

Crowdfunding in Finland – A New Alternative Disruptive Funding Instrument for Businesses

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ABSTRACT

The phenomenon of the crowd on the Internet is widely well known, as well as its collaborative power. Companies use the power of the crowd to improve their products, for marketing campaigns, or co-create their products in collaboration with the consumer. Recently a new phenomenon emerged – *crowdfunding* (CF). Platforms such as Kickstarter assist to raise funds for various projects. In Finland very successful ventures, such as e.g. Timo Vuorensola's campaigns for the new movie Iron Sky demonstrated the possibilities. Within the scope of this research work we elaborate the power of crowdfunding, and particularly explore its possibilities in the Finnish context. We conducted a qualitative study based on interviews to explore crowdfunding as alternative mechanism to existing fundraising mechanism, pinpoint to legal pitfalls, risks, and benefits for entrepreneurs. The study rounds up with a thorough discussion how crowdfunding can be a disruption for traditional financing mechanisms in Finland.

Categories and Subject Descriptors

K.6 [Management of Computing and Information Systems]:
General - Economics

General Terms

Management, Economics, Experimentation, Human Factors,
Theory.

Keywords

Crowdfunding, entrepreneurial finance, motivation, disruption,
entrepreneur, social media, Finland.

1. INTRODUCTION

In the last five years, CF phenomenon in America and Europe has been a significant source of financing new businesses with an estimated 2500 Million Euros raised in 2012 alone as shown in

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Figure 1. CF is getting bigger both in terms of number of active platforms and funds raised are growing at 63% annually over the last three years [4]. According to [2], through CF companies and individuals worldwide raised \$2.7 billion in 2012. This highlights the fact that CF phenomenon is growing rapidly both in terms of funds raised and the number of active platforms around the world as shown in Figure 1.

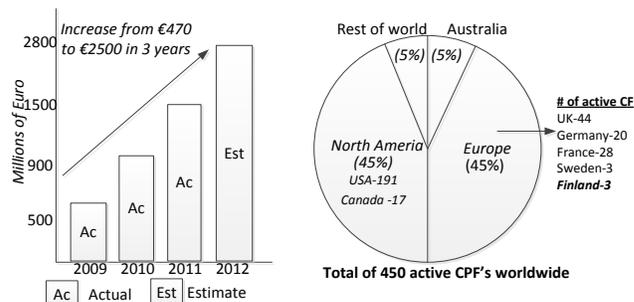


Figure1 Crowdfunding market around the world [4].

The phenomenon of CF has gained momentum in Finland and seen the emergence of five active Finnish platforms as e.g. Mesanaattime, Invesdor, FundedByMe, Fixura, or Venture Bonsai and received high media attention through the recent controversy of a book campaign by Senja Larsen on Kickstarter as a result of legal problems with the Finnish Police. As a matter of fact, director Timo Vuorensola from Finland raised 686270€ for the movie Iron sky budget through CF in 2012. In spite of the recent controversies, CF is gaining popularity in Finland and the launch of CF platforms catering directly to the Finnish market has caught the interest entrepreneurs, researchers and investors around Finland.

2. OBJECTIVES AND METHOD

The objective of this research is "to explore the role of Crowdfunding as disruptive fund raising model in Finland". In particular the study tries to answer the following research questions:

1. What is Crowdfunding (CF)? What are the different models in Crowdfunding? How does Crowdfunding process work?
2. What is the situation of current entrepreneurial finance in Finland? Is there a need for Crowdfunding in Finland? If so, what are the drivers?
3. Would Crowdfunding be disruptive to established fund raising models in Finland?

4. What are the influencers and factors affecting Crowdfunding in Finland?

By answering the above questions, it would be possible to understand the impact Crowdfunding would make in the Finnish business community.

This research involves in-depth analysis of literature published on entrepreneurial finance and Crowdfunding. Furthermore, in depth interviews with the decisions makers of three Crowdfunding service providers in Finland (mesenaatti.me, Invesdor and Fundedby.me) are carried out. In addition, interviews of an experienced banker, a senior government representative and a financial service provider are carried out to provide us with a holistic picture on investor sentiment [14]. Overall, the threefold approach is taken to get a realistic understanding of fund raising environment in Finland.

3. ENTREPRENEURSHIP & FUNDING

3.1 Entrepreneurial Capital

The term “entrepreneur” has been used frequently in this paper and hence in this section an attempt has been made to define the terms associated with it. Entrepreneurship is a dynamic process created and managed by an individual, which strives to exploit economic innovation to create new [5].

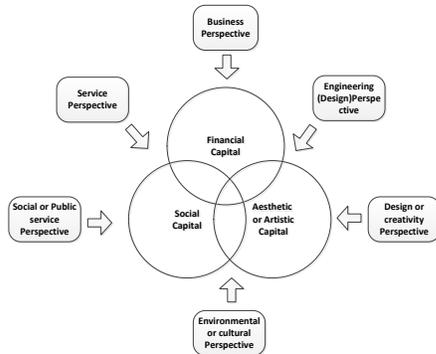


Figure 2 Entrepreneurial capital [6]

There has been a lot of literature analyzing personality traits and motivation of entrepreneurs, but with mixed and inconclusive results [7]. However [6] claims that entrepreneurial activity and behaviour could be found everywhere; be it business, community initiatives (generally termed as social entrepreneurship), public sector initiatives, sport, military, theatre, art, music or exploration.

Entrepreneur’s intellectual capital is used to create one or more of financial capital, social capital, artistic or aesthetic capital as illustrated in Figure 2. However [6] deliberately overlapped the circles as many entrepreneurial ventures clearly create two or even three of these capitals simultaneously. In addition to the capital created, most ventures feature a blend of the six perspectives as highlighted in the Figure.

3.2 Entrepreneurial Finance

There is a strong link between the characteristics of the individual, investment need and the type of finance chosen. Based on the entrepreneurial features and motives, [5] establishes a matrix in Figure 3 characterising various types of finance with respect to

skills of the entrepreneur, size of the investment, risk involved and the innovation and creative capital of the project or venture.

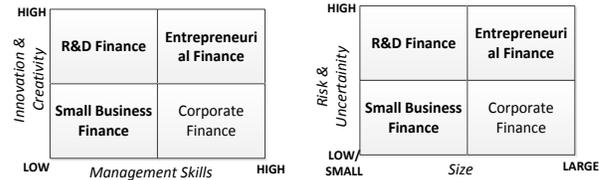


Figure 3 Typology of Finance [5]

[5] clearly defines **entrepreneurial finance** as the finance offered to ventures during the phase they are between opportunity recognition and IPO (they are listed in the stock market). According to him **corporate finance** is for large ventures that have the capability to get listed in the stock exchange. [8] uses the principles of agency theory to differentiate entrepreneurial finance from corporate finance wherein they assign the roles of principal and agent to investors and managers, respectively. Entrepreneurs play the role of both the agent and principal, as in most cases they hold ownership rights in the venture. In a corporate venture, the managers take finance decisions on behalf of the owners or board of directors [8]. Thus in entrepreneurial finance, the entrepreneur assumes agency risk of both agent and principal, therefore positioned high both in management skills as well risk and uncertainty of finance.

Furthermore, according to [1], most entrepreneurial ventures need to raise money during their life cycle to tackle cash flow challenges, capital investments and lengthy product development cycles. Based on need and stage of the venture, they categorize them into sources of personal funding, raise external financing like debt or equity and other creative sources of financing and the same has been illustrated in Figure 4.

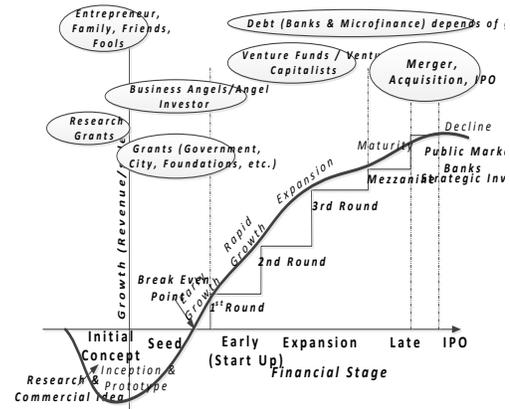


Figure 4 Financing Cycle of a venture [10]

In the following a list of examples for entrepreneurial finance can be found [1]:

- Personal funds, family, friends, bootstrapping and government grants (see e.g. [1]).
- Debt financing (see e.g. [8]).
- Business angel (BA) (and see e.g. [3]).
- Venture capitalists (VC) (see e.g. [9]).

Summarizing, entrepreneurs prefer personal funding over external financing. There is a phase of funding gap when the seed moves into a startup and often requires high creative and management skills of the entrepreneur to cover this gap through bootstrapping or grants.

4. OVERVIEW OF ENTREPRENEURIAL FINANCE IN FINLAND

According to [11], several financing options are made available to entrepreneurs seeking finance in Finland. Provided with a viable and operable business idea, financial support and advice is offered both by government and private organizations. According to [12], Finland rank very high in overall government support to entrepreneurs, but the outcome in terms of new and nascent entrepreneurship has not been good yet.

The entrepreneurial financing agencies in Finland as listed by [11] are state agencies like (i) **Starttiraha (startup money)** which provides entrepreneurs funds for 18 months to start and run a new business, (ii) **SITRA** which offers funding assistance for programs on public health care, nutrition and energy, (iii) **TEKES** which provides funding for technology and innovation projects and (iv) **Finnvera** which is a state owned company granting loans and guarantees to Finnish companies and private agencies like (i) **FVCA-** The Finnish Venture Capital Association, (ii) **FIBAN-** Finnish business angel network and (iii) Commercial banks.

Most of the new business development is funded fully or partially by government agencies in Finland. Even the debt funding provided by commercial banks is often partially guaranteed by Finnvera. In this context [12] claims that the Euro crisis hovering currently would challenge government budgets in the coming years and hence result in rationing of public money and support towards entrepreneurial activities.

Summarizing, entrepreneurship and entrepreneurial culture is on a rise in Finland. According to [13], “Finland is well on its way to an entrepreneurial culture which can be compared with the U.S”. There has been rise in entrepreneurial intentions in Finland, especially among the younger Finns and entrepreneurship is seen as a desirable career choice in Finland. However post the Euro crisis in 2008; entrepreneurial financing from traditional sources has taken a back seat, motivating entrepreneurs in Finland to look for alternate source of financing. Therefore, the next chapter discusses the concept of “Crowdfunding” as a potential source of new venture finance.

5. FINANCING A VENTURE WITH CROWDFUNDING

Entrepreneurs often face hurdles in arranging the necessary finances at the initial stages of establishing a new business. According to [15], many ventures remain unfunded as they either lack resources to be pledged to funding agencies like banks and equity capitalists or they are unsuccessful to find and convince specialized investors like business angels and venture capitalists. This current situation has led entrepreneurs to look for a new source of finance “Crowdfunding” also referred to as “CF” by tapping the crowd instead of specialized investors.

5.1 Definition of Crowdfunding

CF is referred to as a recent phenomenon, but the fact of the matter is that it has been around for centuries in the form of

raising money from people for elections, wars, social causes and micro financing. Much before the formation of intermediaries like crowd funding websites and social networking websites entrepreneurs engaged in personal crowd funding initiatives [16]. However, according to [17], the term “CF” was coined in 2006 by Michael Sullivan while launching his crowd funding website. He further states that *assuming web and crowd are the only two components of CF as an activity*, the very first examples surfaced in the 90’s itself. However, after doing an extensive study on literature available, Table 1 gives the definition of CF with different perspectives.

Table 1: Definition of Crowdfunding

Source	Definition of Crowdfunding
Ordanini (2009)	An initiative undertaken to raise money for a new project proposed by someone, by collecting small to medium-size investments from several other people (i.e. a crowd) [21].
Belleflamme et.al (2011)	Involves an open call, mostly through the Internet, for the provision of financial resources either in form of donation or in exchange for some form of reward and/or voting rights [15].
Ideavibes (2011)	Raising financing via the internet online through the collective efforts of a group of individuals referred as crowd [20].
Rubinton (2011)	The process of one party Financing a project by requesting and receiving small contributions from many parties in exchange for a form of value to those parties [19].
Mollick (2012)	Funding of efforts (cultural, social or business) by drawing small contributions from large number of individuals using the internet [18].
Lehner (2013)	Tapping a large dispersed audience, dubbed as ‘the crowd’, for small sums of money to fund a project or a venture through social media communication via the Internet [9].

Therefore, given the established fact that CF is a subset of crowdsourcing and the umpteen definitions of CF from different perspectives showcased in Table 1, within the scope of this paper, CF is defined as “*process of an individual or group of individuals raising capital for a cause; be it cultural, social or business by attracting small contributions from a large crowd using social media and internet as the medium for communication*” [14].

5.2 Motivation for Crowdfunding

CF goes beyond online community participation and adopts a proactive role to the crowd who act as customers as well investors in both supporting and providing financial assistance for the projects [21]. So, *why do people start a CF initiative?* The very obvious answer is to raise money for their project or idea. CF initiatives found that raising money or financial capital was the main motivation of the project owners, while getting public attention and obtaining feedback was relevant for 60% of them [15]. According to [22], CF gives the project owner with relevant information regarding pricing, market demand and product feedback through direct customer interaction.

However, the motivation for the crowd investing in CF initiative could be social return; financial return and material return [22] as illustrated in Figure 5.



Figure 5 Motivations for Crowd [22]

Given the wide range of CF initiatives and the motives to participate, Figure 6 gives a bird’s eye view of the various perspectives of CF. As suggested earlier, most business or entrepreneurial ventures feature a blend of the six perspectives and the same is applicable to a CF initiative too. Further, the project for which CF initiative is undertaken might create social, financial, artistic capital or a combination of two or more as illustrated below. The Motives can summarize as a culmination of crowd motives to invest along with project owner’s motivation to start a CF initiative. Overall Figure 6 gives a summary of the type of return or capital and various perspectives associated with Crowdfunding.

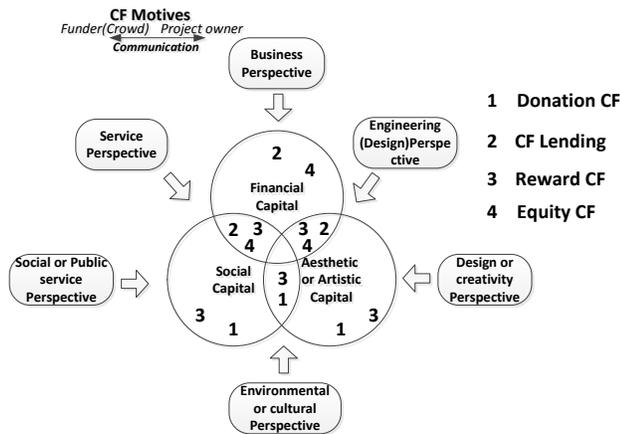


Figure 6 Motives of Crowdfunding

It is very evident that donation CF usually has a social or cultural perspective as illustrated in figure 6 and according to [15]; this is worthwhile model of money collection for many charity organizations and NGOs. However, donation CF can be relevant to generate artistic or aesthetic capital as in the case of music artists discussed earlier. Similarly equity, reward and lending CF have been highlighted in the above figure.

5.3 Positioning Crowdfunding in the Financing market

Analyzing the literature on CF discussed so far and the literature on new venture financing, a comparison between CF with other sources of financing has been established in this section.

The crowd funder or investor forms the backbone of CF, with the motivation of investing either financial, intrinsic or combination of both as discussed [14]. However by virtue participation in CF, be it equity, reward or donation, the crowd displays willingness to take certain monetary risk. Based on the type of CF [14], [23] highlights the parameters of motivation, risks and rewards in Figure 7. Reward or Donation based CF has fixed rewards and hence cannot be equated with risk, as the investor expects something in return.

The inclination of an individual towards intrinsic or extrinsic factors decides on the type of project an individual chooses to invest. One important observation is the closeness of the risk profile of equity crowd funder to that of a BA/VC [23] [14]. Usually BA/VC are expert investor with a sole purpose of financial return as compared to CF investor, but the sheer amount of money and expectation of higher returns increases the risk as illustrate in the figure. Figure 7 also nicely summarizes the comparison of CF with traditional financing options with an investors view point.

Furthermore, another end of the spectrum to ensure the success of CF is the entrepreneurs and innovators. As discussed, entrepreneurial finance varies over a wide range from seed, start up to growth ventures and financed by various options ranging from self, debt to equity.

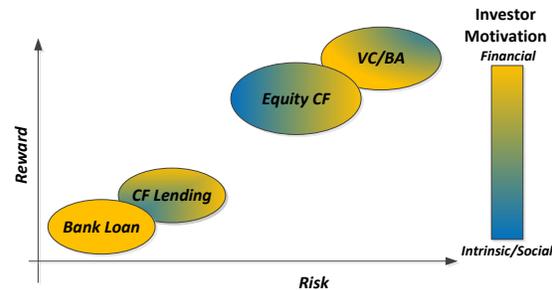


Figure 7 Investing in CF (extended from [23])

In addition to this donation and reward CF was seen as tools to fund pre seed stages or some small projects. However there have been instances of reward CF gathering funding for growth ventures during the 2nd or 3rd round of funding too [14]. In general CF is a very new phenomenon and the precise definition of its application is still developing.

6. CASE FINLAND: CROWDFUNDING AS DISRUPTIVE ENTREPRENEURIAL FUNDING MODEL

6.1 Current state of Crowdfunding in Finland

During the research and interview phase, information about Crowdfunding Platforms in Finland was compiled and the same has been illustrated in Table 2. In addition to the platforms operating out of Finland, many international CF platforms like Kickstarter, Indiegogo and many others has attracted public attention too. Overall, CF is a new phenomenon in Finland, but has been growing steadily over the last two years.

Currently the investment attracted by entrepreneurs through these platforms in Finland is a little over 1 million Euros. The peer to

peer lending platform “Fixura.com” has attracted over EUR 15 million over the last three years of its existence.

Table 2: CF Platforms in Finland

Platform	Current Type	Established, Investment attracted & origin
Mesenaatti.me	Reward/Pre-purchase/Pre-sales	Autumn 2013, EUR 100000 till date , Finnish origin (Operates in Finnish mostly) [14].
Invesdor	Equity	Early 2013, EUR 709000 till date, Finnish origin (operates both Finnish & English) [29] [14].
Fundedbyme	Equity/ Reward/Pre-purchase/Pre-sales	Spring 2013 in Finland, Swedish origin (operates in English); EUR 3 million in Sweden till date in 2 years [28] [14].
Fixura	Lending (peer to peer)	2009 in Finland; EUR 15 million; Operates in Multiple languages (Open to borrowers from Finland & investors from Europe) [14].
Venture Bonsai	Equity	Earliest CF venture in Finland (2012). No success yet [14].

Based on the information presented through the interviews and information study [14], the Finnish Crowdfunding Platforms are plotted using Thompson’s framework.

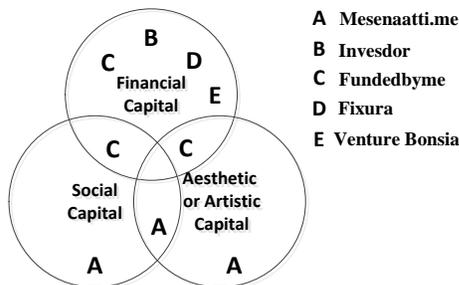


Figure 8 Type of Projects on specific Finnish Platform’s

Mesenaatti.me, for example is seen by the author in the current state wherein projects related to public service, art, culture or music could seek finance. This assessment is based on analysis of information available in public domain, information gathered through interviews and intuitive observation. Similarly the author feels that Invesdor, Fixura and Venture Bonsai would suit for companies looking to raise capital with a business perspective. However, the author plots Fundedbyme as highlighted not only because it operates as both equity and reward based Crowdfunding Platform in Finland, but also due to its successful experience as reward based Crowdfunding Platform in Sweden [14].

6.2 Observations about Entrepreneurial Financing in Finland

- Entrepreneurial intention is on a rise in Finland, especially among the younger generation who view it as a potential career choice [13] [25] [12], thus creating a huge demand for entrepreneurial finance [14].
- Equity Financing in Finland has dropped drastically post the 2008 crisis. Venture capital and Business angel investment in new ventures have dropped by 30 to 40% per venture as compared to 2007 [24]. Debt financing via banks has decreased post the crisis [13] [12]. Banks have a safer, low risk policy and hesitate to lend to nascent ventures [14].
- The rate of Informal investors is increasing and the willingness to take risks in investment is booming [25] [12]. The affluence of Finns has increased over years, thus creating a huge investor base looking for opportunities to invest [14].
- Lack of entrepreneurial capital in Finland combined with the local Finnish population affluence and willingness to invest creates a business opportunity for CF in Finland [14].

6.3 General Observations of Crowdfunding in Finland

- CF is in an emerging state in Finland and lags behind other innovative economies with an uncertainty surrounding its adoption in Finland [14].
- Finnish attitude of promoting localized services and understanding of Finnish specific fundraising laws acted as drivers for setting up of Finnish Crowdfunding Platform’s [14].
- Motives for participation in CF are not different from rest of the world with emotional connection for the project being the main motivational factor in addition to financial or material returns [14].
- Financial return for the crowd does play an important part depending on the amount of investment made on the project [14].
- Understanding of Finnish laws is the key to run a CF campaign and educating the Finns is the biggest challenge Crowdfunding Platform’s currently face in Finland. Gaining the trust of people through communication, research and success stories is the current priority of these platforms [14].

The summary of the entire analysis has been represented in figure 9 using the Dedehayir & Nokelainen framework [26], thus showcasing the present state and emerging state of CF in Finland. Equity CF is seen as having potential to disrupt Business angels in the future. However, there is not enough evidence to back this statement in the present state; hence it is positioned in between antagonistic rivalry and fraternal rivalry. There is a divide of opinion on whether BA’s would use CF to complement their business or CF would disrupt substitute BA’s completely. Furthermore, Government funding mechanism like Tekes view CF as a welcoming addition to the financing world, thus positioned in the category of fraternal cooperation [14].

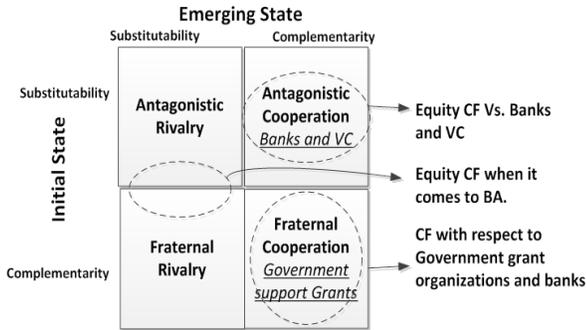


Figure 9 Crowdfunding being disruptive.

However banks and VC's are positioned in the category of antagonistic cooperation. Banks have huge volumes, however with respect to pre seed capital, CF is seen as an avenue to get the necessary capital before approaching banks for further financing. Similarly VC's surpass CF in volumes, but can be seen to collaborate with Crowdfunding Platform's to explore financing options in the future.

6.4 Disruptive Nature of Crowdfunding

The discussion on disruptive nature of CF in Finland was analyzed on two perspectives - one from entrepreneurial finance perspective and the other from an investor's perspective. The highlights of this study can be summarized as

- There is a funding gap with respect to new ventures, especially seed and pre seed capital in Finland.
- CF, especially equity CF positions itself in the territory where Business angels operate. Ventures have up to 100,000 Euros in Finland through equity CF [14].
- One interviewee suggested BA and VC's investing in ventures through CF initially, while another suggested otherwise and felt equity CF would be disruptive to BA's [14].
- Volume of banks and VC's too high for equity or reward CF to act as disruption.
- The majority interviewee [14] voiced opinions that CF would not be disruptive, but instead added potential to the funding market and acted as an additional source of funding which entrepreneurs could explore.
- A positive sentiment was expressed by all interviewees [14] with regards to the Finnish investor participating in CF. Equity CF was seen by two interviewees as attracting Finns dealing in the stock market or mutual funds. However, there was no sentiment of threat or disruption at the present state.

6.5 Other Practicalities of CF in Finland

Over the course of the study and analysis, there were some important practicalities that surfaced [14] and have been summarized -

- Donation CF is not practical for individuals in Finland; it is only applicable for NGO's or non-profit organization under the Finnish fundraising law.
- Reward based CF campaigns must be carefully designed – The project must be sold under consumer law. There should be

a fixed price for a reward to make it look like a sale and VAT is paid for the transaction.

- The success of a campaign depends on the quality of the project, social networking capacity of the entrepreneur and marketing reach of both the entrepreneur and the CF platform.

The study attempts to answer all the research questions raised while defining the objective of the paper. Overall, Crowdfunding in a Finnish context has been discussed elaborately during the course of this research.

7. CONCLUSIONS

7.1 Crowdfunding in a Finnish Context

There are currently five Crowdfunding Platforms, wherein the type of projects promoted and capital generated has been illustrated. The analysis of the information gathered from literature study and qualitative interviews is showcased in Figure 9 and summarized as

- CF is in an emerging state in Finland and lags behind other innovative economies with an uncertainty surrounding its adoption in Finland.
- Finnish attitude of promoting localized services and understanding of Finnish specific fundraising laws acted as drivers for setting up of Finnish Crowdfunding Platform's. There were other social and economic drivers discussed
- Motives for participation in CF are not different from rest of the world and showcased in Figure 10, with emotional connection for the project being the main motivational factor in addition to financial or material returns.
- Financial return for the crowd does play an important part depending on the amount of investment made on the project.
- Understanding of Finnish laws is the key to run a CF campaign and educating the Finns is the biggest challenge Crowdfunding Platform's currently face in Finland. Gaining the trust of people through communication, research and success stories is the current priority of these platforms.

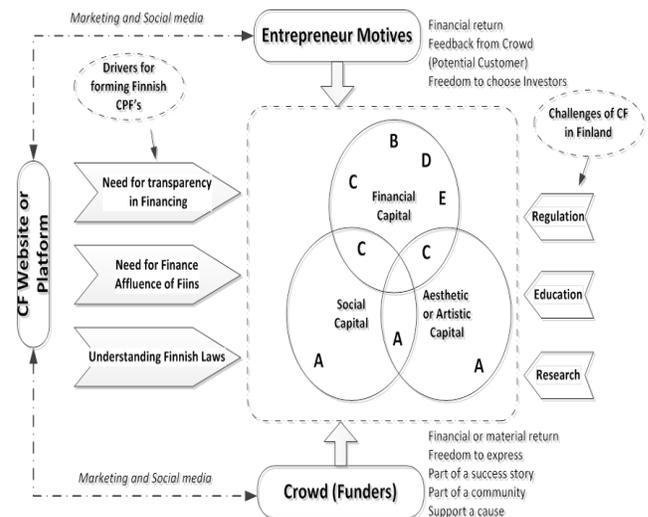


Figure 10 Crowdfunding analyses in Finnish context.

As highlighted in Figure 10, the Finnish entrepreneur's need for risk free finance, crowd investor's need for an alternative investing forum coupled with failure of international CF platforms to operate alongside Finnish fundraising laws form the main drivers of localized CF platforms in Finland.

From motivational perspective, financial return coupled with other intrinsic benefits motivated both the entrepreneur as well as the crowd. From a financial perspective, the factors of ROI and knowing where ones investment came out as an important motive for the crowd. For the entrepreneur, CF formed an alternate way to fund the venture with almost risk free capital and also understand his customer base. From an intrinsic perspective, emotional connection with the project or entrepreneur with other benefits like being part of a community, part of a success story and freedom to express oneself highly motivating the crowd. Moreover, equity CF motivates entrepreneurs as they provide risk free capital and decision making stays with the entrepreneur. This is not the case with BA/VC's where decision making could be shared.

Finnish Crowdfunding Platforms face unique challenges while operating in Finland as analyzed in this paper and highlighted in Figure 10. CF is an emerging issue in Finland and the knowledge of the Finns about this concept is very nascent. Understanding the Finnish laws and customizing services to be able to operate in Finland is a challenge already overcome over the last one year. Educating the customers i.e., both the Finnish entrepreneur and the crowd regarding the legalities and benefits of CF is a huge challenge in the current scenario.

There is a need for Finnish Crowdfunding Platform's to market them and achieve greater success stories to build trust within the community. More research by academia and market experts on CF needs to be undertaken in Finland to gain the confidence of the Finns.

This study was conducted to analyze CF as a potent new entrant in the Finnish fundraising market. The overall objective was to analyze if CF would disrupt traditional fundraising mechanisms in Finland. However, CF being a new phenomenon had been to be defined in Finnish context and parameters associated with it had to be analyzed. The objective was reached though an integrated framework showcasing CF in a Finnish context. The research methodology of literature study and qualitative interviews was adopted to achieve it.

7.2 Concluding Remarks

Within the scope of this paper, Crowdfunding is defined as a process of an individual or group of individuals raising capital for a cause; be it cultural, social or business by attracting small contributions from a large crowd using social media and internet as the medium for communication. The study highlights that Entrepreneurial intention is on a rise in Finland creating a huge demand for entrepreneurial finance. Traditional debt and equity financing have dropped post the crisis, thus creating a funding gap for new ventures. Moreover, the affluence of common Finns and risk taking intent has increased over years. There is a need in the market for democratic and open fundraising mechanism, with CF having these qualities. However the study concludes that in the present scenario CF is an alternate mechanism rather than a disruptive one. Although banks and VC's surpass CF in sheer volumes, there were some apprehensions regarding equity CF

being disruptive to Business angels. In addition to this it was established Finns are slow adopters of new innovations and financial services.

Furthermore, during the journey of achieving the main objective of analyzing CF, an integrated framework highlighting drivers, motives and challenges of CF was developed. The understanding of Finnish fundraising laws and Finns affinity towards localized services proved to be the main drivers for Finnish CF. The study also highlights that donation based CF is not legal in Finland for individuals and reward based CF needs to be designed carefully to meet legal requirements. The Finnish CF platforms have incorporated these factors in their services, however further research by academia and consultants would build consumer confidence. Educating the Finnish entrepreneur and crowd regarding the risks, benefits and legalities of participating in a CF is the biggest challenge of CF in Finland. Overall the study showcases positive and welcoming sentiment towards CF in Finland.

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