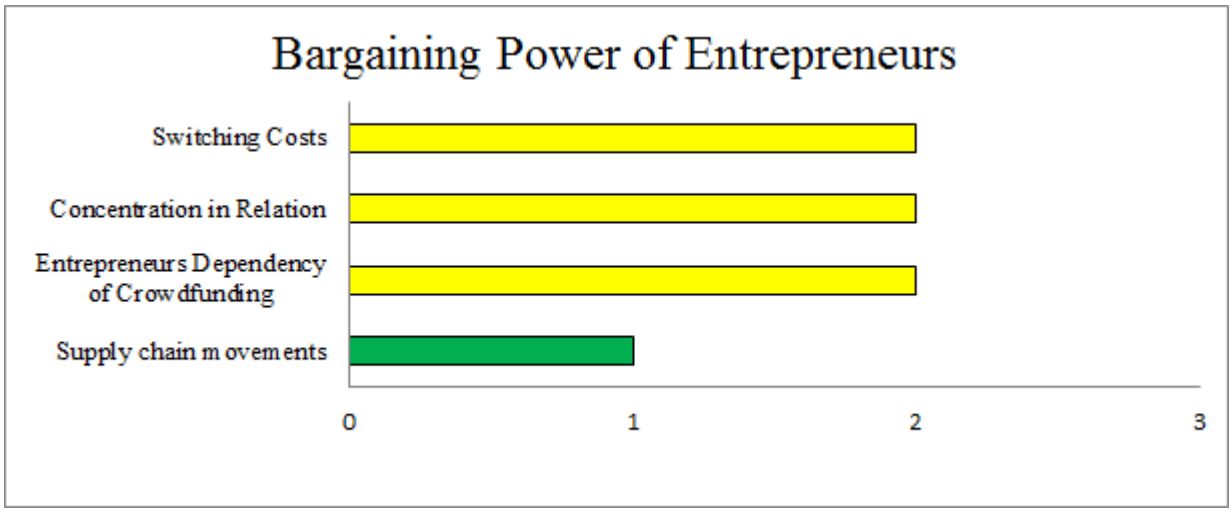

Figure 12: Describing the intensity of different factors of bargaining power of entrepreneurs. The mean value is 1.8.

Since both switching costs and dependency are higher for entrepreneurs, when compared to investors, their bargaining power erodes. All concluded the bargaining power of entrepreneurs is intermediate.

6.1.5 Threat of New Entrants

Threat of new entrants refers to the threat from firms outside of the industry which seek to enter. To compile a good analysis of this threat one has to consider seven aspects in terms of entry barriers. Recall from the section explaining the theoretical framework of Porter's five forces, these aspects, or factors for that matter, are; economies of scale, demand-side benefits of scale, customer switching costs, capital requirements, incumbency advantages independent

of size, unequal access to distribution channels and government policies. Each and every of these factors will affect the threat in a different way.

Switching costs when considering the threat of new entrants differ if compared to switching costs in threat of substitutes and bargaining power of entrepreneurs and investors where the switching costs are between equity crowdfunding and other forms of funding. In the threat of new entrants the switching costs are the costs associated with changing equity crowdfunding platform. This holds true for both investors and entrepreneurs. Since both investors and entrepreneurs can change platform between funding rounds, the switching costs could be considered the same. Both investors and entrepreneurs could also be active at several platforms at the same time. All concluded makes small switching costs a factor heavily affecting the threat of new entrants.

Unequal access to distribution channels is more prominent in industries handling physical products. This means that both the core product distributed as well as the payment are money. It all comes down to digital transactions which mean the access needed to the distribution channel is the access needed to internet. The reality is however not that simple. What is needed is a digital platform on which money is exchanged. Legal restrictions limit the possibility for monetary exchanges and strict requirements has to be fulfilled in order to create your own platform. However, banks possess this opportunity today. Currently active crowdfunding platforms have solved this problem by using external bank platforms for exchanges. Hence, if banks seek to enter the industry of crowdfunding they do not have to rely on an external actor for core activities. This brings them a competitive advantage to incumbent crowd equity platforms, and the threat level rises. However, because of Swedish legal restrictions, crowdfunding platforms are not allowed to offer a platform where investors and entrepreneurs both interact and exchange goods. The threat of banks would therefore be less than it first seemed like. It could anyway be argued that banks are not affected in the same way as new companies when it comes to the trust issue. This is a result from banks good reputation and many citizens, mainly elderly citizens, would not trust anyone else with their money. The behaviour has, however, started to change, especially in the younger generations who are more likely to be unfaithful to their main bank. This means the trust issue would reduce in magnitude in the future. Anyway, the speed of reduction is small and the issue will therefore be present in the coming years.

In crowdfunding economies of scale is not as present in the same way as in a traditional industry with physical products. In traditional terms, the production cost per unit will decrease when the quantity of products produced gets higher because the fixed costs will be distributed among more units of output. This will form an entry barrier in the markets where economies of scale exists, because larger firms are able to sell the products at cheaper prices. In the crowd equity industry these scale effects are not as present as in traditional production industry. Starting a crowdfunding platform does not require any significant investments in for example production facilities or extensive R&D, and operation cost per unit does not decrease with more output in the same way as in traditional industries. Platforms do however benefit from large scale through having many users, i.e. investors and entrepreneurs. As already explained in section 6.1.2, large scale creates value for the platform users and thus it is easier

for an established platform to offer a better value to price ratio. Also successful projects is the source of platforms profitability, hence platforms with large scale has more opportunities to lower their prices compared to new ones. However, looking at the industry and its actors today, no platform has yet reached a significantly large scale. Therefore the entry barriers in terms of scale are for now small, but will probably get higher in the future.

If there are big positive network effects in an industry, it will be harder for new entrants to enter the market, since their product or service will be of less value when there are fewer users. In some industries, network effects are a big part of the service or product provided. In crowdfunding, the service provided is the platform in which entrepreneurs and investors meet. From the point of view of entrepreneurs, if more investors use the platform then the value of the platform increases i.e. a positive network effect. This is because it means more potential projects are presented. Also, if more projects are getting successfully funded on a platform, more entrepreneurs will see the platform as a viable solution to get their company funded, over a platform that has less amounts of companies successfully funded. From the point of view of investors, if more entrepreneurs use the platform it will be a positive network effect because there are more lucrative projects to invest in. On the other hand, there might also be some negative network effects. On a crowdfunding platform, when more entrepreneurs use the platform, the level of competition will also rise in projects of similar nature in terms of which project is more interesting for investors. The amount of projects on the platform will therefore be a negative network effect for entrepreneurs. For investors, the same will be true with the amount of investors.

For companies that are launching a platform, the value of the offering, the platform, will be low in the beginning, before it attracts the entrepreneurs and investors. Network effects could therefore be seen as an entry barrier for new entrants, and extensive marketing campaigns would be needed in order for the platform to gain market share from the existing platforms in the market. The network effects comes with scale and as concluded before, platforms has not yet reached a significant scale, thus platforms existing network effects is an intermediate entry barrier.

To start a new crowdfunding platform the capital requirements are low to intermediate compared to other industries. As mentioned above, there is no need for any big initial investments in order to get the platform running. The required capital to start a crowdfunding website will be costs related to the development and maintenance of the website in terms of paying web developers, paying for the servers, marketing costs and costs related to the provider of the payment mechanism of the platform. Overall, capital requirements are a low barrier to entry in the crowdfunding industry.

First mover advantages can for example be if a firm can lock in customers, entrepreneurs or gain intellectual property rights etc. from being first to market. Suarez and Lanzolla (2005) describe that first mover advantages will only occur in special cases, which depends on the pace of market evolution and the pace of technological evolution. These states are called: Calm waters, The Market Leads, The Technology Leads and Rough Waters (see Table 2 below). Calm waters occur when both the pace of market evolution and the pace of

technological change are slow. The Market Leads occurs when pace of market evolution is faster than the pace of technological change. The Technology Leads is the contrary, and occurs when pace of market evolution is slow and pace of technological evolution is fast. Rough Waters occurs when the pace of market evolution and the pace of technological evolution are fast.

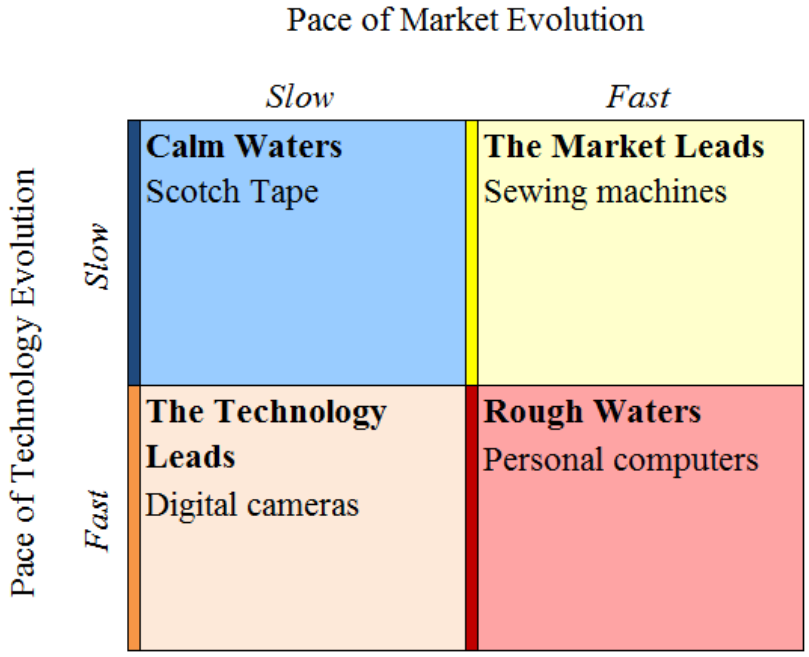

Table 2: Model to use in order to determine first mover advantages. Adopted from Suarez & Lanzolla (2005).

For crowdfunding, the necessary technology was been developed many years ago. In terms of technology, all that is needed to offer the service of crowdfunding, is a website and servers. The technology is not complicated, and therefore the pace of technological evolution can be seen as slow since the technology already exists. The market for crowdfunding has expanded by much in the past five years, and was relatively unknown five to ten years ago. Therefore the pace of market evolution can definitely be seen as fast. The result is that in terms of the model described above, equity crowdfunding can be positioned in the top right, which is The Market Leads.

The Situation Your Company Faces	First-Mover Advantages		Key Resources Required
	Short-Lived	**Durable**	
Calm Waters	**Unlikely** Even if attainable, advantages is not large.	**Very likely** Moving first will almost certainly pay off.	Brand awareness helpful, but resources less crucial here.
The Market Leads	**Very Likely** Even if you can't dominate the category, you should be able to hold onto your customer base.	**Likely** Make sure you have the resources to address all market segments as they emerge.	Large-scale marketing, distribution, and production capacity.
The Technology Leads	**Very unlikely** A fast-changing technology in a slow growing market is the enemy of short-term gains.	**Unlikely** Fast technological changes will give later entrants lots of weapons for attacking you.	Strong R&D and new product development, deep pockets.
Rough Waters	**Likely** A quick-in, quick-out strategy may make good sense here, unless your resources are awesome.	**Very unlikely** There's little chance of long-term success, even if you are a good swimmer. These conditions are the worst.	Large-scale marketing, distribution, production, and strong R&D (all at once).

Table 3: Model to determine likelihood of first mover advantages. Adopted from Suarez & Lanzolla (2005).

Suarez and Lanzolla (2005) further describes whether the first-mover advantages in the different cases are short-lived or durable (see Table 3 above), which means that first-mover advantages can be had for a longer time. The Market Leads category, in which crowdfunding can be placed, describes that short-lived advantages are very likely while durable advantages are likely. In this category, according to Suarez and Lanzolla (2005), the key resources required are large-scale marketing, distribution and production capacity. Distribution and production capacity is less relevant for crowdfunding since everything is handled online. Marketing on the contrary, is more relevant. For crowdfunding, marketing is needed in the initial phase as described earlier. To maintain the market share, marketing will continue to play an important role. This can be in the form of success stories for example, projects that have received the necessary funding and been able to start their business.

Government policy, in the form of legal restrictions, affects the straightforwardness of the act of entering a new industry. Since Swedish equity crowdfunding platforms do not have to register with the national financial regulatory body, Finansinspektionen, as is the case in for example the U.K. where platforms have to go through a registration process with the FCA, the act of entering the Swedish crowdfunding market is pretty straightforward. Because of the legal restrictions in Sweden, Swedish crowdfunding platforms mainly works as meeting points between investors and entrepreneurs, while the British ones works as fully functioning marketplaces where financial transactions are handled via the platform. Legally this makes it quite an easy task to launch an equity crowdfunding platform similar to the ones existing on the Swedish market today.

6.1.5.1 Conclusion Threat of New Entrants

When it comes to threat of new entrants, low switching costs, a low level of economies of scale, almost non legal restrictions, the equal level of access to distribution channels and low capital requirements are all factors that affect the threat heavily, see Figure 13.

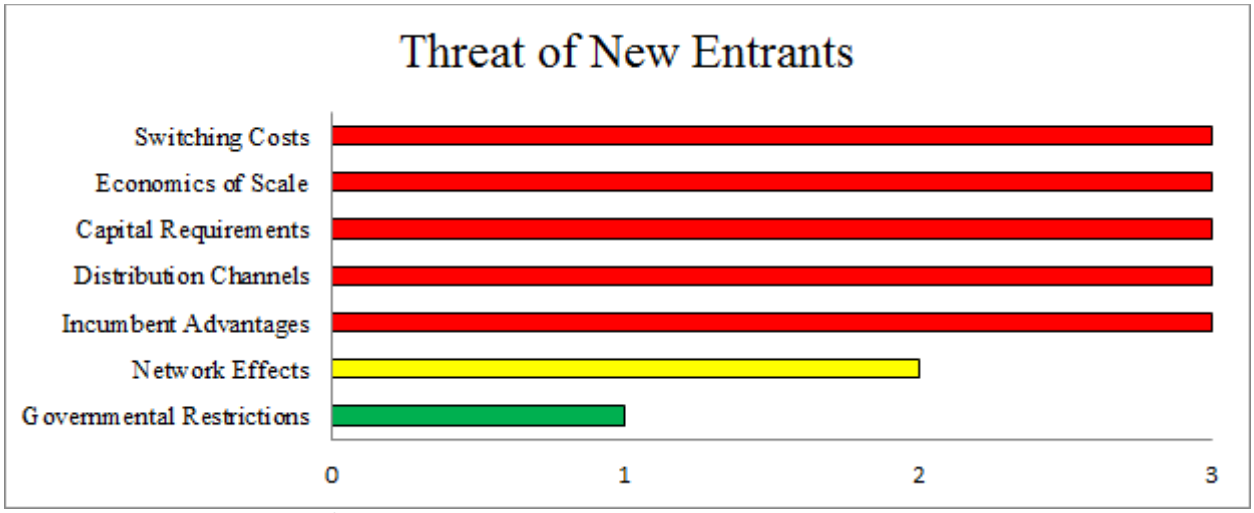

Figure 13: Describing the threat of new entrants. The mean value is 2.6.

Network effects are intermediate while a great proportion of incumbent advantages make the threat less. However, the threat of new entrants is the most prominent force among the five forces analysed. This means that it is the force that pushes down the overall profitability the most.

6.2 Disruptive Analysis of Equity Crowdfunding

In equity crowdfunding it is possible for the public to invest in private companies of their own choosing, which is not possible in many other existing private equity forms in which only a limited amount of investors are allowed to take part. This is an interesting new phenomenon compared to traditional private equity structures that exist in the capital market. The equity crowdfunding platform works as an intermediary between the investors and the entrepreneurs, and is therefore competing with existing financial intermediaries on the equity market, for example the private equity firms. In the Swedish market these companies have had a rapid expansion but this expansion might be threatened in the future by equity crowdfunding.

When analyzing equity crowdfunding and its disruptive character, it is important to note that in terms of the customers of the platform, equity crowdfunding needs to be analyzed from two perspectives: the perspective of the investors and the perspective of the entrepreneurs that are looking for funding. This is because both the investors and the entrepreneurs can be seen as customers of the platform and have different needs.

6.2.1 First Signs of Disruptiveness

In Christensen's definition of disruptive and sustaining innovations, he explains that disruptive innovations are developed by entrant firms, not the established firms in the market. These entrant firms in relation to equity crowdfunding can be seen as the two firms described in this report, Crowdcube and Fundedbyme. It is interesting that the equity crowdfunding platforms have been developed by these entrant firms and not by the established firms in the equity market, which is a first sign according to Christensen of a technology being disruptive. Equity crowdfunding can also be considered to underperform the funds established by the

private equity firms in terms of returns since these are assumed to be lower. This assumption is made because equity crowdfunding in Sweden is a small market today compared to the market of private equity firms, which means that these would be able to find the companies with the highest returns. It is also cheaper to use because of low costs for investors and entrepreneurs and simpler to use because of the convenience of the internet, which are, according to Christensen, further signs of a technology being disruptive.

Equity crowdfunding lowers the costs for investors to participate in the private equity market. Investors on the platform want low costs in participating and of course want profits in return. The institutional investors of the private equity investment funds pay higher participation costs and they also want higher profits in return in order to compensate for this cost. This means that equity crowdfunding takes place in a part of the market which the traditional investors find unattractive, which is a classic entry point for a disruptive technology (see Figure 14, section 6.2.4). As in the example of iStockphoto (see section 5.1), where professional photographers were disrupted by amateurs entering the market, crowdfunding will bring amateur investors into the private equity market. The result is that the participation of investors expands by lowering the cost at the low end of the market, where the traditional incumbents are not able to see profit opportunities.

6.2.2 Market Needs of Investors and Entrepreneurs

In the private equity market, the market needs of investors are to invest in a wide range of companies and get a sizeable return on the investments. They also want access to the most lucrative companies projected to have the highest profits. The return should for instance be higher than the interest rate of having the money in the bank, or compared to other placements where the risks are lower. It is also necessary to be able to assess the risk of investments in order to make smart investments and to obtain information related to the companies and their operations.

From the point of view of the entrepreneurs the needs are to have easy and cheap access to investors for necessary funding, while still maintaining a desired equity share of the company. An efficient funding process is desired in order to get the business up and running to make profits. Time needed to search for funding is time that could have been spent developing the business. Also competitors might beat the company to market if it is not possible to obtain the necessary funding in time. Entrepreneurs in the private equity market might also want the expertise that comes with the professional management of private equity firms and angel investors. As described in the private equity market section, these can offer more than just financial aid.

6.2.3 Performance of the Technology

With the current performance of equity crowdfunding, it is possible for private investors to get higher returns compared to other forms of equity investing, because of the opportunity to invest under startup phases of companies. This will depend on the type of project and the risks related to it. The possibility for investors to select different companies to invest in also exists. The question is whether there are enough lucrative companies to invest in, which is a difficult question to answer since different investors have different needs. Because equity

crowdfunding is a rather new phenomenon it is reasonable to suggest that, at the moment, there are not enough lucrative companies to invest in. It might also be hard to judge the risk related to the investments. The owners of the platforms reviews the companies before they are accepted to the platform (see section 5.4.2) but there are of course still risks related to the projects. Compared to the private equity firms that have a close collaboration with the portfolio companies, which means that they better can assess the risks related to the companies, the ability to assess risks in equity crowdfunding for investors is low. This means that the current yield/risk ratio of equity crowdfunding is low.

Equity crowdfunding also offers the performance of obtaining quick and necessary funding for entrepreneurs. This is however dependent on the number of investors trusting the equity platforms for their investments. If equity crowdfunding continues to grow on the Swedish market the current problem of finding investors and spending time searching for investors could be a problem of the past. However, equity crowdfunding is missing some key features that might limit its potential magnitude. The fact that the entrepreneurs will have to deal with many owners does complicate the owner structure and may require a lot of administrational activities. Further, crowdfunding is not for entrepreneurs who want to keep their business idea a secret, because it lies in the nature of crowd equity for entrepreneurs to exhibit their ideas before getting funded.

In terms of receiving expertise, equity crowdfunding is lagging behind, although a varying degree of expertise depending on the crowd is provided from the crowd investors. A crowd of amateurs might not have the same competence as professional investors, but summing up each and every one's knowledge and engagement they can become a valuable asset offering other kinds of values. For example the founder of Virtuous vodka, a successful one million SEK campaign at Fundedbyme, says that:

"Besides the money I saw it as an opportunity to get more competence in the company, also the investors becomes ambassadors that creates brand awareness. A kind of free marketing" (Entreprenör, 2013, translated)

To summarize, the current performance of equity crowdfunding is not optimal for most investors that invest in the private equity market. For entrepreneurs, the performance of equity crowdfunding offers a solution for many but still lacks the element of expertise and other value added services.

6.2.4 Trajectories of Market Needs and Performance Improvement

The market needs of investors and entrepreneurs are relatively constant over time, which means that the trajectories of market needs in the future will be relatively flat.

Equity crowdfunding has the potential to grow in a different market compared to the traditional market for private equity. In this market entrepreneurs are mostly looking for financial aid and investors are willing to invest in a limited amount of companies without having a close relationship with the owners of the company. For the time being it functions to close the funding gap in the Swedish market. With this market, it has the potential to grow and attract more lucrative projects in the future. Also in equity crowdfunding, risk assessment

of investments is mainly performed by the crowd, and with more investors the ability of the crowd to assess risks will increase.

For the entrepreneurs that are looking for expertise in their fields, they can get the expertise from the collective amount of investors. The possibility of obtaining help from these will also increase with a growing amount of investors. As the equity crowdfunding industry grows it is possible that platforms will evolve into super platforms with a great variety of expertise or into niche players with specialized expertise. Thus how well the majority of entrepreneurs respond to the emergence of new expertise offered via crowdfunding will be crucial for crowd equity's potential disruptiveness.

The performance improvement of equity crowdfunding in terms of numbers of investment opportunities, risk assessment and expertise (see Figure 14) might make it interesting for investors and entrepreneurs that operate in the traditional forms in the private equity market. Thus, the technology, according to Christensen's theories, can be considered to be potentially disruptive against the current financial structures.

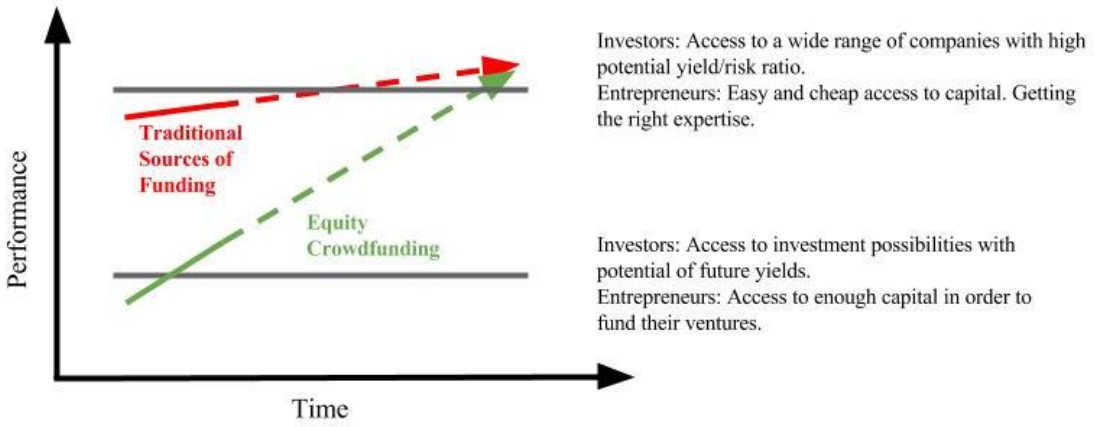

Figure 14: Trajectories of traditional sources of funding and equity crowdfunding. Showing requirements at low end and high end of the market.

6.3 Sustainable Development

In order to understand how crowdfunding can be a tool for a more sustainable development, we must first understand what it means to have sustainable development on both a macro and micro scale. Development implies that we have a destination and common goals which are valuable for us both individually and on a societal scale. When we realize the potential of our society and how we can strive towards a destination of freedom, opportunities and abundance, then we will deliberately fall into a never ending spiral of prosperity with innovation being the key ingredient. Economies face recessions and crisis. However, just like history has proven, these misfortunes will be overcome by creating innovative solutions and hence lay the foundation for a more adapted society.

6.3.1 Innovation

What makes crowdfunding applicable to sustainable development is that it allows for a communication that stimulates innovation, which was previously absent. On both the crowd equity and crowd lending markets it does this by, in a more elegant manner than previously, connecting the people who seek capital with the people that seek ways to realize a return on their capital. Innovation gives us a constantly better standard of living since it, in its very definition, creates value and medicates what is hurting the society. In the same fashion, it is comforting to understand that the problems and circumstances that we face today are only a first step of creating a more adapted and enriched ecosystem.

6.3.2 The Characteristics of the Marketplace

What makes the marketplace of the crowdfunding platform sustainable is that it exists on the premises that all participants act for their own purposes. This natural attraction works as a force that takes us to the destination where all the things that we as customers and fellow citizens are craving for are satisfied. The more that crowdfunding works as a tool to open up for interaction in the commercial life, the more the country will prosper and be affluent. If one more startup is actualized, it may lead to job openings which generate income through employment tax rather than costs through unemployment funds. It also allows for capital that may otherwise lay dormant to be invested and yield a return. Because of the momentum that startups sometimes take on, the market of startups has the potential to capture a high ROI. This capital is later used as a lubricant in other parts of the economy, such as to pay for goods and services in other markets, which in turn will make these markets grow. The more money that circulates, the more money is created and the higher the GDP.

Another characteristic of the marketplace is that it is built on non-discriminatory pillars where all people regardless of background can publish their business ideas. Its response is then determined by the wisdom of the crowd which acts as a reality check and an indication on how successful the launch will be. It loses the discriminatory aspect because only the people that believe in the business get involved. This early-stage encounter between the entrepreneur and potential customers opens up for an effective marketing where the crowd can be part of the product development. In the same way, entrepreneurs can, on reward-based platforms, guarantee themselves sales and get payments even before the production has started. This greatly reduces the uncertainty of how successful the launch of the product will be.

It is worth mentioning the characteristics of the medium on which the business is built. Internet is sustainable and ever growing and allows for a worldwide communication, which means that platforms can reach an international crowd and also fill the communication gap of potential affinity groups. The idea of building a platform that lays the ground for the users to create value on is a sustainable way of letting the crowd co-operate. This will also mean that the content on the website is not created by employees that cost, but by the crowd, and hence requires little maintenance. Subsequently, the platform providers have a large advantage on economies of scale because new projects only account for relatively low administrative costs.

Another aspect of the social sustainable development is that it creates a context for people that would never before associate themselves with their entrepreneurial spirit. It medicates

alienation and hence contributes to a more united people. With a more united people the common goals will be better executed. Crowdfunding not only opens up for economic and social developments, but because the donation-based platforms allow for a place where public goals can be met through projects initiated by volunteers, it also opens for the good of ecology and communion. Projects can contribute to better care for forests, more humanitarian care and charity or for any other altruistic purposes.

6.3.3 Opens New Markets

The role of equity crowdfunding and how it opens up for new markets gives an alternative perspective to that of Porter, which focuses more on competition on existing markets. Angel investors, venture capitalists, investment banks, Almi etc. may be able to collaborate with and participate on the platforms as capital investors. On the donation-based platform Crowdculture public actors such as governmental agencies and regional culture funds will donate money to help with the remaining funding if they believe that the project has value for the society. It is possible that actors such as Almi will be able to do this on equity crowdfunding platforms as well.

Because equity crowdfunding can be considered to fill the funding gap it enables for economical sustainable development through opening up for new innovations and value creation, which in turn have economic advantages on the actors involved as well as on the society as a whole with more tax revenues and job openings.

Sweden has been successful during the 1900's in creating a society that is sustainable, such as that we have strong trade unions and have encouraged companies to grow large. This has allowed for example Volvo, H&M and Ericsson to give birth to ecosystems or networks of business needs around them, which in turn generate taxes, higher GDP and job openings. These large companies have also led to an entrepreneurial culture. It has proven to be beneficial to let the momentum of companies and movements grow strong and equity crowdfunding as a phenomenon could be treated the same way.

7. Conclusions

In the very first chapter of this report, three questions to be answered throughout the thesis were identified. These questions were:

- What is equity-based crowdfunding, does it bridge the funding gap and how does it contribute to a sustainable development?
- What level of profitability do, existing and emerging, Swedish crowdfunding platforms face?
- Is equity crowdfunding a disruptive innovation and hence a threat against current financial structures?

In the following chapter, the answers to these questions are summarized and further elaborated upon.

7.1 What is equity-based crowdfunding, does it bridge the funding gap and how does it contribute to a sustainable development?

Equity-based crowdfunding is a sub-category of crowdfunding, wherein the crowdfunded asset is equity capital, predominantly in SMEs. The equity crowdfunding activity involves at least three types of actors: the platform owner, the entrepreneur and the investor. The value of the activity is co-created among the actors, yet each of them receives the benefits of this value in different forms. The platform owner gets revenue through platform fees, the entrepreneur receives equity capital, market response and broadened shareholder base, while the investor gets shares in an exciting venture with potential for future financial returns (see Figure 8).

Equity crowdfunding has experienced rapid growth in recent years. Since legal uncertainties in the U.K. were wiped out equity crowdfunding has surged in terms of funding volume. In the U.S., expectations are high for a similar surge when the JOBS Act goes into full effect, and all over Europe regulators are looking into the phenomenon. In countries where the legal framework is clearly set, platform owners seem to be more satisfied with the appropriateness of the regulations. However, with disparate national regulations, the tendency seems to be that platforms stay national to a large extent. This tendency goes against the striving for larger markets and free movement of capital that is one of the four freedoms of the European Union. For the time being, harmonised European regulation seems to be a long way off, but in a not too far future such measures should be expected, since that has been the case in other parts of the capital market. With harmonised regulation, the small Swedish market can expand into the integrated European market with more potential entrepreneurs and investors, and thereby higher potential revenue, but also stronger competition.

Equity crowdfunding has some characteristics that the current financial markets lack. One of the more prominent characteristics is that it gives private investors the opportunity to invest in a company's early stages. This opportunity has until now only been available to larger actors in the capital market, e.g. banks and angel investors. The high operational risks that are

present in SMEs are however deterring these actors, leaving SMEs with fewer funding alternatives. This fact has left SMEs facing a funding gap that has been identified as investments in early-stage companies in the range of 1-20 million SEK. This range is pretty much exactly where equity crowdfunding operates today. Equity crowdfunding thus enables more investors, and hence more capital, to be invested in SMEs that otherwise would not be able to raise sufficient funds, i.e. it works to bridge the gap.

As the world grows smaller, the distance between investors and entrepreneurs will decrease which makes it possible for wealthier Europeans to invest in less developed regions such as countries in the sub-Sahara region in Africa. It would develop the human civilization in a positive way. This may be possible when considering a long time horizon. In the near future, however, the use of crowdfunding on an international level is more likely where countries currently share laws e.g. in the European Union. An integrated European market for equity crowdfunding would give rise to a more effective distribution of capital, when entrepreneurs from less affluent parts of Europe can get access to the deep pockets of Northern European investors. Once this happens, these less affluent parts that can also be regarded as developing countries can expect an inflow of capital. The general attitude that Sweden and other wealthy parts of Europe have towards these developing countries is that they need help and support. That is true, but with crowd equity these countries can be supported when investors are looking to make a profit. For example, producers of goods or agriculture products that use old and inefficient tools can operate much more efficiently if they would get ahold of a small investment that could buy them more advanced tools. To share technology and knowledge that already exists is easy and can contribute to high growth, which suggests that this kind of leapfrog could take place if crowdfunding platforms become international.

7.2 What level of profitability do, existing and emerging, Swedish crowdfunding platforms face?

The main force platforms need to tackle is the threat of new entrants. Bargaining power of investors and entrepreneurs along with threat of substitutes are also of importance, but as the industry is in a rapidly expanding phase there will be an inflow of new customers to withhold profitability. Rivalry among firms will become of greater importance as new platforms enter the market and the level of rivalry increases. Hence, the threat of new entrants and the rivalry among firms are forces more important to further elaborate upon. The amplitude of all the forces and the context in which they operate are visualized in Figure 15 below. To summarize, the overall profitability of the Swedish equity crowdfunding industry is neither low nor high. However, since it is difficult to give the level of profitability an exact value, the answer to the question is that profitability and level of competition is somewhere between low and high.

The main issue for platforms should be to fend off new entrants in order to secure their place in an upcoming consolidation. However, factors such as capital requirements, distribution channels and governmental restrictions cannot be affected by platforms. Thus, what platforms need to focus on is switching costs and economies of scale in order to build barriers to entry.

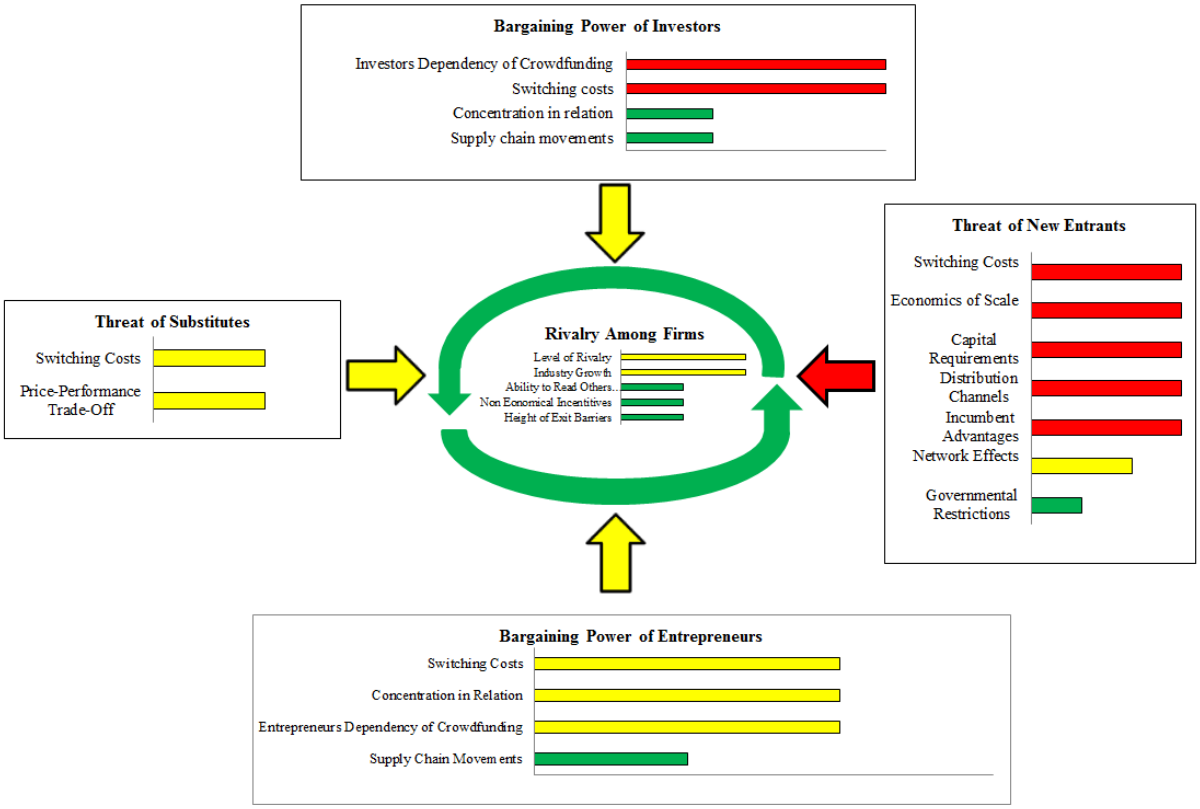

Figure 15: Porter's Five Forces applied on the Swedish equity crowdfunding industry.

As could be seen in Figure 15, the low level of switching costs is a major factor generating strong threat in multiple forces, in one way as switching cost for substitutes, but primarily as switching cost for investors and entrepreneurs between platforms. Hence platforms should try to make switching costs higher. For investors it is easy to switch, and even to use multiple platforms at the same time, since they for investors are free of charge. Thus platforms need to create greater incentives for investors to invest in their particular platform. This could be done by offering more investment opportunities but also by increasing the added value for investors. One suggestion in order to increase the number of times an investor uses a specific platform is to reward loyalty. This could be carried out in several ways. Examples are loyalty programs where the investor gets different bonuses in accordance with amount invested, and the use of gamification, which is a way of engaging and motivating use of a product or service without the need to offer material rewards. An example of the gamification approach is the Swedish bank Nordnet's initiative Shareville, where private investors in the public equity market can see each other's portfolios and rankings of the most successful investors. Another approach that could attract investors is by offering a closer contact with the entrepreneurs. This would motivate the investor by adding an emotional relation to the previously economic connection connecting investors and entrepreneurs. This would require entrepreneurs to put more effort in their relation with investors, a matter sometimes hard to motivate. However, emotionally close investors should be attractive to keep for the entrepreneurs, especially if the entrepreneurs have planned to conduct a re-run of funding or to start a new company. Thus also the switching cost for the entrepreneur would be higher if already having engaged investors via a certain platform.

Another method to create higher entry barriers for platforms is to increase their scale benefits. As explained in sections 6.1.5 and 6.1.2.2, this would be done by connecting more entrepreneurs and investors to the platform and thus increase co-creation of value. Then not only barriers by scale would be higher but also network barriers. Thus the threat of new entrants will diminish as platforms grow in size.

Taking the conclusions made in section 7.1 into account of more integrated European markets in the future, competition will increase and Swedish platforms will have to compete with for example British platforms that today are the most successful in Europe. This will increase the rivalry among platforms, and more different strategies might come forth. In the other types of crowdfunding, platforms specialized in a unique niche, like Sellaband, has been successful. When the markets get bigger, platforms will not have to take such a large part of the market share to be able to get large enough scale benefits, and a similar development may start, with equity crowdfunding platforms specializing in specific industries. Thus it is likely that in the future there will be a few larger crowd equity platforms and many smaller specialized platforms.

For now there are no actors with non-economic incentives, but this will possibly change. As explained in section 7.1, crowd equity is filling a funding gap which in many ways is beneficial for a society. Thus it would be in the Swedish Government's interest, since they already have multiple funding organisations for startups such as Almi, to create a non-profitable crowd equity platform for both national and local level. Municipalities should supposedly have incentives to start local platforms in order to promote local SMEs and grow organically. Using the local community as an investing crowd would make sure that only projects with actual appreciation from the citizens get funded. Also it would be a democratising of investments in SMEs taking the power from large capital owners and giving it to the people.

Still incumbent platforms have first-mover advantages and good possibilities to remain market leaders in the future. As seen en Figure 15, they are likely to have durable advantages given that they have the resources to address all market segments as they emerge. Large-scale marketing will be an important factor to get more users and expand. Thus it is important for platforms to have enough resources for marketing, since new platforms that already earned a lot of money on another market, or with strong capital backers, might emerge.

7.3 Is equity crowdfunding a disruptive innovation and hence a threat against current financial structures?

Based on the study in section 6.2, equity crowdfunding can be considered to be a potentially disruptive technology against traditional forms of investments in the private equity market. It does not however offer all the necessary services to be competitive in the mainstream market of private equity firms today. But because there is a market for equity crowdfunding in

Sweden it has, according to the theories of Christensen, the potential to increase its performance and move from the low-end to the high-end market and then become competitive against other intermediaries on the private equity market.

It has however also been shown that equity crowdfunding fills an existing funding gap, and hence opens up for funding of ventures that traditional funding structures missed, or did not want to invest in. Thus, it should not necessarily be seen as a cannibalisation of other sources of funding where actors on the capital market are outcompeted, but rather as an enabling for more actors to take part in the funding of SMEs than currently. The traditional actors do not have to see crowdfunding as a threat only, since their offering to a large extent differs, with professional knowledge and experience being a big part of for example private equity firms' and angel investors' product. Instead they can find ways to co-operate with and take advantage of the new phenomenon. The funding gap exists partly because the risk in such investments, as discussed earlier, is deemed too high for traditional actors to handle. But after a company has successfully managed to raise equity capital from a large number of private investors who has thereby endorsed the business model, this risk, to some extent, has been mitigated. Thereafter it might be easier for the company to raise additional capital from traditional sources.

Whether crowdfunding will be disruptive against current financial structures or not, time will tell, but what already can be seen is how it has started to disrupt bureaucratic barriers and regulations that today hinder innovation. Laws and regulations has already started to change in many countries to make way for equity crowdfunding and all the possible good impacts on the economy and the society that comes with it. These changes break down the barriers between private investors and entrepreneurs and pave the way for a more prospering entrepreneurial landscape.

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