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Digital Financing Revolution: Assessing the Impact of Equity Crowdfunding on Pakistani Startup Ecosystem

Sahar Fatima[i]

i) Ph. D. Scholar, Department of Business Administration, Iqra University (Main Campus), Karachi.

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ABSTRACT

This study examines how equity crowdfunding can help close the funding gap for startups in Pakistan, where traditional financing options like bank loans and venture capital are limited. Many startups, especially in their early stages, struggle to get the funds they need from conventional sources, making crowdfunding an attractive alternative. The research draws on Social Capital Theory and Signaling Theory to explain how networks, relationships, and signals of credibility play a crucial role in the success of equity crowdfunding campaigns, particularly in emerging markets like Pakistan. These theories show how startups can build trust with potential investors, improving their chances of securing funds. To gather data, semi-structured interviews were conducted with business owners who had experienced the challenges of raising funds through traditional means. The interviews, which were shared via email and social media, focused on the advantages and risks of crowdfunding compared to conventional methods. Responses were collected as short audio clips, with some participants opting to provide written responses. The participants, all owners of small and medium-sized businesses, shared their experiences with crowdfunding and the obstacles they faced. Thematic analysis was used to identify key challenges, such as the need for better regulations and safeguards to prevent fraud, and opportunities like the potential for Shariah-compliant financing, which could encourage more investors to participate in crowdfunding. The findings suggest that equity crowdfunding could be a game-changer for startups in Pakistan, providing them with an alternative way to raise capital and grow their businesses. The study offers insights that can help shape future policies and strategies to support the development of a healthy startup ecosystem in Pakistan.

Corresponding Authors: Sahar Fatima
Email: shr.programmer@gmail.com

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1. Introduction

1.1 Background

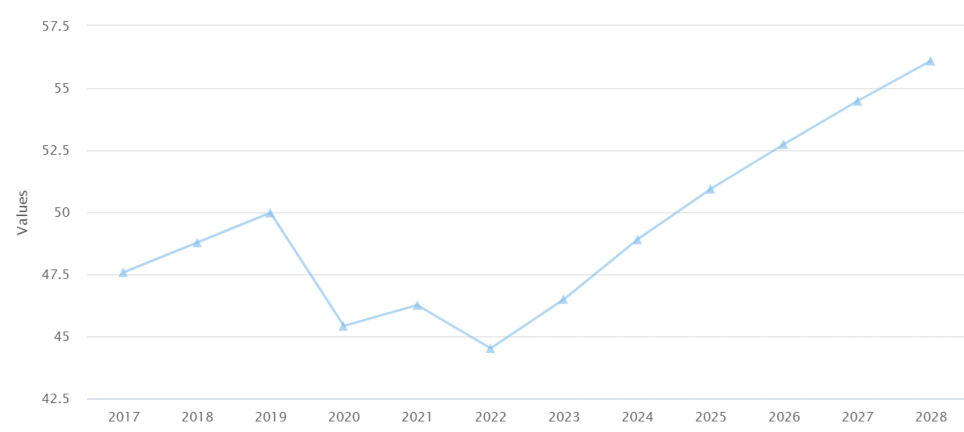
Currently, entrepreneurship and new ventures have become indispensable to the economy as they play a critical role in creating new ideas, refreshing existing ones and hence growing the economy. Newly formed businesses that intend to introduce new concepts, products, or services to a particular audience are considered to be in a very uncertain environment and are called as startups. Despite these great opportunities for innovation, it has been reported that most of the startups fail as around 90% of the startup ventures fail, do not survive. In particular, about 21.5% of startup businesses operated for less than a year and failed, 30% ceased business operations at the end of the second year (SBA, 2020; CB Insights, 2021). One explanation for the high rate of unsuccessful business endeavours is the problem of mismanagement of funds, as new startups often struggle to identify suitable market needs and acquire adequate resources during their growing phase (CB Insights, 2021; Gage, 2012).

One of the critical problems that startups across the globe encounter is that of obtaining financial resources, particularly in their infancy. It is especially challenging for entrepreneurs at this stage since the usual sources of funding, i. e. bank loans, venture capital, and angel investments are difficult to access, especially for startups that haven't established a record of accomplishments (Cosh et al., 2009; Nofsinger & Wang, 2011). The position is even worse for emerging markets where the development of financial systems is still badly needed and the amount of invested funds from venture capitals is low (Groh et al., 2016; Khavul, 2010). Owing to these challenges, however, crowdfunding has turned out to be a solution (Mollick, 2014; Belleflamme et al., 2014).

1.2 Startup Ecosystem in Pakistan:

In Pakistan, the entrepreneurial ecosystem has developed quite significantly over the last few years, but still, the availability of funds is a major issue (Khan & Siddiqui, 2020; Ali & Babak, 2021). The country's capital markets are in the nascent stage and venture capital is scarce, available but limited (Khan & Siddiqui, 2020). Sources of financing from conventional banks such as loans may not be available to young businesses because of the degree of collateral that must be pledged and the punitive interest repayment terms availed (Naseem et al., 2019). Fundamental importance for venture capital or angel financing is characterized by a substantial funding gap, It is particularly pronounced for seed – stage startups which lack personnel and essential networks to support them in soliciting investment at the initial round stage (Hussain & Mahmood, 2019).. Crowdfunding, defined as "the collective effort of individuals who network and pool their money via the Internet," also provides a solution for such startup challenges (Vismara, 2016; Brown et al., 2020).

In effect, equity crowdfunding allows startups access to potential investors without using traditional financial intermediaries making it possible for businesses to meet in a digital environment and raise fund to invest in their businesses. This model allows seed-stage startups to access more investors, potentially including those who would not otherwise invest in venture capital markets (Bade & Walther, 2021; Ahlers et al., 2015).



Graph 1: Average Funding per Crowdfunding Campaign Worldwide (2017 – 2028)

The graph demonstrates the global increase in average funding for crowdfunding campaigns, highlighting the growing importance of this model for early-stage businesses.

In recent years, crowdfunding has grown significantly, reflecting the increasing role of startup financing, as shown in Graph 1, which highlights the average funding raised per crowdfunding campaign globally. It highlights the growing interest of investors, and the projected annual growth of crowdfunding options considered as a viable alternative to conventional financing methods. In addition to raising needed capital, It offers other benefits, i.e., raising needed capital and a bundle with complementary benefits (such as market validation & early customers engagement) (Agrawal et al, 2015; Vismara, 2018). Equity crowdfunding also enhances social capital which is crucial for startups to attract a different set of investors as well improves their network hence improving the probability of long-term success (Lehner, 2013; Colombo et al., 2015).

This study is critical because it responds to a major problem in Pakistan related to seed-stage startups and they seek investment as capital; and an exploration into how equity crowdfunding might deliver social impact by providing an alternative form of funding (Hussain & Mahmood, 2019; Ali & Babak, 2021). Through investigating the effect of social capital on equity crowdfunding, this research endeavors to contribute towards filling in knowledge gaps concerning how startups can leverage their networks and resource-incapable conditions for success within competitive startup landscape (Stam et al., 2014; Nahapiet & Ghoshal, 1998).

While equity crowdfunding has become popular over the years but fewer studies explain how it impacts seed-stage startups in emerging countries especially Pakistan (Khan & Siddiqui, 2020). This study therefore seeks to address this by examining those characteristics of equity crowdfunding campaigns that determine their success, and how startups can utilize them successfully to raise finance (Brown et al., 2020). This study will emphasize the role played by social capital and how startups can develop trust and legitimacy with prospective investors via equity crowdfunding platforms (Lehner, 2013; Shane & Cable, 2002). This research addresses the following research questions:

1. What is the role of equity crowdfunding in addressing the funding gap for startups in Pakistan?

2. How does equity crowdfunding contribute to the development of the startup ecosystem in Pakistan?

3. How can regulatory frameworks be designed to effectively support equity crowdfunding in Pakistan?

4. How does the lack of traditional financing options make equity crowdfunding a viable alternative for startups in Pakistan?

5. How do Pakistani investors perceive the risks and rewards of equity crowdfunding compared to traditional investment methods?

The research is also timely and pertinent since equity crowdfunding has emerged as an alternative funding mechanism for startups (Vismara, 2016; Colombo et al., 2015). Focusing on an emerging market with unique challenges for startups, Pakistan, will provide important lessons about how equity crowdfunding could help to bridge the funding gap faced by seed-stage startups (Hussain & Mahmood, 2019). The results can inform entrepreneurs, policymakers and investors who set out to unleash the power of crowdfunding for innovation and growth (Khan & Siddiqui, 2020).

This research article is organized as follows: The next section elaborates on Social Capital Theory and its relatedness to our study. After that, it will review extant empirical research on crowdfunding, specifically equity-based crowdfunding, and its effects on seed-stage startups. The methodology section will describe the research design, data collection process, and analysis methods used in this study. The result section will explain the essential findings, and the discussion will interpret these findings in relationship to the research question. Finally, a conclusion will synthesize the implications of the study and suggest potential avenues for future research.

2. Literature review

2.1 Theoretical Framework:

Crowdfunding has proved to be an effective means of mobilizing resources, especially in cases where conventional finance is not easily accessible to new small ventures and the market in general. The theoretical framework used to explain the mechanisms of crowdfunding draws significantly from Social Capital Theory and Signaling Theory.

2.1.1 Social Capital Theory:

Focused on equity crowdfunding, Social Capital Theory is also a facilitator of entrepreneurial success through networks and relationships (Burt, 2000; Coleman, 1988). Social capital is defined as resources that are being accessed through networks, that built on trust and mutual obligations (Putnam, 1995; Lin, 1999). For startups, in particular social capital may play a role when seeking funding, resources as well as acceptability within the market (Stam et al., 2014; Nahapiet & Ghoshal, 1998). Social capital is particularly important in equity crowdfunding because it allows startups to develop credibility and trust that is required by investors (Shane & Cable, 2002; Sorenson & Stuart, 2001). Traditional investors are more willing to invest in firms that have been recommended and endorsed by reputed brokers or by respected individuals within those networks (Granovetter, 1985; Shane, 2003). Social capital can reduce the perception of risks regarding investment by signaling that a particular startup is reliable and trustworthy (Mollick, 2014; Ahlers et al., 2015).

In addition to building trust, social capital can assist startups in various other ways, such as spreading information to a wider audience through networks and reaching out to potential investors (Adler & Kwon, 2002; Burt, 2004). These social networks allow startups to get access of valuable resources including advice, mentorship, and other business opportunities for overall growth and success (Bourdieu, 1986; Uzzi, 1997). Furthermore, social capital enables startups to be recognized as credible and trustworthy, which can be used as a tool to attract more potential investors and boost fundraising activities for growth (Suchman, 1995; Lounsbury & Glynn, 2001).

Moreover, social capital also strengthens equity crowdfunding platforms, since many crowdfunding channels use social networks to promote fundraising campaigns that increase the chances of gaining investor confidence (Belleflamme et al., 2014; Agrawal et al., 2015). Usage of social media and online communities are often used to build trust of potential investors and enable more successful crowdfunding campaigns (Lehner, 2013; Colombo et al., 2015). Thus, companies who represent social capital rightly will have more opportunities to be successful in equity crowdfunding and acquire much-needed finances as well as a loyal customer audience (Brown et al., 2020; Vismara, 2016).

Recent research validates the position that stronger social networks lead to a higher probability of a successful funding campaign. These networks enable startups to reach a wider and more supportive audience, thus enhancing the prospects of crowdfunding success (Butticè & Vismara, 2021; Block et al., 2021). Social networks, combined with symmetric information, motivate investors to confidently participate in fundraising campaigns, further increasing the likelihood of successful crowdfunding activities (Mollick, 2019; Vismara, 2020).

2.1.2 Signaling Theory:

Signaling theory, which is another important theoretical perspective in crowdfunding, explains how entrepreneurs send signals to investors to showcase their business projects and receive investment. It helps in reducing information asymmetry and makes investor feel confident about the quality of the project. For example, holding equity back, showcasing previous funding success, and getting endorsed by trusted sources all make the project more trustworthy and give confidence to the investor to invest (Ahlers et al., 2019; Vismara, 2020). In equity-based crowdfunding, these signals are especially crucial because investing in a new business is always risky and investors don’t always have full information. Therefore, these signals reduce uncertainty and make investors more confident and comfortable when responding to uncertainties and risks (Schwienbacher, 2021; Vismara, 2021). Recent studies show that effectively sending signals becomes a decisive factor whether a business project reaches its funding goal or not, as these signals give investors a confidence and significantly improve campaign performance. (Butticè & Vismara, 2021; Cumming et al., 2020).

2.2 Conceptual Framework

This study elaborates on social capital and signaling ideas alike. It seeks to ascertain the determinants of success in equity crowdfunding, especially in emerging economies. In this regard, it aims at comprehending these factors through the assistance of a theoretical framework. This framework enables a comprehensive understanding of how these theoretical constructs work toward the dynamics of the crowdfunding process.

Researchers have employed quantitative and qualitative approaches to investigate features, and factors that promote the success of crowdfunding campaigns. Where regression analysis is common to examine the effect of some predictors such as social media activity, goal specificity, or business plan comprehensiveness (Cumming et al., 2020; Butticè and Vismara, 2021). The general conclusion of these past works is that campaigns with transparent goals and detailed information, along with available social media tools for interaction will receive more funding as they can attract a larger audience, which in turn helps to build legitimacy (Vismara, 2021; Kleinert, Volkmann, & Grünhagen, 2020).

However, qualitative research digs much deeper into the motivations, problems, and stories of both entrepreneurs and investors. This approach by utilizing case studies, interviews, and thematic analysis, has identified that entrepreneurs with a sizable social network or who can develop their project's story and context tend to perform better in crowdfunding campaigns (Mochkabadi & Volkmann, 2020; Kleinert et al., 2020). Although qualitative methods allow for a richer and deeper insight into the context of crowdfunding, but they are criticized to be constrained by small sample size and subjective data analyses (Lehner, 2019; Block et al., 2021).

The benefits and challenges of crowdfunding, compared to traditional financing, show that crowdfunding replaces the need for large investments by allowing many small investors to contribute. This reduces the financial pressure on any single investor (Cumming et al., 2020; Block et al., 2021). This approach can be especially helpful in regions with limited access to traditional capital, providing a real financing option for startups as an alternative to regular funding (Vismara, 2020; Kleinert et al., 2020). However, recent studies (Schwienbacher, 2021; Butticè & Vismara, 2021) point out challenges like the risk of fraud and the lack of security for investors that traditional financial institutions usually provide.

Research on crowdfunding shows that this area is becoming more important, especially in places like Pakistan where traditional financing options are limited. Crowdfunding gives technology startups in these regions a chance to raise funds and test the strength of their business ideas at the same time (Block et al., 2021; Butticè & Vismara, 2021). In such markets, the success of crowdfunding depends heavily on the entrepreneur's social connections and their ability to build trust and credibility with potential investors (Mollick, 2019; Vismara, 2021).

Crowdfunding has become a lifeline for new startups, as raising funds is essential in Pakistan, where traditional financing options are limited. The growing interest in equity crowdfunding is gaining attention as a powerful tool for promoting entrepreneurship in the country (Bruton et al., 2015; Agrawal et al., 2015).

3. Methodology

3.1 Philosophical Underpinnings:

The philosophical underpinnings of the internet-based source of financing (i.e., crowdfunding) are exceptionally distinctive from the conventional methods of raising capital. It is expanding in the financial market and demonstrates its real existence not only in terms of supply, but its characteristics of financing create a significant difference in the market. The widening participation of the crowdfunding process, by removing the geographical barriers between investor and fund-raiser is contributing a significant impact on the startup business, and its unique characteristics exhibit color in the monochrome financial market. Due to its additional valuable benefits, it is become more apparent and increasingly considered an alternative for many investors and startups. The usage of crowdfunding is continuing to grow in both dimensions, such as a range of various platforms reflecting its breadth, while the amount of funds being raised through these channels shows its depth. The perceived acceptability of potential users, availability of crowdfunding projects, and its distinctive features are growing global recognition. If this process of growth is cultivated and nurtured by the policy makers through interventions, so undoubtedly it will yield exponential benefits and better results will start to observe soon, therefore the role of regulatory bodies is highly crucial for the success of crowdfunding channels.

Since small businesses are the engine of employment growth, therefore, to fulfill the financing needs of seed-stage businesses crowdfunding appears in the market. But the main motive for policymakers is to prevent fraudulent activities, make provisions for ineligibility and suspension of "bad actors", and mitigate the risks of investing in small enterprises, and this is called "the wisdom of the crowd".

The purpose of this research work is to get an understanding of crowdfunding channels within the Pakistani economy and what underlying opportunities and threats exist for the developing country of Pakistan. In addition, how intrinsic risk factors can be mitigated through policies and regulations. Therefore, to obtain understanding empathetically followed by the actions of the participants interpretive model is used. Moreover, Maykut and Morehouse[1] mentioned that qualitative research allows for gaining a better understanding of the social phenomenon and helps in developing the meaning from participants' perspectives.

3.2 Research Design:

This study adopts a narrative approach, congruent with the interpretive paradigm, for judging how owners of startup businesses make sense of crowdfunding in everyday life. This approach is consistent with the framework of Creswell et al. (2013) for qualitative analyses, where he emphasizes the context and participant perspective to elucidate the human implications of social phenomena. This research also tries to understand the challenges that these business owners have faced with conventional financing methods and the potential advantages and vulnerabilities of crowdfunding for startups.

To collect data, semi-structured interviews were conducted with purposely selected respondents who had extensive knowledge of crowdfunding and had faced challenges with securing traditional financing methods. Semi-structured interviews were designed to cover various aspects of crowdfunding,

1 Maykut and Morehouse (1994)

including its advantages, potential risks associated with digital financing methods, and its comparison with conventional methods. Interview questions were shared with participants via email and on social media platforms and they were requested to provide their responses in the form of short audio clips. However, some responses were also collected in written form. The research participants were owners of small and medium-sized businesses in Pakistan who faced numerous challenges during their business endeavors. All participant identities were kept anonymized, and collected responses were stored by maintaining confidentiality and integrity throughout the research process.

4. Data Analysis

4.1 Thematic Analysis:

Thematic analysis was utilized to examine interviews conducted for this study. This method encompassed six distinct cycles, as illustrated in Figure 1.

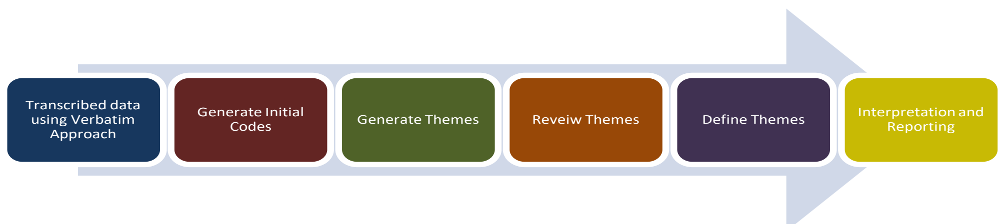


Figure 1

An iterative methodology was consistently applied to systematically categorize the data through various phases. The analysis unfolded in six clear stages, initiating with transcription, wherein narrative interviews were meticulously transformed into written text following a verbatim approach. Ensuring precision, the transcripts underwent thorough review multiple times to validate the accurate portrayal of the narrator's intended meaning and statements.

In the second phase of data analysis, initial coding is performed in a systematic fashion, where important features and information has been highlighted. The data is divided into the smallest piece of information which can explicitly define the complete information without having a look at additional information. Initial coding is performed to discover the indispensable information from the data set. Each discrete group is labeled with a proper title so that it can explain the underlying phenomenon within each group that could describe the concept of the theme from a broader perspective.

In the third phase, the coded groups that were generated in the second phase were systematized into different categories by structuring more relevant and similar codes into a distinct category. Each category reflects a more structured and broader meaning that could help in further evaluation. In this phase, the theme is generated by relabeling and integrating common coding. Each coding group allocated a meaningful name that could reflect the underlying meaning of the group.

After theme generation, the theme has been reviewed in the fourth phase by checking and reviewing the extracted data set for each category by a thematic map of analysis. During the fifth phase of analysis, each theme was refined and specified with proper naming and creating proper definition. The data reduction process is involved in this phase where the categories are consolidated into a more abstract and philosophical framework. Themes are conceptually mapped into a thematic framework to investigate the relationship with one another.

In the last phase, analytical memos are generated followed by synthesizing the memos. These memos represent the summary of each category. These memos are tested and validated systematically. After validation, memos are synthesized in a coherent and cohesive manner.

To ensure the truthfulness and validation of the analytical memos, these memos are re-validated by the participants. The purpose of revalidation is the process of self-auditing where the researcher aims to exclude the biasness of his/her perception, prior assumptions, and beliefs.

4.2 Results and Discussion

Figure 2 illustrates the five themes generated from interviews conducted by various participants. These themes are comprehensively mentioned in Table 1. The following are the five distinct themes extracted from the thematic analysis:

Reference Statements	Coding	First-Order Theme	Extracted Theme
- Getting money to start a business is really hard here. - Most of us can't get loans from banks unless we know someone big or have a lot of property to promise them.	Challenges in Securing Bank Loans	Access to Capital	**Capital challenges for startup business in Pakistan**
- Even though the government tries to help with some loan programs, it's not enough. - Most of us new businesses just can't get enough support.	Insufficient Government Loan Programs		
- A lot of us are just making do with what we have, pulling money from friends and family to keep our businesses going because banks won't take a chance on us yet	Reliance on Informal Funding	Alternative Funding Sources	
- It's tough getting loans, and without enough credit, our growth is not possible. - When you compare Pakistan to neighboring countries, we're really falling behind in supporting startups financially.	Lack of Credit and Regional Disparity	Financial Ecosystem Challenges	
- Crowdfunding is an exciting opportunity for our startups. - Crowdfunding has the potential to open new opportunities for Pakistani startup	Positive Outlook on Crowdfunding	Positive Perception and Potential of Crowdfunding	**Need to Regularize Crowdfunding Channels**
- Crowdfunding could act as a game changer, the way we raise money for new businesses. - This approach has the potential to create many jobs.	Economic Potential of Crowdfunding		
- We need strong regulatory policies for crowdfunding to work well. - Proper regulations are required to provide protection to both startups as well as investors.	Need for Effective Regulation and Policy Support	Need for a Strong Regulatory Framework	
- Stopping fraud is crucial for crowdfunding success in Pakistan. - We must learn from places like Indonesia where strong laws keep crowdfunding safe.	Global Lessons in Fraud Prevention	Global Insights and Local Implementation	**Critical Role of Investor Protection to mitigate fraudulent activities**
- Strong safety measures make people ready to invest. - Clear rules can boost our economy by helping startups grow.	Benefits of Regulatory Measures		
- Investors need to feel safe. Without good laws, they're too scared to invest. - Fear of scams makes people hesitate to put their money in.	Impact of Lack of Regulation on Investment Confidence	Strengthening Investor Trust Through Regulation	
- We need clear, simple explanations of how crowdfunding works. - Many of us are new to this and need guidance.	Need for Basic Crowdfunding Education	Comprehensive Crowdfundin	**Educate People about the Dynamics**

- Teaching about the risks and benefits of crowdfunding is essential. - Universities should offer courses on crowdfunding.	Importance of Comprehensive Education on Crowdfunding	g Education	**of Crowdfundin g**
- The government and institutions should work together to teach everyone about crowdfunding. - Collaboration is key to effective crowdfunding education.	Collaboration in Crowdfunding Education	Collaborativ e Educational Efforts by All Stakeholders	
- Investors need to feel safe to invest here. - If the country is stable, more money comes in.	Importance of Political Stability for Investment	Ensuring Investment Stability	**Socio-political Instability May Refrain, Foreign Investors**
- Foreign investors look for legal protections before investing. - Stability in laws makes us more attractive to international investors.	Need for Legal and Political Stability		
- Foreign investors don't just care about the business idea; they care about how safe their money will be in our country.	Need for Safe Investment Environment	Building Investor Trust	
- Right now, with all the economic and political problems, it's hard for us to attract investors. They worry they might lose their money.	Economic and Political Instability Affecting Confidence		
- The government must create a secure environment for investments. - Strong policies can build trust with foreign investors.	Role of Government in Securing Investments		
- Many are turning to Shariah-compliant methods. - Regular loans don't fit our beliefs. - We value financial options that respect our religious practices.	Cultural and Religious Alignment in Financing	Aligning Finance with Cultural and Religious Values	**Shariah-Compliant Mode of Financing**
- Shariah financing isn't just about the money, it's about doing business the right way and respecting our values. - This type of financing helps us stay true to our principles.	Ethical and Value-based Financing		
- By offering Shariah-compliant options, more people will feel comfortable investing. - Shariah-compliant platforms could drive our economic growth, attracting more investors who want interest-free financing option.	Boosting Economic Participation through interest-free financing	Promoting Economic Growth through Interest- free Financing	

1. Capital challenges for startup business in Pakistan.
2. Need to regularize crowdfunding channels.
3. Fraudulent activities are a significant threat.
4. Educate people about the dynamics of crowdfunding.
5. Socio-political instability may refrain, foreign investors.
6. People are concerned about the Interest-based mode of financing.

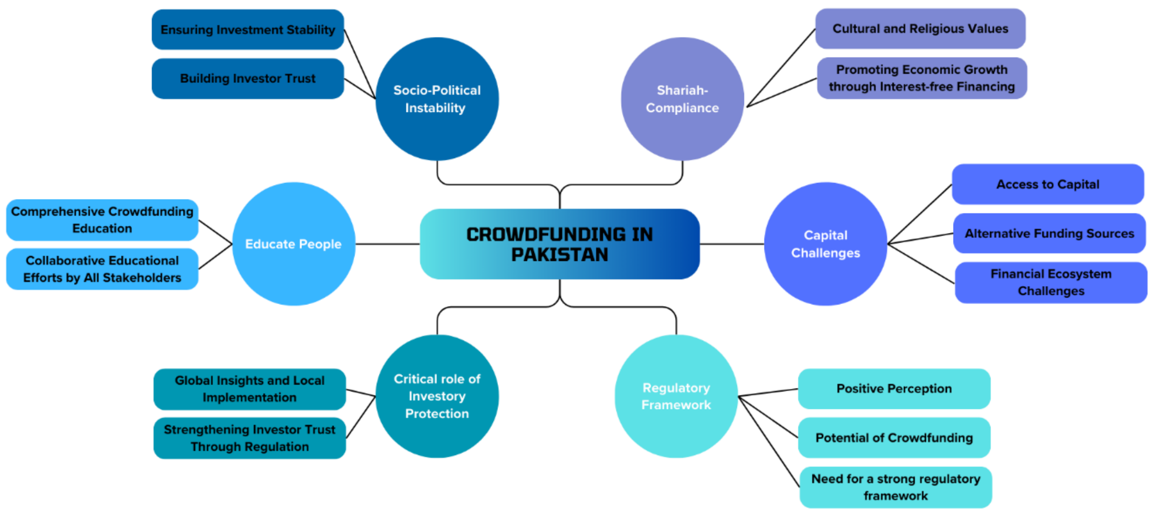
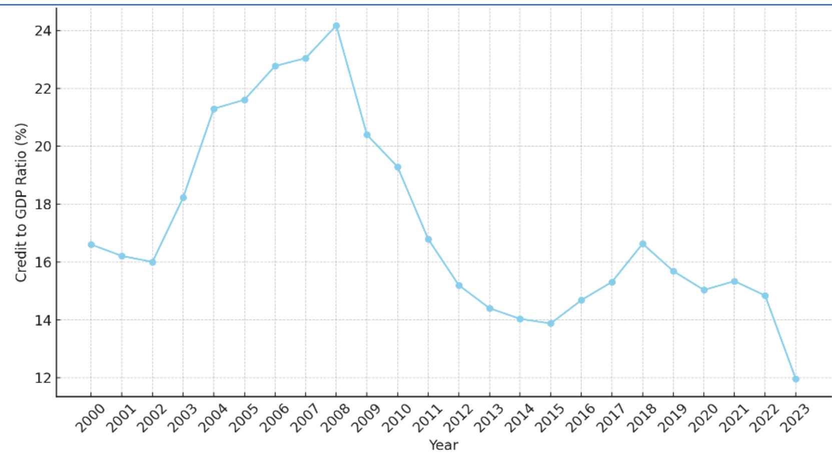


Figure 1

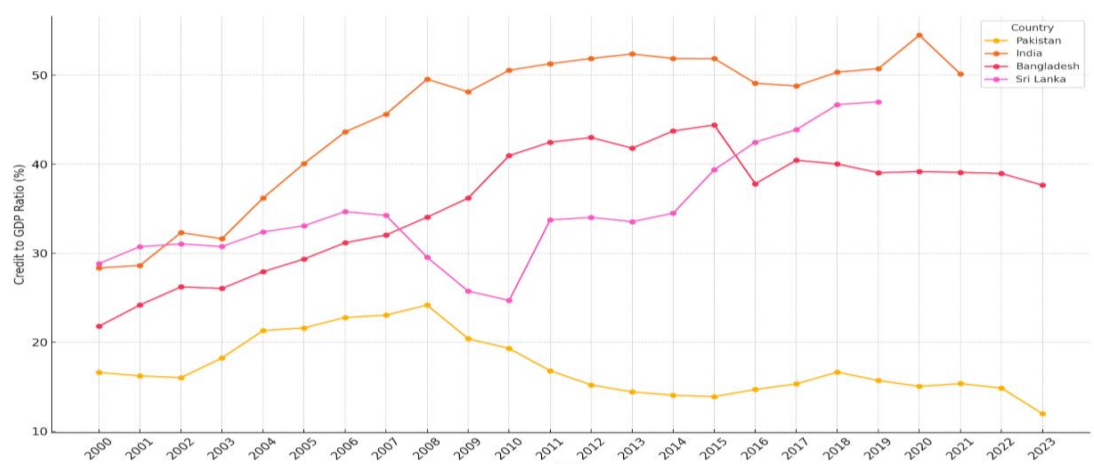
4.2.1 Capital Challenges for Startup Business in Pakistan:

There are several challenges and improvement gaps exist in the startup ecosystem of Pakistan that make the road difficult for seed and early-stage businesses to grow and flourish within the existing framework. During the initial stage of new ventures, convenience, and availability of capital funding are crucial prerequisites that contribute to making a successful attempt for a startup business, specifically in a developing country such as Pakistan. However, the majority of startups and SMEs in Pakistan lack access in attaining formal credits for their businesses, limiting a larger portion of the population from receiving funds through regulated channels (Salamzadeh & Tajpour, 2021). This fundamental problem can be illustrated by graph 2, that reflects the domestic credit to private sector as a percentage of GDP from 2000 to 2023. The downward slope in this graph indicates a significant drop in the scale of financing activities over these years, with a decreased supply of credit, thus limiting the ability of startups to obtain the necessary funding. Such a trend evidences the rising demand for alternative financing methods to address the widening gap.



Graph 2: *Domestic Credit to Private Sector (% of GDP) for Pakistan (2000-2023)*
Source: World Bank

Bank loans are the most desirable source of financing for startup businesses to meet their capital requirements. Despite the government has arranged many schemes for the startup business through commercial banks that allow them to acquire loans for their business, but these programs operate on a limited scale, and the problem persists for many new ventures (Ahmed et al., 2022). Interviewers mentioned that many startup businesses use bootstrapping for their business needs and receive financial support from their friends and families. On the other hand, local funding organizations are more inclined toward funding well-established organizations as compared to early-stage ventures (Srivastava et al., 2024). While SME financing accounts for less than 1% of GDP, only about 7% of SMEs in Pakistan gain access to formal finance. This is notably lower than that of regional peers, further widening the gap between funding availability and the needs of startups. This underdevelopment of the financial ecosystem concerning SMEs and startups (World Bank, 2021) significantly increases the demand for innovative financial solutions, such as crowdfunding.



Graph 3: *Trend comparison compares of domestic credit provided to the private sector as a percentage of GDP across four countries: Pakistan, India, Bangladesh, and Sri Lanka.*

Source: World Bank

Graph 3 further contextualizes this issue as a regional comparison. This graph compares the trending of domestic credit provided to the private sector as a percent of GDP in four countries, namely, Pakistan, India, Bangladesh, and Sri Lanka, ranging from 2000 to 2023. It shows that in the neighboring countries like India and Bangladesh, the availability of credit has either gone up or remained stable, while the graphs for Pakistan show a sharp decline, especially quite drastic starting from 2016 onwards. It points not only to a domestic challenge but also to a competitive disadvantage in the region, underlining the need for innovative solutions such as equity crowdfunding.

4.2.2 Need to Regularize crowdfunding Channels:

Interviewers consider crowdfunding as an exciting alternative for startups to relegate their funding needs. Small and medium-size enterprises could better finance their operations through crowdfunding channels, which would help strengthen the economy and provide more employment opportunities for their people. As crowdfunding has gained popularity across the globe as a form of alternative financing, its regulation has become a top government priority worldwide. Crowdfunding fulfills the financial requirements of SMEs, helping startups and entrepreneurs to reshape existing businesses and launch new ventures. Figure 3 depicts the coding process of identifying the need of a regulatory framework in Pakistan.

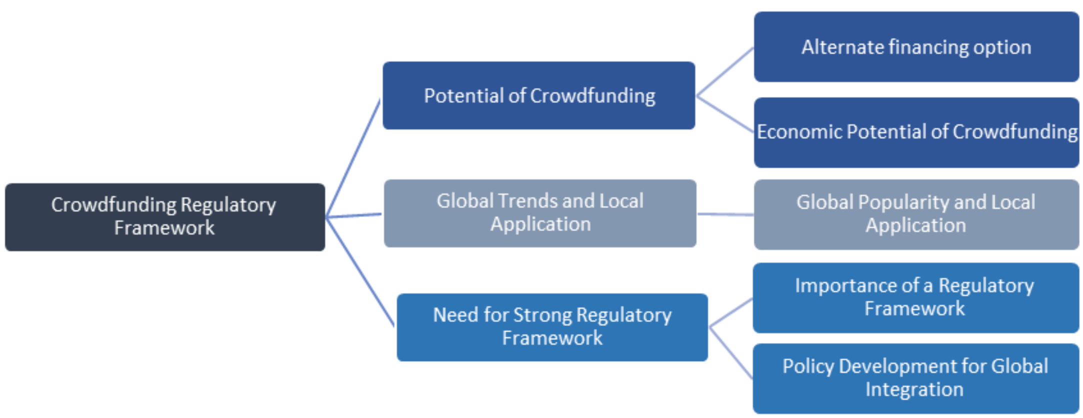


Figure 2

However, the success of equity-based crowdfunding demands a robust regulatory framework in Pakistan (Rizwan et al., 2024). Establishing strong regulation would have been a determining factor for the growth of equity crowdfunding in Pakistan, like the experience of other countries, such as the U.S., UK, and other BRICS countries that have regulated their market and experienced the maturity and sustainable growth of crowdfunding models. Therefore, Pakistan needs a trusted and regulated ecosystem so that its crowdfunding will grow in a sustainable manner (Amina an Shabana, 2024). The government should seriously look for adopting new policies and devising regulatory strategies that not only support digital financing methods in Pakistan but also allow startups to collect funds from all around the world by exploding geographical barriers (Aydemir and Aysan, 2023).

4.2.3 Mitigating Fraudulent Activities to Ensure Crowdfunding Success:

Addressing the issue of fraudulent activities is crucial for the success of crowdfunding in Pakistan. Interviewees emphasized on the necessity of robust investor protection mechanisms to instill confidence and ensure the integrity of online financing platforms. Regulatory bodies play a pivotal role in this process, tasked with formulating and enforcing regulations designed to safeguard investors from potential scams. Like Indonesia where successful implementation of regulatory framework enhanced investor protection and confidence against illegal activities (Noor et al., 2023). The foundation of trust is paramount in encouraging participation in crowdfunding ventures. Without proper regulatory policies and monitoring, investor feel hesitant to participate in crowdfunding channels, as observed in various countries where opacity brought significant collapse in marketplace (Choirunnisa & Fadilah, 2020). Figure 4 explains the critical role of investor protection in mitigating fraudulent activities. By enhancing protective measures and ensuring transparent operations, crowdfunding can significantly contribute to the economic development of Pakistan. Not only does this bolster investor confidence, allowing them to support startup ventures without undue fear, but it also facilitates a smoother flow of funds.

Figure 3

This, in turn, empowers startups to engage more actively in business endeavors, creating employment opportunities and driving sustainable economic growth. Strengthening the regulatory framework and investor protection is therefore essential in nurturing a thriving crowdfunding ecosystem that can attract investment, support entrepreneurship, and contribute to the broader economic landscape (Wiridin et al., 2023) of Pakistan.

4.2.4 Educate People about the Dynamics of Crowdfunding:

Only a few experienced players understand the dynamics of successful crowdfunding. New entrants, both startups and investors are unaware of its full utilization that how seed-stage ventures could efficiently raise capital using such platforms, and new investors have lack of experience and guidance to avoid risky ventures. Concisely, this new area of the digital ecosystem and fundraising activities are understudied specially in developing economies like Pakistan. Therefore, it demands attention from the government to provide channels for educating young entrepreneurs and allow them to get the maximum benefit from this growing area of the digital entrepreneurial ecosystem.

Ensuring the presence of comprehensive guidelines for both investors and entrepreneurs and educate them to evaluate asymmetric and confidential information is the key to nurturing a prosperous pro-startup climate in Pakistan. Asymmetric information raises serious concerns among investors and causes difficulties in assessing the business idea and identifying the underlying potential (Belleflamme et al., 2015). Universities and Institutions should play a role in providing comprehensive education and understanding of hidden risks and benefits within a digital entrepreneurial ecosystem that could stimulate decision-making skills and help in providing the right talent in the market (Hakizimana & Muathe, 2023). Moreover, incorporating the role of organizational stakeholders such as government bodies, incubation centers, and policymakers is the essential element in creating a well-functioning entrepreneurial ecosystem (Kumar et al., 2024).

4.2.5 Socio-Political Instability May Refrain Foreign Investors:

Crowdfunding typically involves an investment from local and foreign investors. When it comes to attracting foreign investors, socio-political stability plays a significant role in driving investment. Foreign investors prefer a politically stable environment where their rights are legally protected by law to secure their investment. When startups bring their ideas into crowdfunding platforms to access capital from geographically distant investors, they mainly come forward with two things; the first one is a strong business idea and the second one is a soft image of the country to access foreign investment. Considering the fact, that political instability and current economic crisis in Pakistan may dent investor's confidence and could pose a deteriorating effect on the success of crowdfunding channels in Pakistan. As research shows, political instability is one of the major factors that restrict foreign investment in various regions, as it raises concerns about the security of their returns and the overall risk associated with cross-border investment (Khan & Ejaz, 2023). Therefore, government and regulatory agencies must play their due part by developing favorable infrastructure and constructing a legislative framework that could assist in crowdfunding mobilization in Pakistan. This will require the establishment of a mechanism to gain public confidence by offering assurance to protect both investors' money and startup businesses in Pakistan (Mai et al., 2023).

4.2.6 Shariah-Compliant Mode of Financing:

Participants expressed their concern regarding existing interest-based modes of financing. Expanding on the importance of Shariah-compliant financing in Pakistan, given its Muslim-majority population, it's clear that the traditional interest-based financial models offered by conventional banks do not align with the religious beliefs of many individuals (Shah et al., 2023). This misalignment highlights the necessity for financial mechanisms that adhere to Islamic principles, fostering an environment where investments and business ventures can thrive within the bounds of Shariah law (Selim et al., 2023). The call for Shariah-compliant crowdfunding platforms is not just about providing alternative financing options but about creating a financial ecosystem that respects cultural and religious values, ensuring inclusivity and ethical compliance.

These platforms would not only cater to the unmet needs of a significant portion of the population but also encourage broader participation in the country's economic activities, promoting entrepreneurship and innovation in a manner that aligns with the faith-based values of the investors and entrepreneurs alike. Research supports the idea that such products have a positive impact on financial behavior and enhance investor confidence (Ali, 2020). The establishment of Shariah-compliant financing channels could significantly impact Pakistan's startup landscape, offering a more accessible and ethically aligned pathway for business growth and development (Siddique et al., 2022).

4.3 Strategical Recommendations:

4.3.1 Regulation of Crowdfunding Platforms:

The crowdfunding regulatory framework focuses on highly efficient platforms along with investors and issuer's regulatory policies. Highly efficient and regulated crowdfunding platforms are the backbone of promoting crowdfunding channels and play a crucial role in job creation and socio-economic development in the country. The government must establish a dedicated regulatory body that should be responsible for licensing and monitoring all crowdfunding platforms. These platforms act as gatekeepers, and their regulations are aimed at protecting consumers from any fraudulent activities and preventing significant losses, hence promoting healthy competition in the market. All crowdfunding platforms must be legally required to register with national financial agencies and undergo regular audits by third-party regulators to ensure maximum protection of investors. Likewise, all platforms should be required to provide clear and detailed information on their platforms related to business structures, consent from the regulatory bodies, and fraud prevention strategies to ensure transparent transactions at each level.

Moreover, the government should implement a national public awareness campaign to educate investors about associated risks and encourage their trust in crowdfunding platforms. Each investment-related transaction on the crowdfunding platforms must be authorized by the financial regulatory authorities, and regulators must conduct monthly reviews of platform activities to ensure the maximum protection of customers. For instance, ensure that only authorized investors, who understand the associated risks, are allowed to invest. Similarly, platforms should declare mandatory requirements for all fund-seekers to provide comprehensive business plans and risk-avoidance strategies, helping investors assess the securities offered.

Equity crowdfunding platforms should also be required to ensure the accuracy of financial promotions that appear on their websites, so that all information is clear, transparent and not intended to deceive investors aesthetically. Investors should not be approved without completing a simple automated test that assesses their level of understanding related to the crowdfunding investment process and its underlying risks (Armour and Enriques 2018). In addition, Policy makers must define clear legal consequences for platforms not following these standards, while making sure that everything is transparent and following ethical practices.

According to the FCA report[2], some common problems were reported from the review of various crowdfunding platforms, for example, a lack of balance was experienced on many platforms where it highlights the cherry-picking information and emphasized mostly benefits while trying to overlook the accompanying risk and giving an impractical positive picture of the investment. Besides, playing with some important information like risk warnings is less projected as compared

[2] https://www.fca.org.uk/publication/thematic-reviews/crowdfunding-review.pdf

to affirmative facts and figures along with, making false claims that no capital loss had been incurred aiming to diminish the risk warnings. Therefore, a proactive strategy by the policymakers can act as a catalyst for promoting an entrepreneurial climate in the country hence stimulating the economic growth of Pakistan.

Therefore, to ensure the above regulatory procedures, platform owners and management must be qualified and highly trained to ensure the transparency of all transactions and should have the competency to actively monitor any fraudulent activities henceforward assist the customers to protect their money from all aspects. Consequently, platforms without proving their eligibility should not be given a license to operate crowdfunding platforms in Pakistan.

4.3.2 Systems Control:

It is essential to delve deeper into the necessity of establishing robust regulatory frameworks for crowdfunding platforms. These frameworks should clearly outline the standard operating procedures for addressing complaints, managing conflicts of interest, and ensuring transparency in client interactions. Governmental bodies should mandate that each crowdfunding platform must disclose its conflict resolution and complaint management procedures for regulatory review. Crowdfunding entities must develop and implement comprehensive strategies for efficiently resolving disputes and grievances. By publicly detailing these procedures on their platforms, it not only builds trust among users but also sets a precedent for operational transparency. Such proactive measures are crucial for fostering a fair and equitable crowdfunding environment, ultimately enhancing user satisfaction and fostering loyalty. This approach not only aligns with best practices in financial services but also reinforces the commitment to upholding the highest standards of integrity and accountability within the crowdfunding ecosystem.

4.3.3 Investor Protection Measures:

Equity crowdfunding channels offer an opportunity for investors to invest their money in early-stage ventures and become a partner in their business. While, before making an investment decision it is necessary to thoroughly review the project and its offering whereas, keeping in mind that early-stage businesses hold high risk within. Therefore, below are some notable measures that need to be considered by the policymakers to protect investors from any deceptive activity:

- The platforms should offer the credit risk assessment features to their clients, where platforms make price assessments of the offered securities, and publish the procedure of conducting such assessment. Policymakers should mandate it obligatory that the pricing is fair, must meet the market standard, and regularly reviewed by the financial regulators**.**
- Digital platforms must perform at least a basic level of due diligence against each project, it would be helpful for the investors to make the right decision. This due diligence must include the assessment of any legal and commercial infraction, the company's insolvency record, criminal record, fraudulent and deceptive activities, and money laundering issues.
- To obtain maximum transparency, every project owner is required to draft the information of investment sheet containing the detailed information of the project and business owners

along with key financial records and activities such as debt capital raising, investor rights, risk warning, and other related risks, complaints and fees, and disclaimer, etc.

- To assess the non-sophisticated investors an appropriateness test must be carried out by the platform. Should be designed in a way that could assess the investor's financial situation, ability to bear the loss and basic understanding of the crowdfunding investment practices and their accompanying risk. These assessment tests should be performed on a recurrent basis after a certain period, and risk warnings should be generated after the occurrence of any inappropriateness.
- Accredited and non-accredited investors should be subject to certain limits to investing money based on their assets and financial capability.
- A transparent communication channel (i.e., an online forum) where all parties involved in the crowdfunding process can communicate with each other, and the crowd of investors could be able to ask questions from participants (such as broker-dealers, companies, and other investors). It would be worthwhile for the investors to review the communication before making an investment decision and even after.
- Client's review and rating system allow the investors to maintain their level of trust and make the right choice.

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