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# Crowd-funding

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Crowdfunding has developed powerfully in the past decade as a new means of financing by which businesses and individual people can raise the money they need for projects by collecting small amounts of money from lots of separate people.

Crowdfunding usually operates through open internet platforms. The applicant for financing is looking to fund their project within a fixed time frame. Those who invest money in the project want to earn a return on their investment, through interest income or a share of the profits for example. This means that crowdfunding brings together three types of participant, with the project owner who is applying for funding, the investor, and the crowdfunding platform that provides the crowdfunding service.

Crowdfunding can come in three forms:

- loan-based crowdfunding, which brings together people who want to borrow money with those who are prepared to lend it to them for a fee.
- investment-based crowdfunding, where the applicant for financing uses the crowdfunding platform to offer securities, shares, units or equity instruments, and the funder can earn income from equity, bonds or participation in the project.
- crowdfunding without financial income, where projects are supported and money is given for charitable goals that do not earn any income.

## The development of crowdfunding

Rapidly developing crowdfunding offers new opportunities alongside the services of banks, funds and investment firms. Crowdfunding is used as an alternative source of funding by start-up businesses and growing businesses, and also by individual people. Crowdfunding finds finance for projects, initiatives and consumer desires that would not always be satisfied through traditional financing solutions.

It also gives people with savings the chance to earn additional income on them. It should be remembered though that with every investment there is a risk that the money invested will be lost. Crowdfunding makes investment more accessible as money can be put into separate projects in small amounts. Crowdfunding has probably also become popular in places because of its promises of high returns, but these may partly reflect the higher risk of investment.

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## The risks to crowdfunding

Investing or borrowing through crowdfunding platforms comes with the following risks:

- Financial loss risk. Money that is invested can be lost. Projects offered through crowdfunding can be very speculative, especially start-up businesses, as they have no history of operation or any guarantee that their business plan will succeed. This means that investments and businesses can lose all of their value. There is also the risk that the borrower is later unable to repay the loan or to meet the obligations of their bonds. Crowdfunded real estate projects may later not sell at the price hoped for and so the profit that depended directly on the sale may not materialise.
- The duration of the investment. Whether crowdfunded investments are repaid depends a great deal on the performance of the company receiving the investment. It can in consequence often take a long time for investments to be repaid, especially with start-up companies, as it can take a long time for them to achieve profitability, or they may never do so.
- Liquidity risk. Crowdfunding platforms, or the businesses operating through them, do not necessarily allow investments to be realised before their maturity dates. Furthermore, there is generally no secondary market where the investments can be sold on.
- Criminal abuse of good faith. Before making their investment, those investing through crowdfunding platforms need to check the credibility and trustworthiness of the platform and its owners or management, including its earlier projects. The investor needs to look closely at the conditions of the crowdfunding platform and at the liabilities that they are taking on.
- The economic cycle. Crowdfunding is not isolated from the general performance of the economy or the state of the financial sector. The success of earlier projects that received crowdfunding provides no guarantee that similar projects will prove successful in future.
- Risk to the household budget. Investment should be limited to amounts that can be lost without affecting everyday life. Anyone deciding to invest needs to consider the risk to themselves and their family budget.