

## **Crowdfunding as One of the Recent Trends in Financing Emerging and Small Projects in the Arab World**

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### **Abstract**

*Small and medium enterprises (SME) are the real engine of economic growth and job creation in developing countries. Furthermore, the social and economic developments still the best hope for any nation to prosper. However, communities quest to meet operating requirements highlight the critical importance of care of a new generation of entrepreneurs, whether employers or workers with entrepreneurial spirit.*

*The funding problem remains the most important problem facing entrepreneurship, small, medium, emerging enterprises in all countries of the world. This paper provides a new way to finance the so-called collective funding or crowdfunding.*

**Keywords:** *Crowdfunding, Financing, collective financing, entrepreneurship, emerging business*

### **1. Introduction**

Entrepreneurship is one of the primary purposes for which human efforts is heading to, every day trying to find new and innovative ways to earn his living, start a new project or take advantage of an idea. There are various patterns of entrepreneurs between peddlers to creators of advanced technology, and these all are united by the desire to exploit their talents and resources in the best way possible, while distinguishes them is the success rate in achieving the ambitions that depend on the environment in which they work.

Entrepreneurship requires innovation and change that might take different forms, where the Arab world is beating young talented and creative ideas. But those ideas often do not see the light for several reasons including lack of financial support from relatives, government agencies, or business men.

There is a growing interest of governments of the importance of entrepreneurial trend in stimulating the economy which led to an increase in the number of government and international institutions to take care of and help entrepreneurs. They offer special financial and technical support for them to enable them to establish their own projects and thus increase the entrepreneurial projects. However, the financing gap still exists, especially for start-ups and entrepreneurship due to the high degree of risk.

Since the occurrence of the global economic crisis (2008), there is an aversion to individual investment portfolios in banks and investment on the one hand, and fear on the part of banks and finance lending in financing emerging and pilot projects because of fears of high degree of risk.

The nature of the decentralization of the internet and the growth of social media contributed in revolutionizing the ways of financing all over the world, where the online fundraising efforts liberated from the restrictions and hierarchy strictly imposed by the traditional donors institutions. The strength of local and global networks is employed to obtain financial support for projects and ideas. This kind of transformation in contemporary finance called (Crowdfunding), or electronic participatory funding or collective funding.

This paper will address some global indicators related to innovation and entrepreneurship and ease of doing business.

## 2. Global Business Indicators

Global indicators are used for measuring the most important standards that guide governments towards the future and development of their plans to achieve their development, economic, and social goals.

We will discuss here three indicators for the year (2016) namely:

1. Innovation index,
2. Entrepreneurship index,
3. Ease of doing business index

These indicators help planning and decision-making centers in the analysis of the current situation and take appropriate measures for improvement as shown in Table (1).

Table (1) Arab global indicators for the year (2015)

No.	Entrepreneurship Index		Ease of Doing Business Index		Innovation Index	
	Country	Center	Country	Center	Country	Center
1	USA	1	Singapore	1	Switzerland	1
2	Canada	2	New Zealand	2	Britain	2
3	Egypt	91	Egypt	112	Egypt	99
4	Algeria	79	Algeria	154	Algeria	133
5	Tunisia	63	Tunisia	60	Tunisia	78
6	Morocco	82	Morocco	71	Morocco	84
7	Jordan	65	Jordan	117	Jordan	64
8	Kuwait	37	Kuwait	86	Kuwait	69
9	Saudi Arabia	31	Saudi Arabia	49	Saudi Arabia	38
10	UAE	20	UAE	22	UAE	36
11	Bahrain	43	Bahrain	53	Bahrain	62
12	Lebanon	50	Lebanon	104	Lebanon	77

From the previous table, the order of Egypt does not rise to the level required of the same census with the largest Arab population, economic, and human resources outweigh Lebanon, Jordan, Tunisia and the Morocco countries, but those countries are ahead of Egypt respectively in the three indicators.

Furthermore, we infer from that there is a profound imbalance between development plans and their results, education systems and their outputs, scientific research and its output, investment trends, and the current Egyptian government's must lay out an emergency plan to overcome those negative indicators.

## 3. Crowdfunding

The evolution of the concept of funding in recent decades, developed in a remarkable way in terms of its form and those who offer them. This development was due to several reasons, including:

- Increased competition,
- The intensification of inflation,
- Direct government intervention,
- Indirect economic activity,
- The global economic crisis (2008),
- The technological advances.

**Crowdfunding** is one of the most important funding, especially in Islamic banks, which contributes to the activation of the sources of funding for economic foundation, especially start-up projects because of its positive effects on the production of the institution, and is considered an alternative to bank financing that does not fit in often with the status of small and medium enterprises at the beginning of the evolution of its activity (AHMIA, 2006; Sharma, 2016).

With the development of technology, the transition to the age of knowledge, digital economy, the proliferation of online, and high-tech smart phones there has been a contemporary twist on the types of funding and crowdfunding started to take another turn.

In (1997), the fans of the British music band (Marillion) collected donations sums up to (\$60,000) through the Internet without the knowledge of the band. The movement has inspired a lot of people and began Crowdfunding sites to spread on the Internet, such as (ArtistShare) platform for Crowdfunding devoted to music in (2001).

Then the sites began to emerge, such as (Kiva) in (2005), (Prosper) and (LendingClub) in (2006), (Indiegogo) in (2008), (Kickstarter) in (2009), and (Fundable) in (2012).

The World Bank defines crowdfunding as "enabling companies and business organizations relying on the Internet to collect the necessary funds, whether voluntary or investment by many individuals" (InfoDev, 2014).

As defined by (Ehlers et al.) as "a broad term used to describe the increasing spread of the fundraising process is done through the Internet, where there are groups of individuals who own the money make small contributions to achieve a particular goal" (Ahlers and others, 2015; Sharma and Lertnuwat, 2016).

We can define Crowdfunding operationally as follows: "business model is supported on the Internet through which to obtain the necessary funding for entrepreneurial projects through the collective effort of individuals without dependence of the policies of government agencies or investors in terms of adherence to their vision or the sale of the project intellectual and commercial rights".

#### **4. Crowdfunding Models**

Crowdfunding is characterized by its flexibility on the one hand and its ability to adapt to environmental changes around it to fit with the objectives and policies of each country, and with the patterns of entrepreneurial projects prevailing in each country. That is why we find a few of its models. The most famous of these models are reward, lending, investing, and mixed model.

##### **4.1 Reward model:**

This model consists of two partially similar systems: donations system and reward system. We will explain the characteristics of each system.

##### **First: Donations Model**

This model is called (Donation-Based), where individuals financiers donates to the project without expecting any financial return or percentage of the profits from the project owner, and there is no risk to the owner of the project because he does not provide any guarantees to financiers (Lehner, 2013; Sharma and Lertnuwat, 2016).

The owner of the project displays either an idea or a prototype and requests the idea to be financed or the production of prototype to be financed commercially. The project can be an entertaining work, a product, or a game. In this model entrepreneurs cannot increase the original capital for their project later, and donors do not get any guarantee against fraud or failure to implement the idea. A site that provides this service is (Justgiving).

### **Second: Reward Model**

This model is called (Reward-Based), and it resembles donations model in terms of being a low risk to the owner of the project, where the project owner undertakes to provide a non-cash symbolic reward to financiers in order of precedence, or the amount of funding. The project owner faces difficulty in raising the capital.

Financiers received a gift which is a portion of the product or service, or sometimes get a complete product by the amount of their contribution. The return to the investor is low and there is no sufficient guarantees to financiers (InfoDev, 2014;Lehner, 2013).

Reward models (donation - the reward) use two types of financing: (AON) and (KIA). The first type (AON) called "all or nothing" or "fixed funding". The owner of the project does not receive any funding only if it has reached the amount required during the permitted time period for the campaign. In case the necessary amount did not reach what is required, the project owner does not receive any amount and lose the site fees. One of the famous sites is (Kickstarter).

The second type of financing (KIA) is called "retention of what has been collected" or "flexible funding", and allows the entrepreneur to obtain any amounts collected during the campaign period even if they have not attained the desired goal. Among the most famous sites that uses this model (Indiegogo) site; furthermore, (AON) model is also used (Cumming, and others, 2014).

## **4.2 Investment model**

This model consists of two systems also. They are lending and investment (share ownership). An explanation of the characteristics of each system as follows.

### **First: Lending model**

This model is called (Lending-Based) or (Peer-to-Peer). In this type of financing, financiers provide the desired amount in exchange for a certain percentage as interest they agree with the owner of the project; furthermore, they agree on the period of time for repayment. Through this model, a good capital for small and medium enterprises can be formed even for big enterprises (Bruton and others, 2015; Sharma and Lertnuwat, 2016).

In this model, the banking business is not clear for the individual investor and may be exposed to the possibility of loss of the investment if he did not repay the loan. Among the most famous loan sites is (Kiva).

### **Second: Investment model**

This model is called (Equity-Based), and in this model the financiers have part of the property rights or participate in the profits or management, as previously agreed with the owner of the project. This model can achieve a high financial gains and significant

increase in the capital can as a result of attracting large number of investors who are looking for shares in a company or a successful project outside the restrictions of stock market, brokers, and do not have large amounts of money to speculate in the stock market (Deffains-Crapsky and others,2014; Sharma and Lertnuwat, 2016).

This model also carries a risk to the owner of the project where the creditor turns in the case of bankruptcy of the project, and the guarantees related to investment may be a bit complicated in some countries, especially with regard to nationality and transfer of funds. Among the most famous investment sites are (Crowdcube) and (Seedinvest).

#### **4.3 Mixed model**

This model is made up of the previous models together, as those sites allow the entrepreneur to choose those models that commensurate with project characteristics and the time period necessary for the financing, or can choose more than one model of financing. A few of the well-known mixed models sites are (bankable) and (Angelsden) (Danmayer, 2014).

### **5. Crowdfunding Requirements**

Applying crowdfunding requires a range of elements that form an essential basis for the work of those sites including regulations, transfer of funds, investor protection, property rights, the spread of social media, the Internet, and encouraging a culture of entrepreneurship.

#### **First: Laws organize dealing**

Countries that seek to apply crowdfunding should take several measures to create conditions for investment, as the policies and regulations for entering the field of entrepreneurship is cumbersome and expensive (InfoDev, 2014).

For example, the procedures for setting up new businesses in many developing countries is characterized by excessive bureaucracy and the process is expensive and time consuming, and that the tax system needs to be flexible with regard to new projects. Also bankruptcy proceedings should be acceptable and uncomplicated allowing for a leading business risk and lack of fear of failure and bankruptcy (Valanciene and Jegeleviciute, 2013).

There is also a need to provide laws and procedures to enable the transfer and money exchange electronically either through bank credit cards or electronic prepaid cards like (Mobile Phone, Paypal, CashU), with the ability of governments to control money laundering and terrorist financing operations (Schwartz, 2013).

States must also provide laws that protect investors from fraud, swindling, deception, and impose strict restrictions regarding cybercrime that poses a threat to the contemporary business models. Where crowdfunding sites are obliged to establish legal warnings to its users in compliance with the policies and procedures required by the government, and do not bear any liability in the event of project owner has not been able to fulfill its obligations (Hazen, 2012).

As for intellectual property rights and patents, crowdfunding sites often disclaims any fraud or violation of the right to property and the project owner is required to obtain a patent or intellectual property rights.

#### **Second: Social media**

Technology helps in establishing the contemporary business models that depend on the Internet, helps facilitate government regulatory actions on those systems, and get accurate information (Moissejev, 2013; Calic and Mosakowski, 2016).

Technology is also working in these models as the role of a mediator between the financier and the owner of the project. It contributes to the idea of participatory economy and easing formalities for traditional financing.

Social Networks like (Facebook), (Linkedin), (Twitter), and others play key role in crowdfunding models. The more in the circle of acquaintances and friends the more the owner of the project can promote his idea effectively with little effort and without costs (Balboni and others, 2014; Kuppuswamy and Bayus, 2017).

### Third: The culture of encouraging entrepreneurship

Crowdfunding depends on the existence of entrepreneurial culture within the country, and studies on the subject show that factors such as culture, legal environment, and economic incentives have an impact on the development and success of entrepreneurship.

These factors are either restricts or enables stimulating entrepreneurship projects, and therefore governments should encourage entrepreneurial culture by supporting entrepreneurship, business incubators, and business accelerators. Governmental Organizations may enhance or hinder the success of entrepreneurship by identifying the level of its risk, on the other hand, the leading behavior is affected by the laws and procedures in the country (InfoDev, 2014; Josefy and others, 2016).

In order to achieve entrepreneurial success, it needs to have a supportive ecosystem of interrelated factors ranging from infrastructure and access to financial services. Decision-making institutions play a very important role in the ecosystem of entrepreneurship (Nagroudkevich, 2014).

The following figure (1) shows these elements and their relationship to the surrounding environment as an open integrated system.

## 6. The Benefits and drawbacks of crowdfunding

### 6.1 Benefits of crowdfunding:

The benefits of crowdfunding can be determined by the following points (Manchanda and Muralidharan, 2014; Josefy and others, 2016):

1. Funding source for the capital needed for the projects contain a few models that suit any project.
2. Evaluation of the project or the idea is done by public and a preliminary test is made for it.

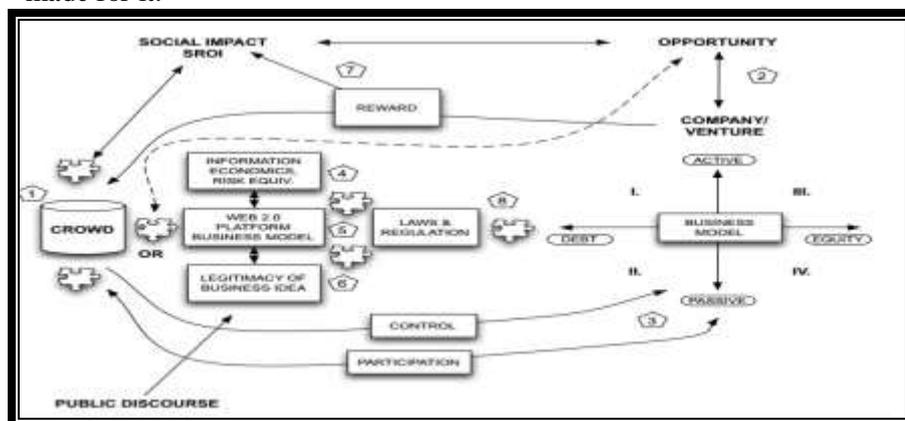


Figure (1): Crowdfunding requirements

**Source:** Lehner, Othmar (2013): **Crowdfunding Social Ventures: A Model and Research Agenda, Venture Capital.**

3. Marketing tool for emerging companies increase production and define targeted markets.
4. Encourage creators and innovators to launch their skills and ideas in all fields without fear of failure. The idea does not have a high material value but brings sufficient funding for its implementation.
5. Constructive feedback to the idea or project by the public helping the owner to know the reasons for his failure if he does not get adequate funding and work on the development of the project.

In the Reward model, the cost for the owner of the project is very low.

1. Providing opportunities for individuals with limited financial resources to own stakes in start-up companies with small amounts of money away from the interference of middlemen and brokers and without extra costs.
2. Financier has the freedom to choose from thousands of projects presented at his personal discretion and reading of what public says about this idea or project. He has the right to withdraw his funding at any time of the campaign, even if it ended.
3. The global market, there is no restrictions on the owners or financiers of the projects in general, although some sites require certain conditions that comply with their local laws.
4. Sites offering various administrative, financial, technical, and legal services to the owner and financier.

## **6.2 Drawbacks of crowdfunding**

Drawbacks of crowdfunding can be summarized as follows (Ramos, 2014):

1. Get tricked by the owners of the project, where they may evade the implementation of their project after getting the required funding, especially in the reward model.
2. Limited funding for some types of projects, and this is linked to the organization laws in the countries where we find that the US legislature prohibits funding for projects with a more than a million dollars, and prevents investment of more than (\$2,000) if the annual income does not exceed (\$100,000) .
3. Fear of losing the privacy of the idea or the project and get stolen as a result of trading on the Internet.
4. The need for time, effort, and continuous follow-up by the project owner to promote his idea during the campaign and to respond to inquiries.
5. Loss of financier to invest, even if the amount is little but it adversely affects the sincerity and realism of these sites.

## **7. Stages of Crowdfunding campaign**

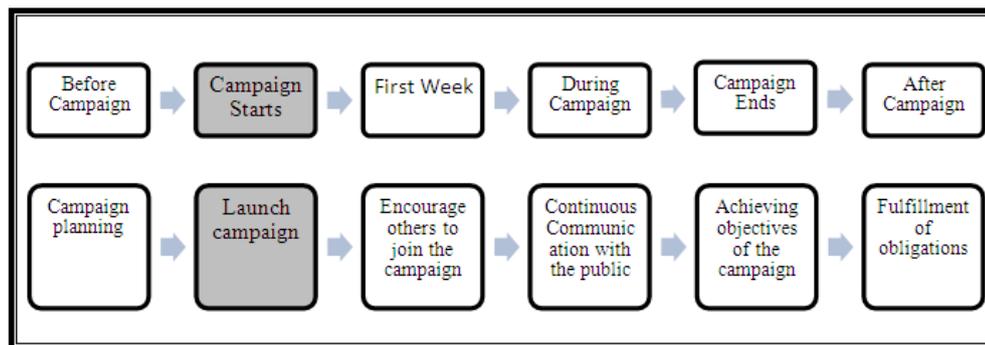
To campaign for the project through crowdfunding sites, the project owner must start search for the site's policies and conditions, the types of available funding and whether it fund his type of project or not.

As for the project itself and how to display it on the site, there are important actions to be taken as follows (Gerber, and others, 2014):

1. Preparation of the campaign content: the preparation of a framework for the project that include: the title, the goal of the project, a video of the definition of the project,

clarify the financing plan, the desired amount, and the time period of the campaign which is often associated with the policies of the site ranging from (30-90 days) as well as a reward if you follow the specifications of the reward model of funding. In case of management of the site accept the project, it moves the project to a special page of the project owner within the site to follow-up financing which contains a mechanism for communication with potential financiers to answer any queries.

2. Check and follow the campaign: by communicating with the public, either through the feedback services provided by the site or through e-mail, to know the project path, the degree of acceptance, to convince financiers of the project, and at the same time taking their suggestions and opinions to improve the project.
3. Circulation of the project during the campaign period: sites provide advertising and promotional services for the project, but should not rely on it completely. Where many project owners seek to promote their campaigns, either through a private project on Facebook pages or publish on Twitter or talk about it in various social forums, in an effort to expand the fan base that hear about the project which may include a possible financier also.
4. After the success of the campaign: project owner succeeded in raising the amount of funding required and therefore the project owner is committed to fulfill the implementation of the project and to deliver to the financiers what was agreed upon, whether in a form of reward or investment. A certain percentage is deducted for site management ranging from (5% -10%) of the amount that has been assembled. Note that in the investment models, there is a legal contract between the owner and financier with the terms and percentages agreed either in terms of loans or ownership.
5. The campaign failure: in the case of a failed project the site management does not get any percentage of the funding even if the (KIA) model was used. This failure does not mean the project itself failed, but is considered a catalyst for the owner to search for the reasons for the failure if the problem is in with the way of presenting the idea, the required amount was large, or inability to communicate with the public. Figure 2 shows the stages of crowdfunding campaign.



**Figure (2)** Phases of crowdfunding campaign

The motives of investors to invest and support the project mostly caused by either a desire to get the reward, a share of the project, a future profit, desire for participation, cooperation, or love to help others.

## 8. (SWOT) Analysis of Crowdfunding

In order to decide whether crowdfunding is suitable for a project, it is useful to examine its strengths, weaknesses, opportunities, and threats (Sharma and Lertnuwat, 2016), (Valanciene and Jegeleviciute, 2013). The following table shows the (SWOT) analysis.

Table (2): analysis (SWOT) of crowdfunding

Power	Weakness
Entrepreneurship control their companies and their projects	Administrative and accounting challenges
Capital required appropriate	Possible theft of the idea or business projects due to display on sites
The project examined in terms of the possibility of marketing	Weak investor protection and the possibility of fraud
Local and international communities benefit from the project	Certified business model on the Internet affects the investor's ability to get detailed tips
Opportunities	Threats
Leveraging the power of social networking for promotion and communication with funders	Laws and legislation in some countries inappropriate
Positive impact of crowdfunding on the economy	High-risk for small and entrepreneurial projects
Investment opportunities for specialized / good way to raise capital	

Source: Valanciene, Loret, Jegeleviciute, Sima (2013): **Valuation of Crowdfunding: Benefits and Drawbacks**, Economics and Management

### 9. Areas of Finance

The most important areas that have been funded through crowdfunding sites are described as in figure 3, where it is clear that the area of services was ranked first, followed by the field of technology, finance and consumer goods.

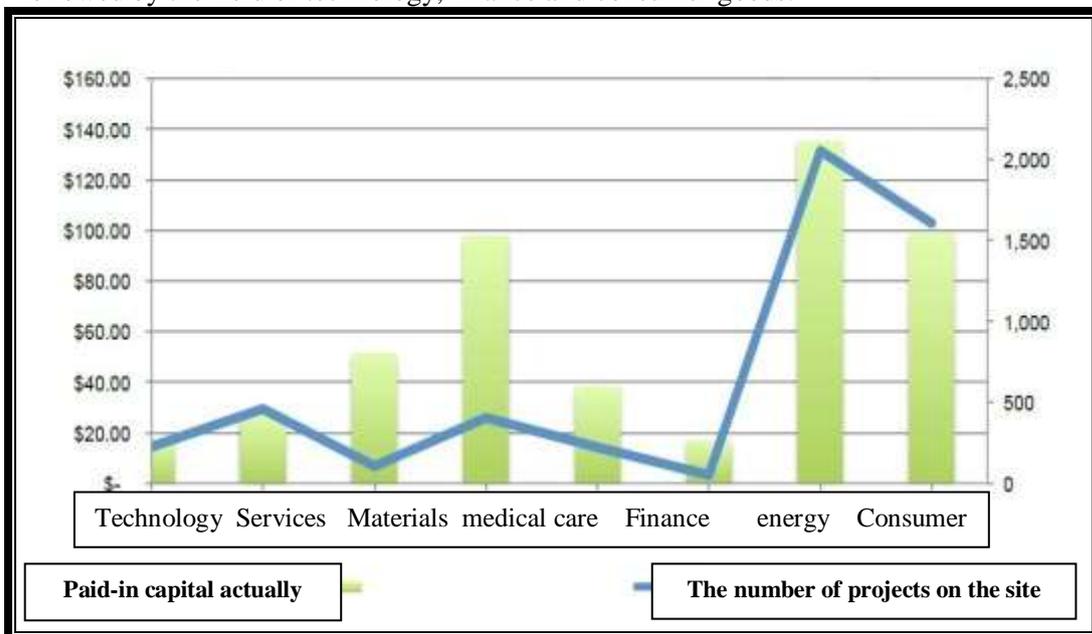
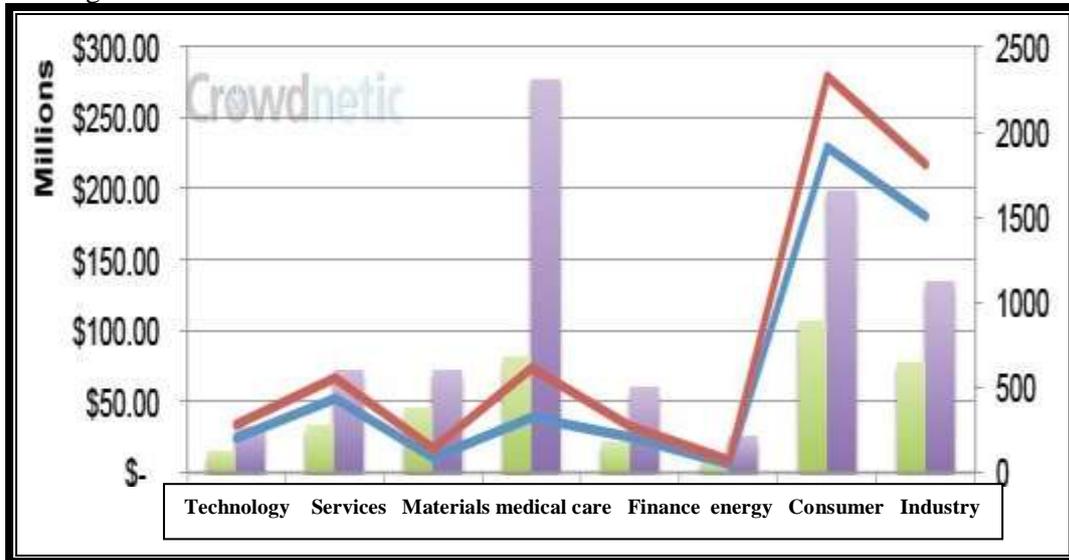


Figure (3) the most important areas that have been funded through the general locations (2014)

Source: <http://www.crowdnetic.com/reports/jan-2015-report>, P. 1, (2015)

### 10. Global Indicators

At the end, we review some of the international and Arab crowdfunding indicators to see the gap between advanced and developing countries in the use of modern methods of funding.



**Figure (4):** Total Offering Activity Through Years 2014-2015  
**Source:** <http://www.crowdnetic.com/reports/oct-2015-report>, P. 3, (2015)

**Table (3)** World crowdfunding sites

No.	Country	Number	No.	Country	Number
1	USA	344	12	South Africa	4
2	France	53	13	India	10
3	Italy	15	14	Russia	4
4	UK	87	15	Belgium	1
5	Spain	27	16	Hong Kong	1
6	Holland	34	17	China	1
7	Germany	26	18	Estonia	1
8	Switzerland	13	19	Palestine	1
9	Brazil	17	20	UAE	2
10	Canada	34	21	Egypt	3
11	Australia	12	22	Lebanon	1

**Source:** InfoDev(2014): **Crowdfunding’s Potential for the Developing World**, Finance and Private Sector Development Department. Washington, DC: World Bank

It is clear from the above table the followings:

1. Crowdfunding concentrated in the continent of North America and Europe, as being one of the leading communications and technology innovations countries and encourage entrepreneurship and small businesses.
2. The number of sites in the continent of Asia and Africa does not exceed (35) sites, which require us to shed more light on the cause of non-proliferation of this type of financing in those continents.
3. Although the continents of North America and Europe are the leaders in the industry and technology, but the spread of Crowdfunding sites demonstrates the attention of the governments of those countries to be proactive in supporting entrepreneurship by all possible means.

4. Arab countries possess (7) sites for Crowdfunding, an indication of the weakness of interest in this method of financing maybe caused by modernity on the one hand, or lack of interest in entrepreneurship on the other.

Table (4) shows total investment in the Crowdfunding sites and the number of global locations between years (2009) and (2014).

Table (4) The evolution of the number of sites and the total of crowdfunding worldwide

S	Year	Number of sites	Finance volume (million dollars)	Funding growth rate
1	2009	208	530	-
2	2010	306	854	61%
3	2011	470	1.470	72%
4	2012	536	2.806	90%
5	2013	688	5.100	81%
6	2014	870	10.000	96%
7	2015	1250	34.400	244%

Source : <http://research.crowdsourcing.org/2015cf-crowdfunding-industry-report>, (2015)

It is clear from the above table the followings:

1. The dramatic increase in the number of participatory Crowdfunding sites demonstrates the effectiveness in the financing process and persuading the investors who represent the public capital.
2. The significant high volume of funding between (2009) and (2014), where the report expect this amount to reach (\$120 billion) in (2020), which demonstrates the importance of Crowdfunding tool for financing entrepreneurship.

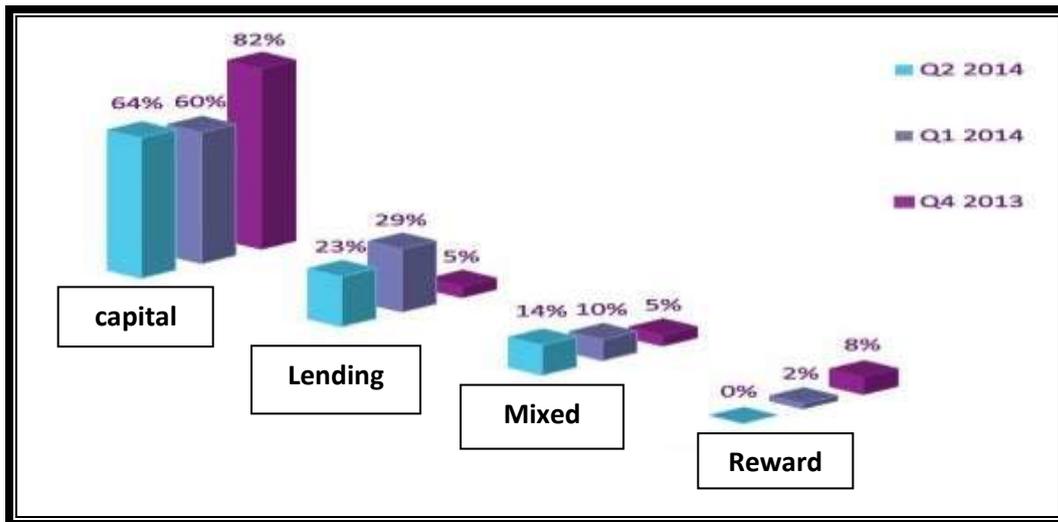
The following table (5) shows a comparison between the amount of funding in some foreign countries and the Arab countries, where we note from the table the followings:

1. The size of Crowdfunding in Arab countries compared to others is negligible. The United States is ranked to be number one and UK is second.
2. The absence of commercial Arab Crowdfunding sites that can compete with global sites and opens a promising market for creators, innovators, and entrepreneurs.

Table (5) Comparison of some International and Arab countries for the year (2014)

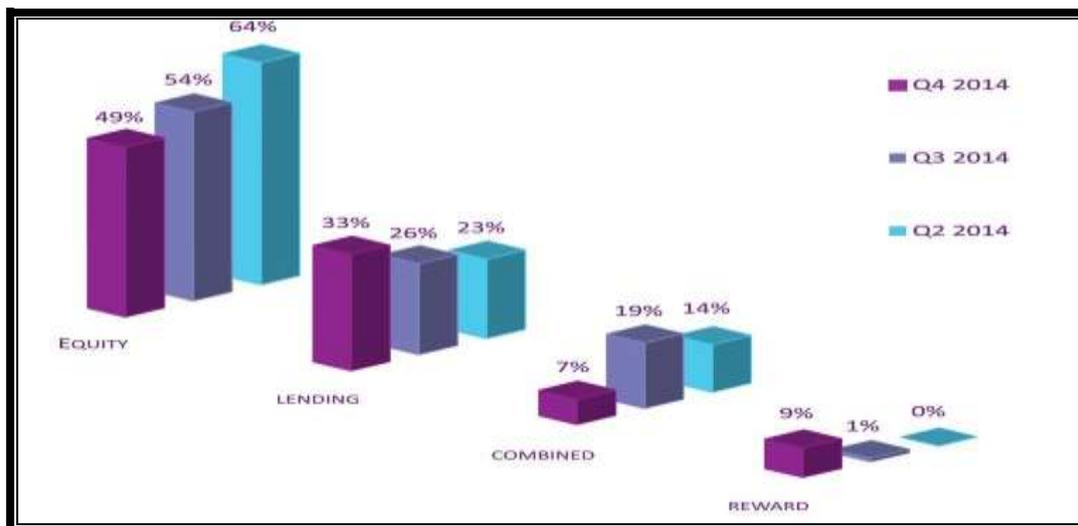
S.	Country	Number of sites	Finance volume
1	USA	344	482 million dollars
2	UK	87	190 million pounds
3	France	53	78 million euros
4	Switzerland	13	11.5 million Swiss francs
5	United Arab Emirates	2	\$ 1,730,000
6	Lebanon	1	\$600, 000
7	Palestine	1	\$80, 000
8	Egypt	3	\$ 33,000
9	Jordan	1	\$ 43.815

Source: prepared by the researchers based on secondary data published in the sites



**Figure (5): crowdfunding models**

**Source: Crowdfunding Marketing Report (2014):** Crowd Valley Inc , P. 5.  
<http://www.crowdvalley.com/research.html>, (2015)



**Figure (6): Crowdfunding models**

**Source: Crowdfunding Marketing Report (2015):** Crowd Valley Inc , P.8.  
<http://www.crowdvalley.com/research.html>, (2016)

The report supports (Crowd Valley) that results in quarterly studies highlight the types of crowdfunding, geographic distribution, and the results are shown in the following figures.

As evident from the previous figure, reduced funding through crowdfunding sites that offer lots of capital (63%), compared with a rise in sites that offer lending services (23%) and mixed (14%). It is a good indicator and one can infer that the crowdfunding process has become finance getter to invest in entrepreneurial companies that need to expand their capital and in need of funding to start their activities.

As shown in Figure (7) the distribution of those sites by continent during the years (2013) and (2014), where the largest share of the North American continent is characterized by the presence of the first formal legislation regulating the work of financing sites was released in the United States of America in (2012).

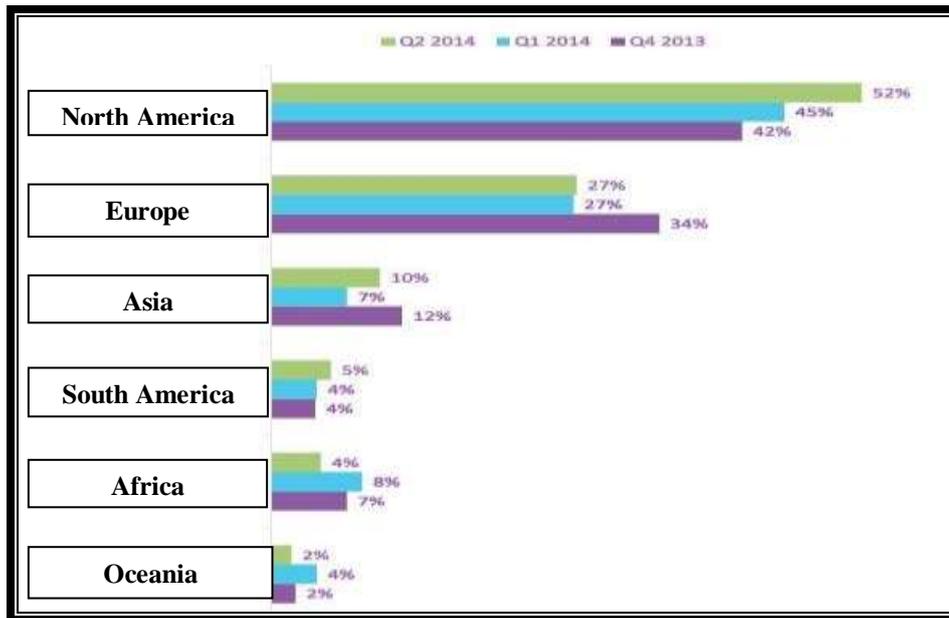


Figure (7) global growth in financing and sites distribution

Source: **Crowdfunding Marketing Report** (2014): Crowd Valley Inc , P. 15.  
<http://www.crowdvalley.com/research.html>, (2015)

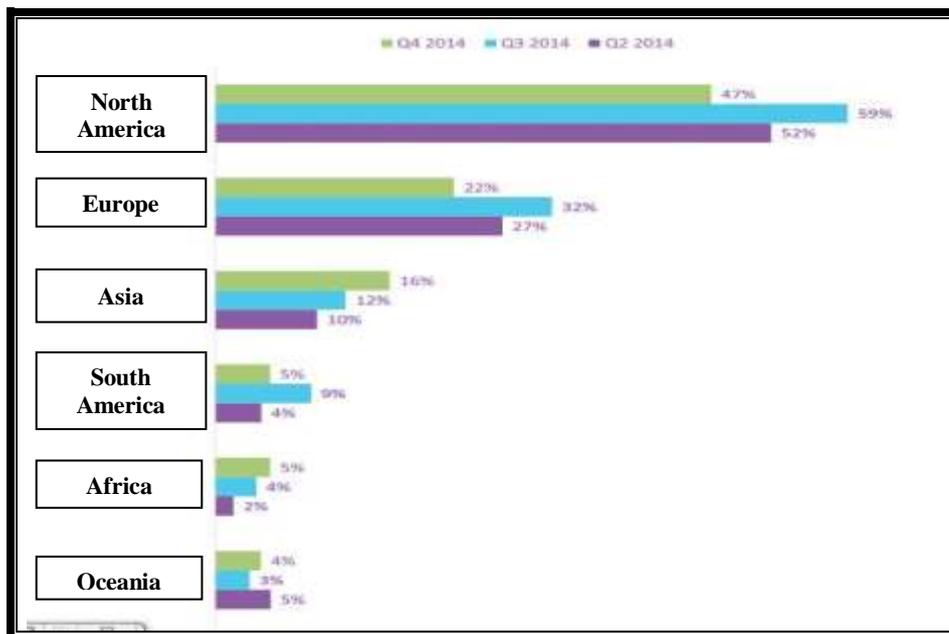


Figure (8) global growth in financing and distribution of sites

Source: [www.crowdvalley.com/research.html](http://www.crowdvalley.com/research.html), (2016)

## 11. Conclusion

Crowdfunding is considered a product of the digital economy and is a contemporary business model which is intended to finance entrepreneurial projects and innovations through a direct relationship between the entrepreneur and the financier. In spite of the industry exceeded ten billion US Dollars in (2014), it is still spreading slowly in Arab world.

The requirements of this type of financing are available in the Arab world and one can benefit from it in the financing of projects that not to see the light before in all fields, especially in countries with low GDP and low economic resources, such as Arabian poor countries, however, we find that most funding sites in the United Arab Emirates (Eureka).

Arabian academic studies in this area are not available, which weakens the possibility of its spread rapidly, as happened in the advanced countries of the world and weaken its formal adoption, and the issuance of appropriate legislation and laws.

Egyptian companies working in this field are trying to put their feet in the right direction, but they find competition from other Arab companies because of some of the laws that limit the spread of this type of financing in Egypt.

Arab region needs more financial and legal flexibility to encourage this type of financing, with the need to highlight the successful models globally and regionally to bring added value to the development of small and entrepreneurial projects.

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